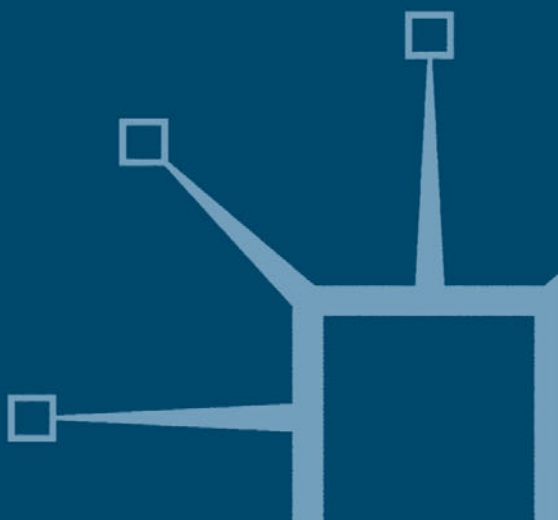


Family Values and Value Creation

The Fostering of Enduring Values
Within Family-Owned Businesses

Edited by

Josep Tàpies and John L. Ward



Family Values and Value Creation

Also by Josep Tàpies

MANAGEMENT BUY OUT (*with Antonio Ortega Gómez*)

Also by John L. Ward

FAMILY BUSINESSES (*with D. Kenyon-Rouvinez*)

PERPETUATING THE FAMILY BUSINESS

STRATEGIC PLANNING FOR THE FAMILY BUSINESS (*with R. Carlock*)

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To our families
Josep Tàpies and John Ward

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Preface

Over the past decade we have witnessed a renewed interest in understanding better the role of family businesses in society and their impact on economic growth, investment and job creation, both in advanced and in emerging economies. Only a few years ago, family businesses were not considered very highly as organizations to work for, to invest in or to be considered as references for their impact on society. Many of them would certainly pale in any comparison with other top-notch international public companies.

Today, family businesses have gone through a huge change process in many countries and become hot companies, not only among investors, but also young talent and senior executives. Public leaders and governments have shown an increased interest in the development and growth of family businesses. One of the reasons that helps explain this renewal is the emphasis that many family business place on the long-term orientation of the company, in a sharp contrast with the most pressing short-term concerns that public companies show. At a time when too many companies and chief executives seem only concerned about the next term's results, a long-term orientation offers a welcome breathe fresh air in the corporate world.

More important than the time horizon itself, family businesses are very special organizations because they show, test and accumulate values embedded over the years in the policies and behaviors of the senior executives and employees alike. Sometimes, they are explicitly defined, sometimes they are implicit. In both cases, they have a clear influence on business strategy and business performance.

This is also a striking feature of family businesses in comparison with public companies. Business leaders, investors and public opinion today lament at the lack of values in some companies and the overriding dominance of economic goals and indicators in assessing the overall performance of a company.

Many family businesses have shown over the years that companies do not need to be single-minded about objectives. They know that economic performance is important but the long-term survival of the firm also needs to take into account people's commitment and customers' loyalty. Today, many companies and their senior leaders want to be recognized as good social actors promoting not only economic progress

but the well-being of the communities they operate in. These are areas in which family businesses have excelled over the years.

For these reasons, today the study and research on the role of family values and its impact on value creation is not only relevant to family businesses, but to the corporate world at large. In a business world often hit by corporate scandals, where public corporations see how their reputations reach new lows, we desperately need companies that show how to strike a new balance between economic performance, organization performance and social impact. Many family businesses already show the way on how to do it.

IESE feels privileged to have developed since the foundation of the school in 1957 so many links with family businesses and their leaders around the world. We have witnessed not only the success of many of them, but also their role in society beyond economic efficiency. In this respect, a turning point for the school was the endowment of the Family Business Chair at IESE back in 1986, the first of this type in Europe, through the generosity of a group of alumni. This Chair has been at the heart of a web of educational and research activities at IESE over the past two decades. The international conference whose papers are presented in this book under the excellent guidance of Professor Josep Tàpies is one of them. Its real value goes beyond the academic contributions made by their authors and it lies more in the way they may help imagine how family businesses and their values could have a deeper impact in the years to come, not only on those companies but on the corporate world at large.

JORDI CANALS
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Barcelona, Spain

Introduction

John L. Ward

Thirty years ago family businesses were virtually unnoticed. Business schools were focused on developing “professional managers” for those companies whose ownership was separated from its management.

These devoted professional managers often sought lifelong careers in one company. Occasionally entrenched management became powerful and served its own interests. Conglomeration strategies in the 1970s were a notable example. Two decades later some executive compensation schemes seemed abusive. Management’s control of the governance system brought frequent calls of “foul.” Enron and others became the example. Many now cry out that value creation and shareholder capitalism are chasing away corporate values.

Twenty years ago family businesses were virtually unstudied. Research and writing was scant. No school taught a course in family business. The Family Business Network (FBN), the Family Firm Institute (FFI), the International Family Enterprise Research Association (IFERA), did not exist.

Business schools were booming and were the pathway to learn the sophisticated tools of marketing and operations to seek careers with multinationals. Learning the principles of corporate strategy and financial theory often promised exciting jobs in consulting and investment management. A well-embraced theory of business decision-making and success was accepted. No one was asking if family businesses behaved differently.

Ten years ago what was known and studied about family business were its special challenges. Doing business with relatives was felt to be fraught with failures. The subjects were sibling conflict, unsuccessful successions, punishing death taxes, disinterested cousins and parochial management styles. Trying to help these troubled, but usually sincere,

enterprises became, for the first time, a focus of continuing education programs by universities and trade associations.

In business schools many of those from business families led private lives. This was the proud era of entrepreneurship. Working for mom and dad held negative connotations.

The world's markets were opening. Globalization called for scale and focus and adapting to the different cultures of new markets. The family businesses in those markets were often seen as relics protected by sheltered markets. While sometimes true, few noticed the irreplaceable contributions these businesses made for their communities. Few studied how many old family firms were already unusually successful across the world.

Yet fifty years ago, when IESE was founded, the business landscape was crowded with great family companies. Unacknowledged, DuPont, IBM, Cadbury, Fiat, Banco Santander, Merck, Johnson & Johnson, for example, were among the most esteemed places to work and role model companies. Exciting family-founded upstarts like Motorola, Toyota, Samsung, Hewlett-Packard, Cemex, the Ayala Group and Wal-Mart, and scores of others, were examples of excellence. No one noted the family business reasons for their success. Their values and cultures were acclaimed, but not examined.

This symposium and this book celebrates the fiftieth anniversary of IESE, but also marks, in many ways, the coming of age of the field of family business. Recent studies provide significant evidence that family firms have many special competitive advantages, not just problematic familial challenges. There's great new attention to the role of family firms in the healthy development of emerging markets, as well as in corporate social responsibility and in business philanthropy. Family firms highlight the lists of the "best places to work."

Underpinning all these newfound recognitions, of course, is the realization that family businesses are values driven. Distinct, powerful, nurtured values define their ways and means.

Values pervade every aspect of a family business. Values are a driving independent variable shaping every dimension of family business management. The owning family's values drive their key decisions regarding:

- Strategy
- Structure
- Competitive advantage
- Culture

- Employee recruitment
- Governance
- Succession
- Owners' cohesion
- Owners' commitment
- Owners' Constitution or Protocol

The family's values often define the number of business units and which markets a firm chooses, and certainly the degree of risk-taking. The family's values often define the organizational structure: who works where, for whom, and in what areas. The family's values might make quality differentiation or long-term investing the obvious competitive advantage. Or, the key to success may be the goodwill created in their community or country through lifelong relationships and local philanthropy.

The family's values *are* the company's culture. That culture is so important to most business owners that it calls for unique ways to recruit, train and compensate the employees – or members or associates, as many family firms call their employees. The Hilti Company of Lichtenstein recently won the Bertelsmann Award for the most outstanding corporate culture. It is a case example of how family values are operationalized in all aspects of a family company's management system.¹

The family's values will hugely determine how the company is governed. Does the owning family prefer transparency or privacy? Full control or partnerships? Trusting others easily or not?

Values shape the most problematic family business issue: succession. Does the senior generation see the business as a personal proprietorship or as a steward for the indefinite continuity of the institution? Does the senior generation believe a single leader or a team of leaders is best? Does the senior generation hope that the business will hold together the eventually dispersed crowd of cousins?

The owning family's cohesion comes in large part from their shared values. Which values to embrace and how to pass them from one generation to the next is at the core of long-term ownership unity.

The owning family's commitment, too, is a function of its values. Commitment comes from pride in the business – for how it treats its people or how it makes a difference in society or how its brand builds the family's reputation and social networks.

Finally, the family's values are the critical assumptions underlying the Family's Constitution or Protocol. Does the owning family believe that making policies on a family-first basis is best, or on a business-first

basis? How the owning family even defines family membership is a judgment from values.

The chapters in this book examine how family business values create value – for the owners, for society, for all the stakeholders. Which values are essential and fundamental to family firms are identified. How those values are nurtured and supported and transmitted from generation to generation in the owning family are examined. The family office plays an important role in support of the owners and preparation of the next generation. The impact of those values – particularly in Spain – is illustrated. How values shape the family firm's strategy and its governance is presented.

In my own research I find that the culture of family controlled firms is, on average, much stronger than in non-family firms.² And that this stronger culture provides competitive advantages far superior to create market performance.

There are, of course, several explanations for such a stronger culture. There is the much longer, stable tenure of leadership. There is also a more celebrated and preserved history that reinforces the founding values of the business and that is part of new employee orientation and training. Family firms are notorious for investing in the “values fit” of new employees, new directors on the board, even new strategic partnerships.

In fact, a close examination of the successful examples in the popular book *Built to Last*³ shows a disproportionate number of family firms. And the family firms in that study have stronger cultures than the successful non-family firms.⁴

Moreover, what my studies show is that the values at the foundation of the culture of family firms are different. Examining the values statements of family firms and non-family firms shows interesting patterns (Table 0.1)

The values of family firms are more human, more emotional, more fundamental. The values expressed in values statements of non-family firms are more transactional, more impersonal, more driven by outcomes. I believe this difference is instrumental in the stronger cultures found in family firms.

My studies also indicate other ways family firm values are different. Family firms emphasize collectivity more than individuality; family firms emphasize past and future orientation to time more than a present orientation; family firms have a stronger belief in the “natural goodness of man.” More research of these differences, of their impact on organizational culture and on company performance, is needed.

Table 0.1 Values common in non-family firms versus values common in family firms

Values Common in Non-Family Firms	Values Common in Family Firms
Innovation	Courage
Empowerment	Dignity
Performance	Reputation
Teamwork	Fairness
Change	Open-Mindedness
Leadership	Authenticity
Efficiency	Hard Work
Profitability	Stewardship
Quality	Dependability
Communication	Empathy
Creativity	Curiosity
Learning	Humility
Continuous Improvement	Discipline
Entrepreneurship	Prudence
Excellence	Loyalty
Add Value	Sincerity
Customer Service	Respect

Certainly a basic value that both rewards and challenges family firms is their “familiness.” Family companies often emphasize a “family-like” workplace. Some find they attract many relatives of other employees into their workforce. Perhaps counter-intuitively, they encourage this.

Family-oriented family firms are also challenged, though, by their “familiness.” Too much family orientation can lead to unprofessional practices in order to avoid family conflicts. Several chapters in this book look at how to bring balance to the “family-first” or “business-first” values inherent to all business families.

It is fitting that this symposium and this book are part of IESE’s Fiftieth Anniversary Celebration. IESE has itself, from its founding, been values driven and a leader in business ethics. IESE has also been a pioneer and leader in family business recognition and research over the past 20 years. IESE is the home of the first Europe-endowed professorship of family business. IESE Professor Emeritus Miguel Angel Gallo, the first holder, is a founder of the Family Business Network (FBN) and the International Family Enterprise Research Association (IFERA).

The IESE family business area has produced many research papers and numerous books. The current team, led by Professor Josep Tàpies, is a partner in bold new research initiatives on global family firms and on family offices.

If and how family values create shareholder value in business and inherent value in society are the topics of this book. IESE's leadership in this subject is a great gift by the school as it celebrates its first 50 years.

Notes

1. Colleen Lief and John L. Ward, *Hilti: Our Culture Journey*, © 2005 IMD.
2. Daniel Denison, Colleen Lief and John L. Ward, "Culture in Family-Owned Enterprises: Recognizing and Leveraging Unique Strengths," *Family Business Review* xvii(1), March 2004.
3. Jim Collins and Jerry I. Porras, *Built to Last*, HarperCollins, New York 2002.
4. John L. Ward, "Better Built to Last Longer," *Families in Business*, Jan./Feb. 2006, pp. 71–2.

Part I

Building the Future

1

Learning from Practice: How to Avoid Mistakes in Succession Processes

Guido Corbetta

Introduction

The succession process is the research topic from which the family business research stream originated (Sharma, 2004). The reasons why most of the succession processes fail, especially passing from the first to the second generation have been investigated since the 1950s (Danco, 1998). The first to be interested in the topic were some consultants, who tried to identify valid practical solutions based on the small amount of empirical evidences available in those years. These studies, though, have been criticized for not having solid scientific premises. As a consequence, over the years several scholars from various scientific fields dealt with the issue of succession. Their efforts led to two different research approaches:

- The first is grounded in the financial economic scholarly tradition, and aims to model the relevant variables to yield deductive prescriptive conclusions through an extensive use of econometric models (Burkart, Panunzi and Shleifer, 2003).
- The second stems from the management scholarly tradition, and aims to provide for positive models to represent reality by describing the succession processes in the best possible way. One of the most representative examples of such efforts is the study by Le Breton-Miller, Miller and Steier (2004), in which the authors make a significant integration effort with respect to the voluminous contributions in the past literature (see Figure 1.1).

The development of such approaches allows us today to have a more comprehensive and theoretically grounded picture of the succession

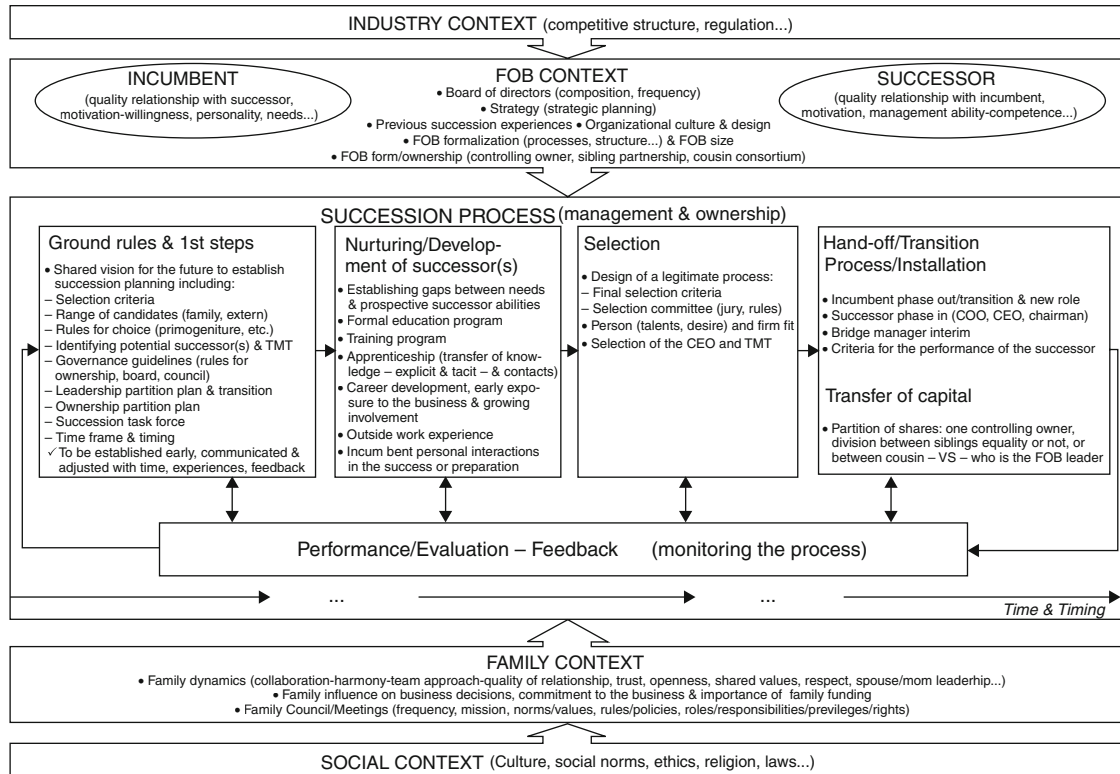


Figure 1.1 The integrative model of successful FOB successions

Source: Le Breton-Miller, Miller and Steier 2004, p. 318.

process. Nevertheless, these approaches, in my opinion, make it more difficult to provide entrepreneurial families with practical and suitable solutions for their specific needs. Behind the formal rigor of such models and theories, indeed, it hides a sort of “hypothesis paralysis” (for econometric models), and/or “analysis paralysis” (for positive models). It might be helpful, thus, to draw on the methodology followed by these first scholars, trying to “learn from the case studies” and build up some normative indications. Differently from the past, though, this inductive approach can rely on a definitely wider empirical base, and can turn to account the knowledge developed in the contributions from econometric and/or positive models. As a consequence, it should be possible to suggest more reliable and well-grounded alternative of solutions to entrepreneurial families.

This work aims to highlight some of the lessons learned by observing the mistakes that occurred in dozens and dozens of family firms, relying also on the contributions of similar works by other colleagues (Aronoff and Ward, 1992; Aronoff, McClure and Ward, 2003; Carlock and Ward, 2001; Corbetta, 1996, 1999; Gallo, 1995; Ward, 1987, 1991). My argument is that whilst the successful cases are often difficult to generalize, being grounded in an always different combination of various elements, choosing to focus on the mistakes allows us to identify some “recurring elements”. This choice thus allows us to provide entrepreneurial families with more certain indications on the sort of behaviors and actions to avoid, without being presumptuousness by supplying simple solutions to a complex issue like that of succession.

Before describing the identified mistakes, it is useful to specify that in this work the succession is considered as a process directed transferring control of the firm to the following generation. This process actually starts when the heirs are still pretty young (Handler, 1990) and carries on through various phases of different length. The process is considered complete when the new generation takes over the control of the firm and the new leader (or leaders) exerts the leadership. In other words, younger people take the place of older ones who, whether they like or not, pass on the “baton of the leadership” (Beckhard and Burke, 1983; Gersick, Davis et al., 1997).

The departure and arrival points of this transition can present significant differences in terms of structure. As an example: the ownership role and the managerial role can be covered by one or more persons; the two roles can both be covered by family members; or, instead, management can be delegated to non-family managers and so on (Barry, 1975). In general terms, although there is an almost endless list of possible

cases, all the succession processes share a dynamic that carries from one equilibrium point to a new equilibrium point, passing through a period of varying length and difficulty of disequilibrium. The outcome of a succession process can be measured by considering the soundness of the firm and the dynamics inside the owning family after the succession (Handler, 1989; Morris, Williams et al., 1997; Sharma, Chrisman and Chua, 2003).

The most common mistakes

Mistakes can be ascribed to the wrong behavior of people or to inadequate systems and structures. For the purpose of this work, I consider only the mistakes that can be ascribed to people, and specifically the mistakes of members of both the generations involved in the succession process, without limiting to a unique perspective of analysis. Neither do I consider the mistakes originating from the relationships within a given generation, as I believe that they are always the consequence of mistakes during the shift from a generation to another. In order to avoid presenting a mere list of the numerous mistakes that could be identified, I considered it more appropriate to group them in classes of elements similar to each other. A long list risks wasting attention and discouraging focus on the most important mistakes. The order by which I present the classes of mistakes does not represent a ranking in terms of their diffusion. Rather, it represents a personal evaluation of their relevance.

Sometimes, there may be good intentions behind mistakes. Nevertheless, what really matters are not only the intentions but also the practical consequences of behaviors and choices. This is particularly true in family businesses where family members will often justify their actions by saying they had good intentions. Here I do not voice an assessment of the intentions, but rather the consequences they get.

Mistake 1: failure to understand the differences between ownership, governance and management

Family members involved in the company can play three different roles: they can be owners, directors or managers. In many family businesses, especially in first and second generation and in small companies, these roles often overlap because the same people may carry out more than one. Failing to understand that these roles differ in content, that they require specific structures and professional skills, and that they are transmitted according to different rules, can make generational transitions

more complicated. The first mistake that can be made is to consider business ownership as a right rather than as a responsibility, and to believe that being owners automatically means possessing good governance and management skills. To assign high governance or managerial responsibility to heirs that are not skilled enough may lead to negative consequences:

- *For the family member.* If he or she is unable to contribute to the business, sooner or later this will cause problems with colleagues as well as leading to a loss of self-esteem. This is likely to have negative consequences both for the family member and for the family.
- *For other employees.* Other employees, dealing with or reporting to the unsuitable family member, will have to take on some of his or her responsibilities or find themselves in the embarrassing situation of having to complain about him or her.
- *For the business.* The unsuitable family member is a cost, although he or she does not produce any value. There is also the risk that the best employees will decide to leave the business in order to avoid the situations described above.

Mistake 2: considering succession as an obligation to the past and not as an opportunity for the future

It is just natural that a parent who has built up a successful company wishes to pass it on to the next generation. It is only natural, and even desirable, that for this wish to come true a parent is ready to show all positive aspects of the entrepreneur's job to his/her children. It is quite legitimate that a parent influences children by leveraging on their aptitudes and, by this means, leading them to commit themselves to the company.

It is, though, absolutely wrong for a parent to force children to embark on studies or experiences aimed at facilitating their entry into the family business against their will, only for the purpose of perpetuating the past family history. Sooner or later, many of these children will look back and regret they could not pursue their own vocation; for this reason, they will find it difficult to commit themselves to the family business.

The same mistake could be made by a son/daughter who hesitates to frankly present his or her ambitions, diverging from commitment within the family firm, in order to avoid displeasing parents and/or grandparents. A likely consequence of this mistake is the disesteem that parents develop with respect to their children. Due to scant motivation,

indeed, the children will fail to meet the expectations of their parents and this will thus feed into a vicious circle of reciprocal conflict.

Mistake 3: considering succession as an event and not as a process

Generational transition of family leadership is something that occurs in a moment – making a simplification, when the new generation formally takes over – but is actually the end of a long process made up of a number of different phases. If it is not interrupted by any sort of traumatic event, the transition starts with children's training, it goes on with them (possibly) being introduced into the family business, it continues with parents and children working together over a set period of time, and it ends with children taking over.

Considering succession as an event leads some entrepreneurs to not modifying their roles over time. The entrepreneur does not deal with the natural aging process in a reasonable way. This behavior can have the following effects:

- The business can suffer from strategic and organizational delays that endanger its competitive and financial success. This delay can occur because the person normally taking final decisions has less will to change than in the past (Appendix Figure 2); or because the entrepreneur is unable to manage a changing business with new tools; or because an aging person finds it difficult to commit to projects with a long-term time frame (Drucker, 1986).
- Sons and daughters fall into a sort of competence trap because the know-how built up by the entrepreneur is outdated and it is very difficult to acquire new updated skills when working in an ageing company (Kang, 1998). So, they lose the motivation to commit themselves and they either “make themselves comfortable” in the existing situation or they prefer to leave the company altogether.
- New managers who are hired, perhaps by the children themselves, tend to leave the company as soon as they find out that the effective exercise of their role in the business is seriously compromised by the conservative attitudes and behavior of the entrepreneurs and their collaborators who have been in the firm for decades (see Figure 1.2).

It is possible to make a mistake also considering the succession as a process but from a wrong, rigid, “goal-oriented” perspective. This perspective implies the definition of final goals to reach independently from the possible changes the reality would suggest. In this way all the

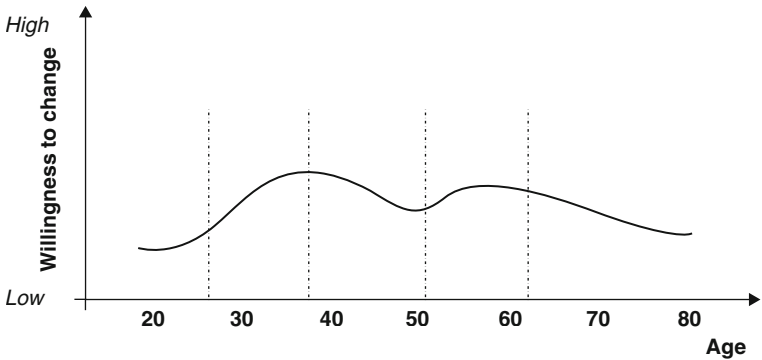


Figure 1.2 The age factor

changes that could likely occur during the several years in which a succession process takes place are not considered. People can change, companies can change and the context at large can change: it could make it inconvenient or simply impossible to reach the final goal the family imagined.

Mistake 4: failure to transmit entrepreneurial orientation

Research on family businesses in the third and fourth generation converges on one point: each generation has added something to the entrepreneurial tradition of the family. In other words, each successive generation has produced at least one person with the attitudes of an entrepreneur, who is future-oriented, able to assume the risk of difficult decisions, able to involve other people in a long-term strategic plan, with the necessary strength to start again after a partial failure. To become entrepreneurs, it is necessary to develop the entrepreneurial attitudes that are latent in many people; thinking of successful entrepreneurs' distinctive features, I think young candidates to succession should:

- love the company in an “adult” way and not in an “adolescent” one
- develop self-esteem without becoming narcissists
- be bold without becoming reckless
- develop “visioning” skills without falling into the temptation of just dreaming
- develop generalist competencies without mistaking them for superficial knowledge

- learn how to behave in different contexts (one's family, one's company, a negotiation, a meeting, ...)
- develop the tenacity and spirit of sacrifice necessary to overcome troubled times that sooner or later occur in all companies
- learn how to evaluate people wisely.

Some entrepreneurs, who are firmly convinced that entrepreneurial skills are merely innate in people, believe training the next generation is not important. This belief is contradicted by numerous studies according to which a person's skills are never separate from his/her practical experiences and specific training.

Mistake 5: lack of a sound dialectic between parents and children

A series of mistakes relate to the inability of actors involved in the succession process to check their opinions with evidence coming from reality and with the opinions of others. This inability to compare can present different shapes: entrepreneurs who fall in love with their children without having the courage to properly assess them; entrepreneurs who consider the business model they have established as the best possible model and do not allow for any critique; children who believe that the business model of their father or mother is "completely wrong" or that the parents' collaborators are "old", without trying to distinguish what should be retained from what should be changed. The lack of a sound dialectic can thus mean that this dialectic either does not exist or has fallen into conflicts. Without a dialectic, the children do not develop their own personality and do not become leading actors within the firm; on the other hand, if the dialectic turns into a permanent conflict, it both makes interpersonal communication extremely difficult (to the extreme of complete incommunicability) and produces – sooner or later – negative results for the firm.

The reasons for such mistakes should be identified in a lack of parental self-criticism which has its roots in an out-of-control ego. The lack of time to devote to quiet and prolonged discussions during which reciprocal opinions could be faced with the required depth represents another reason for this relevant mistake.

Mistake 6: considering patrimony of values as the solution!

A family able to transmit positive values such as sobriety, humility, tendency to family unity, spirit of sacrifice, meritocracy and entrepreneurship has undoubtedly more chances of successfully coping with

succession. Some families, especially those characterized by a deep religiousness, think that it is enough to maintain the patrimony of values to secure the continuity and survival of the firm. In reality every patrimony of values, although made up of deeply-rooted principles and convictions that keep their validity over time, needs to be re-interpreted and updated due to the change in the social, cultural and economic context in which they are embodied. Every generation has thus to recognize and interiorize the values of the past, and should also re-interpret them to allow their use in the new context. Furthermore, values are not enough to choose among alternative solutions, especially when the generational transition is made even more complicated by the presence of more than one heir, or when it has reached the third or fourth generation, with the presence of several owners with different expectations due to the fact that some of them are employed in the firm and others are not.

Mistake 7: choosing the wrong "third actor"

In the history of family businesses which have been successful in overcoming one or more generational transitions we always find "third parties" – that is, people or institutions other than the owning family or family members in trouble – who have helped overcome some delicate phase. The third party can be a relative, a manager of the company, an outside director, a professional or a consultant, or a friend of the entrepreneur.

First, the role of third parties is to bridge any gap of knowledge or resources to the benefit of the entrepreneur and/or the key decision-making team. Secondly, their role is to reduce the area of emotion, which is typically quite vast in the case of family businesses, as well as to enlarge the area of technical-economic evaluations.

There is another role that a third party can play for set periods of time. In some cases, in fact, the owning family can involve a third party to have him/her manage the whole succession process. This is the typical case of a non-family CEO who is hired to run the company in the absence of a suitable family member (which may be due either to young age or to lack of competencies) or to settle disparities between two relatives (e.g., young siblings or cousins) struggling for company leadership.

In order to understand whether the third party is able to provide a positive contribution to the evolution of the succession process, it can be useful to consider what follows:

- The third party must arm him/herself with a lot of patience because many generational transitions can last for years and be subject to

sudden slowdowns and accelerations which cannot always be explained rationally.

- The third party must avoid a technocratic approach (based on the predominance of technical judgment). Such an approach can make him/her incapable of fully understanding the reasons why owning families' decision-making may be quite slow, and so often ends up being completely useless.
- The right third party contributes to the decision-making process, but does not actually make any decisions. Decisions are made by people directly involved in the process. Distrust third parties who want to take the decisions directly.

How to avoid mistakes

My purpose is now to indicate, although with all the cautions, some possible hints to entrepreneurial families on how to face the succession process with good chances of success.

A proper concept of the ownership

First of all, it is necessary to consider that the link between the ownership and the business in family firms has a special strength, which tends to confer stability to the governance and the direction of the firm, or to the group of controlled firms. In family firms, indeed, the ownership takes part intensively in the life of the firm since the economic and emotional ties are considerable and the exit process is often difficult to achieve;¹ the ownership is strongly identified with the owners, whose values and objectives influence the strategic choices; it presents dynamics within the owning family (intra- and intergenerational) which have a strong impact on the firm's life (also because one or more family members are usually involved in governance or management roles).²

This linkage between the family and the business has both positive and negative potentials. The former is revealed in the complete devotion the family has to the firm, and in the subsequent willingness to bear economic and personal sacrifices for the sake of the firm itself; the latter show up in possessive attitudes and in refusing to make the necessary distinction between the needs of the firm and the needs of the owning family, and in the consequent confusion between the administration of the firm and that of the family.

The first recommendation to the owning family is thus to develop and pass on to the next generations a concept of ownership that considers the firm as a valuable asset which, although ownership is in the hands of few, must be managed with a deep sense of responsibility with respect

to all the firm's stakeholders: customers, collaborators, partners, banks and other financiers, territory and local communities. As Sen argues: "The overall success of the firm is really a public good, from which all benefit, to which all contribute, and which is not parceled out in little boxes of person-specific rewards strictly linked with each person's respective contribution. And this is precisely where motives other than narrow self-seeking became productively important" (Sen, 1993: 61).

A culture of merit

The second recommendation to adopt without delay is the culture of merit. Companies must be managed by competent people and if the children are not, it is fair to look for alternatives, both for them and for the company itself. It is possible to learn a culture of merit when people are fairly young; this culture relies on the definition of targets, the timely assessment of achievements, a variety of evaluations, the sharing of both evaluation and self-evaluation, comparison with people of the same age. Without a culture of merit, nepotism takes place, engaging a vicious circle: incompetent or unsuited people reach the highest offices in the firm and are unable to fulfill their tasks, the best among both family and non-family members leave the firm or becomes unmotivated, the firm's results sooner or later worsen, and, finally, the young and incompetent also unjustly target complaints about the situation at the apex of the firm. A culture of merit does not imply exclusion from their rights of the incompetent or unsuitable children. It implies, though, that the children, in their own interest, are supported in understanding their limits and in finding suitable jobs inside or outside the firm. I would even dare to say that the satisfaction of a young person lacking a relevant role in the firm is a good success indicator of the generational transfer process.

It is rare to find an entrepreneur who opposes a culture of merit in theory. Actually, it should be a component of an entrepreneur's DNA. Within their own family, though, it raises doubt about whether or not a less skilful son or daughter could properly lead the firm, maybe with the support of a non-family manager. Everything gets complicated when a sense of guilt arises with respect to one or another children, for varying reasons. The complexity increases in those entrepreneurial families with several family members since it becomes hard to make comparisons among the children of different family members. It is possible to overcome such complexity with bravery and patience. Without bravery, it is impossible to face the issue even with their own children; it is impossible to express an assessment of the next generation; it is

impossible to discuss among brothers (or sisters) on the assessment of their own children. Without patience, it is impossible to help all the people to accept and understand the outcomes of the evaluation processes. Without patience, it is impossible to avoid those rivalries, jealousies and so on, which can lead to splits between family members (Lansberg, 1999).

A culture of merit involves some pain, even though it is the only culture that might help all the children to find in the long run a professional dimension suitable to their characteristics – in their interests, and in the interests of their future families. In these years of work with dozens and dozens of entrepreneurs, I have learnt from them that it is unnecessary to pursue painful choices, since the establishment of a culture of merit leads the children themselves to identify and to comply with the evaluations that emerge from the process.

The education of the young

The third recommendation relates to the need to worry about the education of the upcoming generation. Education is essentially the transfer of values, as human and intellectual capital is the most important capital that needs to be transferred (Hughes, Ginnett and Curphy, 1993). But, how can values be transferred? Also, in entrepreneurial families, values transfer first of all and mostly by living them, that is, through the coherent and continuative evidence of behaviors. It must be through clear, joyful evidence demonstrated by someone who believes in the values they profess and, although loyalty to those values requires sacrifices, nevertheless, draws from them intimate satisfaction and self-esteem. Only in this shape can the values be perceived by the new generations as fascinating, and thus worthy to guide their behaviors. Personal commitment, as Camus argues, comes from love rather than from law. That is to say that the “ethics of duties” cannot capture the young, but it is the “ethics of passion” that may help both to build up and make good companies work. Furthermore, since the young are at an age full of sense-making questions to which only some values and ideals can give an answer, it means to stimulate their aspirations in good, constructive ways. Novak argues on this point: “sound practices in the business world are rooted in the *kalòs* of Greeks who used this adjective to mean a sort of ‘grace in action,’ a goodness which inspires to make everything good, to consider with the necessary care every aspect of the thing” (Novak, 1996).

Testimony through actions and behaviors represents a necessary, but not sufficient condition to transfer the patrimony of values which

characterizes family firms: there is also a need to devote enough time and commitment to explaining the reasons that led the family to practice certain values as fundamental tenets to new generations. Testimony without explanations and checks, indeed, risks not inducing proper understanding and the deep assimilation of those values. A great entrepreneur-educator of one of the ancient Italian entrepreneurial families, coming back from a trip to the mountains with his own children, encouraged each of the children to fill out a short report to better secure the relevant memories in their minds and to show that they had learnt something.

Transfer of the patrimony of values may require, then, a codification of the values themselves and the sharing of written documents in order to help remembering and securing memory of the past. The same process through which a code of values or a good family protocol is realized allows deepening the consciousness of those values and facilitates a persuaded adherence to them.

It should be very clear, though, that words and written documents are helpful to transmit the values only if they are communicated mostly and foremost through actions; that is to say, through decisions and behaviors coherent to them. Otherwise, both the oral and the written traditions can even become counterproductive, inducing rejection reactions in those people, and especially the young, who are usually very astute in perceiving the incoherence between what is declared and what is actually done.

Choice of the entrepreneurial development model

Family firms represent a highly important reality in developing and spreading an extremely scarce and crucial productive factor for the development of a country and this is the “entrepreneurial factor”. This role of being a reservoir of entrepreneurship is covered by family firms in different ways, referable basically to two alternative models: the family model (restricted to the family circle of the family entrepreneur) and the dynastic model.

The “family model” (a pretty notable example in the world is the case of Rothschild) is characterized by tension in the diffusion of individual entrepreneurship among the members of the owning family, done in the conviction that every member of the family might better perform their entrepreneurial skills and carry on their initiatives in full autonomy by separating from their brothers and sisters.

The family of the owner entrepreneur is thus the context in which the vocation to become an entrepreneur can rise and develop. This

context has a length related to the life cycle of the current owner entrepreneur, even though it is destined to reproduce in relation to each descendant who picks up the entrepreneurial baton.

The reproduction of the individual entrepreneurship model is typically prepared by the entrepreneur at the head of the family through the establishment of several firms which will be assigned to each of the descendants in the process of family division.

The “dynastic model” (a widely notable example in the world is the case of the Italian-Argentinian Rocca family, owner of Techint) is yet characterized by tension in the diffusion of entrepreneurship within the “widened family context”, which progressively represents a reservoir of familial entrepreneurship destined to persist generation by generation, welcoming all the descendants who want to stay linked to the familial group as simple shareholders or by working within the familial group itself. At the base of this model there is not only the conviction that “unity is strength” and that the strategic options are wider than those available to each family member separately, but also a spirit of clan and the pride in belonging to a vital entrepreneurial family. Essential in this model is the freedom of choice to belong or not to the family group, and there are thus proper mechanisms to facilitate exit from the ownership structure. As the dynamistic model is set up with simple and effective rules that discipline the relationships among family members and among those members and the firms, and as the kinship ties and the sensitiveness which characterize the strict relatives loosen, the problem of holding on to family unity despite its progressive widening becomes paradoxically easier. Also in this case, obviously, each family member can suggest and require the financing of his or her own entrepreneurial idea. Let us consider the case of the French group whose base is the Mulliez family (who own, among others, Auchan, Leroy Merlin and Les Trois Suisses), made up of hundreds of family members. In this case, before approving the launch of new entrepreneurial initiatives, the owning family members evaluate the existence of the following requirements:

- An entrepreneurial project (the business plan) that is valid, concrete, and with innovative contents
- A well-motivated and skilful leader or project head
- A cohesive team of people with the required mix of knowledge and core competences
- A board of directors that directs the management and monitors its actions to secure a proper outcome from the initiative, in the interest of the people involved and the familial group at large.

Both the models, that of the “family” and the “dynastic”, deserve consideration and appreciation as the cases of the vital family firms that originated from both of them emphasize. Nevertheless, there is no doubt that the dynastic model is by its nature more suited to favor the making of large family businesses which can aim to cover leadership positions worldwide.

Some specific indications for the succession process

A proper concept of ownership, a culture of merit, education of the young, and the choice of the entrepreneurial development model are four elements of general validity that can be helpful both for family firms of different kinds and to face other family-related issues. Nevertheless, it is now necessary to deal with the specific issues of the succession process for the purpose of trying to indicate some rules and mechanisms which, in my opinion, enhance the likelihood of success in the generational transfer. Using a *contingency approach*, every person, every family and every firm will then use these rules and mechanisms, adapting them to the personal, firm-related or external specificities. For the sake of simplicity, I will use the term “seniors” to indicate the leading generation and the term “juniors” to indicate the new generation. I will also for simplicity consider only the dynastic entrepreneurial development model.

First of all, juniors should complete their school-based studies. Any kind of school can be useful if one wants to take on an entrepreneurial role, as long as appropriate commitment and curiosity have been put into it. During childhood and adolescence, then, it is desirable that juniors are helped to compare their capacities with that of others, also through sports or voluntary activities. Once studies have been completed, it is advisable that juniors gain some working experience in other companies or in companies of the group not strictly managed by the previous generation. This helps them a great deal: to learn to be judged on their own merits or demerits regardless of their surname; to get to know the organizational dynamics of a company without the “bias” that may derive from the fact of being the son or daughter of the owner; to experience a different entrepreneurial and managerial culture; to see other parents-owners (“the grass is not always greener on the other side”); to acquire some specific skills; and finally, to be free to make the first, inevitable mistakes without compromising their credibility. The aim of these experiences is also to give juniors (and their parents as well) the possibility of measuring their capabilities before deciding whether to enter the family business or not.

In some cases, juniors are not given the opportunity of experiencing work in other companies because their presence is immediately requested in the family business. In these cases, it may be useful to interrupt one's work every now and again to attend courses and seminars where it is possible to interact with managers and juniors of other companies and, by this means, gain some of the above mentioned benefits.

Before entering the company it's useful to evaluate juniors' aptitudes and aspirations as objectively (according to the culture of merit) and early as possible, so as to identify and train candidates to succession in entrepreneurial and managerial roles, and also to help whoever is obviously unsuited to a business career to find his/her own way. Recognizing family members' shortcomings is traumatic, but it may be necessary in some cases in order to assure company continuity and therefore to preserve family wealth. If no juniors are able to take on the entrepreneurial role, particularly in small and medium-sized companies, it's better to evaluate carefully the option of selling the company.

In the early working years in the family business, juniors need not necessarily undergo the same experiences as their seniors. Their path should be carefully planned from the moment they enter the company, with particular attention to the strategic challenges the company will have to face in the future. "Looking ahead" is indispensable in succession processes.

After some months of apprenticeship, a good rule is generally to assign juniors some limited, but definite responsibilities quickly, possibly having them report to a non-family manager. This helps juniors get used to making decisions, which is absolutely necessary if they want to assume an important role in the company. All positions which are not clearly defined or do not imply any direct responsibility (such as some staff ones) should be avoided.

The following career steps cannot be defined *a priori*: in any case, the relationship which is established between juniors and seniors and between juniors and non family managers is very delicate. Entrepreneurs possess "tacit knowledge" which juniors can only learn by working with their seniors closely, "watching" their behaviors and attitudes. This is why it is important that juniors participate as early as possible in business meetings between the entrepreneur and his/her collaborators, suppliers, clients, banks and all other actors who are critical for company success (perhaps with no "right to speak" at first). Researchers suggest that seniors should bear in mind the fact that the learning curve of juniors does not only depend on "what" is transmitted to them, but also on "how" it is transmitted. In other words, an open, positive

attitude aimed at mutual enrichment certainly facilitates the learning process.

With regard to the relationship between juniors and non-family managers (who, in many cases, were professionally “grown up” with the seniors), if the company is doing well, it is advisable to patiently look for the right balance between the need for change and the need to assure management continuity at the same time. The impact of any organizational move on key collaborators’ motivations as well as on relationships between seniors and juniors should be carefully considered.

For those juniors who have shown they possess the right skills to succeed to the seniors, the last step is taking the company over. During this step, very intense emotions characterize seniors–juniors relationships: for seniors, passing the baton can represent the end of active life and the sign of old age, while juniors are achieving what they have long hoped for. As a consequence, many seniors tend to postpone it; many juniors, in turn, would like to succeed as quickly as possible. Looking at many successful cases, it is possible to draw some important lessons on how to go through this step smoothly:

- Juniors and seniors should tell each other what their expectations are.
- Seniors should gradually let go and pass new responsibilities on to juniors, avoiding two types of behavior that can be problematic for both juniors and the family company. In other words, they should avoid either not delegating any power until they die or keeping all powers up to a certain point and then delegating them all at once.
- Juniors should look for new roles for the seniors in advance, to keep them from leaving the company completely.
- Seniors should understand that juniors’ leadership can bring strategic renewal that improves company performances. With advancing age, in fact, many successful entrepreneurs increase the tendency not to modify the existing entrepreneurial formula even when environmental changes would recommend it.

The secret behind many successful generational transitions lies in the attitude with which things were done. In other words, it is necessary to go through the different phases in a “process-oriented” perspective rather than in a rigid, “goal-oriented” one. In the former, a vision of the future is formulated based on the available information. Starting from this vision, the initial steps of the process are then decided; once these have been carried out, the outcome is evaluated and the vision is changed accordingly. It is then possible to decide the next steps, and so

on. The “process-oriented” perspective is based on the conviction that it is not reasonable to figure out all steps, especially in a process like succession where the personal freedom of the people involved and their interaction with one another are of capital importance. In these cases there is no “perfect” solution: valid solutions only exist to the extent they emerge from the process as being the most convincing and practicable.

A short final note on the succession processes, which are always more numerous,³ and which involve more than one junior with some additional problems (Ward, 1997). As Table 1.1 points out, seniors should also worry about securing fairness of treatment among the different juniors, giving them equal or at least comparable opportunities.

Moreover, it is important to facilitate the junior to devote sufficient time to appreciate reciprocal expectations and to assess reciprocal qualities in order to promote a quiet acceptance of the intra-generational leadership. Also juniors should in these cases prepare themselves by working on the concept of the firm as a common good, and by learning to live in a climate of “coopetition”. Many successful experiences of coopetition between juniors (siblings or cousins) lead to the view that it is certainly possible to build a team at the top, but this necessitates a high degree of reciprocal respect and esteem, comparable commitment levels, complementary skills and competencies, different and well-defined operating areas, the will and ability to work together on major decisions and on the frontiers between operating areas, and there must be an intensive two-way communication flow.⁴

Table 1.1 The generational challenge

	Parents	Children
One heir	• Plan educational paths • Plan periodical assessments • Carefully communicate educational plans and results of assessments	• Devote time to get knowing themselves and the others • Commit to responsibilities • Self-evaluate, and accept to be evaluated
More heirs	Moreover ... • Secure equal treatment • Favour reciprocal knowledge • Favour the acceptance of a leadership	Moreover ... • Identify a common purpose and recognize a leadership • Learn the behaviours of a sound “coopetition”

Notes

1. In Italy, for instance, in 57 per cent of small and medium family firms more than the 75 per cent of the family wealth is represented by the value of the firm (Corbetta and Montemerlo, 1999).
2. In Italy, for instance, only the 11 per cent of the owners of small and medium family firms are involved solely in their role as shareholders (Corbetta and Montemerlo, 1999).
3. The increases in the number of owners and family member managers are cited by Aronoff as two of the ten *megatrends* which family businesses will have to face up to in the next years, C. E. Aronoff, "Megatrends in Family Business", in *Family Business Review* 3, 1998.
4. Regarding *teams at the top*, see J. R. Katzenbach, *Teams at the Top*, Harvard Business School Press, Boston 1998.

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2

The Shape of Things to Come – Emotional Ownership and the Next Generation in the Family Firm

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Introduction

It is understandable that the family business field is highly business-focused, yet whether value is created and sustained – or wantonly destroyed – is in almost all cases due to the family and its dynamic. Some families are able to generate remarkable “family capital,” based on a mixture of strong values and positive relationships that sustains a market-beating culture, but some others are clearly highly dysfunctional. Indeed, some become so as a result of the pressures that owning and running a business bring to bear on the family (Gordon and Nicholson, 2008). They lack the adaptability and resilience to be able to harness the forces underlying the business and drive them in a positive direction. Indeed, businesses doubly test families by not only subjecting them to unusual pressures, but also by locking them into a shared fate when otherwise members might better escape, to develop in their own personal directions.

Our theme in this chapter is the role of the next generation in relation to family business. Clearly, a critical success factor for the continuance and performance of family firms is their ability effectively to engage the up and coming young family members as responsible owners or constructive contributors to the running of the business. This is the business-centered view – one that regards the next generation as a help or a hindrance to the future prosperity of the firm. In this chapter we have the same goal of understanding, but we believe that only by taking a family-centered view can one identify the key factors and

obstacles on the road to achieving this. This means considering what is good for the next generation, and what part the business can play in their developing lives, rather than just the business-centered view.

Our approach is biographical, considering involvement with the business as an element in the life-journey of young adults, within the context of a family business. A key concept we shall introduce in this context is emotional ownership, to explore its relation to identity formation, career development, family dynamics and company culture and leadership. We draw upon our empirical findings from an investigation of next generation members in eight family firms (Nicholson and Björnberg, 2007) as well as reviewing various literatures that help us to understand young family members' life journeys in relation to the family business.

Theoretical approach

We shall be drawing upon several theoretical frameworks in this analysis. First, we take the Darwinian approach that goes under the name of evolutionary psychology (Nicholson, 2008). This views the family as an adaptive entity, functioning as a source of biological generativity, economic production and consumption and wider cooperation within society. These key functions maintain the status of the family as the cornerstone institution of all societies. This perspective has special relevance through its analysis of the inherent conflicts within kinship groups, and how they can be resolved. The concept of "emotional ownership," the key theme of this chapter can also be identified with the fundamental bio-social functions of the family – to hold fitness-enhancing resources in common ownership for the ultimate benefit of future generations.

We draw upon social psychology and its applications in the field of organizational behavior to explore more particularly the nature of emotional ownership (EO) and its roots in social identity. EO is a moving picture, and we use the theory and research from developmental and family psychology to explore a range of issues relating to early adulthood. These include identity formation; roles and relationships in the family in early adulthood, encompassing processes within, as well as between, generations.

Our perspective leads us to focus more on the impact of the business on the family than the reverse, and we draw on the career development literature to explore emerging professional identity and career development. We call on the family business literature for insights into succession issues and how the next generation plays a part in the formation of family firm culture, and then examine the neglected, but especially

important issue of the effects of wealth on families and children. We conclude with a discussion of the implications for interventions to support the next generation (NxG).

Part I Emotional ownership

Psychological aspects of ownership

To have, to be and to do are fundamentals of human existence (Sartre, 1969). The first of these – possession – is central to a primary attribute of human survival. Much of what our ancestors owned was perishable, but the ability to get, hold and pass on the next generation is critical to the success criterion that drives evolutionary development – reproductive fitness. Making provision for one's kin is basic, hence the drive to acquire is a core dimension of humanity (Lawrence and Nohria, 2002).

Ownership extends naturally into the cognitive/affective sphere, representing our propensity to claim a stake in ideas, relationships and other elements outside the material sphere, as if they were within it. One well-known concept in the psychology literature is psychological ownership, described as a cognitive-affective state with *possessiveness* at its core (Pierce, Kostova and Dirks, 2001). It asks “What is MINE?” and defines the individual's psychological tie with the target. The target of ownership is more than the object itself, since it is part of the self.

As the child develops, objects that are within control are initially in the self-region; thus the extension of self is part of socially constructed “ownership.” Like an arm or hand, ownership of an item or concept is closely tied to control and immediacy. The roots or motivators of psychological ownership are described as: (1) self-identity; (2) effectance or efficacy (meaning having influence or effect); and (3) a place to be (Pierce Kostova and Dirks, 2001).

Reference to psychological aspects of ownership is made in the family business literature, but needs further elaboration. Gómez-Mejía, Táakacs Haynes, Nuñez-Nickel, Jacobson and Moyano-Fuentes use the term “socio-emotional wealth” in reference to “the non-financial aspects of the firm that meet the family's affective needs, such as identity, the ability to exercise family influence, and the perpetuation of the family dynasty” (2007: 106).

The concept of emotional ownership

We first developed the idea of “emotional ownership” (EO) in our qualitative study of 60 next-generation members from eight UK family firms (Nicholson and Björnberg, 2007). In the study, the interviewees’

concept of “ownership” emerged as something quite complex. Above and beyond financial benefits, possession and legal ties, interviewees spoke of experiences that involved responsibility, pride, legacy, attachment-detachment and personification. Drawing on the literature on adolescence and early adulthood, we concluded that our data were revealing that the underlying motivators of this state are *attachment* and *identification*. The family system and its life cycle form an integral part of the EO concept, above and beyond the organization.

Emotional ownership is theoretically orthogonal to actual legal/monetary ownership, though they may be correlated. Working in the business is not a prerequisite for EO. We formulated the idea as fundamental to the longevity of the family business as a socioeconomic unit, in that it represents the psychological bond between the individual and business across generations. It unifies those next generation members on the “outside” (not working, not owning or being an in-law, for example) with those on the “inside” (such as working, owning and being bloodline family).

Another strong theme that came out of our qualitative data is that it can also be the basis of schism in the family firm – embodying distinctions between “outsiders” and “insiders” among next-generation members. In effect, all next generations begin their relationship with the family firm on the “outside” and work their way towards cognitive/emotional engagement or disengagement with the organization, depending on their circumstances. Their relationship with the family business, like all relationships, is characterised by a continual negotiation between closeness and distance.

Dimensions of emotional ownership

We define EO thus:

Emotional ownership is a cognitive and affective state of association that describes a (young) family member’s attachment to and identification with their family business.

Social identity

In our definition of EO, we draw on Ashforth and Mael’s analysis of organizational identification as a specific form of social identification. Social identification is defined as “a perception of oneness with or belongingness to some human aggregate” (1989: 21). In other words, it is a cognitive process, answering the question: Who am I? Social identity is distinct from affect and behavior, which are regarded as its antecedents

or outcomes. Social identification requires that the individual regards his or her fate as intertwined with that of the group. Success or failure of the group is experienced as one's own. Outcomes include organizational commitment, the internalization of values, and assessment of the group in positive terms (Turner, 1982, 1984). Factors that promote social identification include the *distinctiveness* of the group's values and practices, its *prestige* (Chatman, Bell and Staw, 1986) and *salience* or awareness of *out-group(s)* (Allen, Wilder and Atkinson, 1983; Turner, 1981).

Our case material contains many examples of social identification with the family business and associated outcomes. Next-generation members spoke of belongingness to a "team" that unites the family and other people in a goal-directed activity, and being part of a trusted inner circle. Outcomes of this identification that were mentioned frequently include pride, loyalty, privilege and responsibility. It was particularly interesting to note that fathers (business leaders) were frequently mentioned as central to the pride younger members felt about what he and the business had achieved in the community.

Attachment

Attachment theory was originally developed by John Bowlby (1969, 1973, 1980) in his studies of infant-mother interactions. Ainsworth, Blehar, Waters and Wall (1978) built on Bowlby's theory to formulate different attachment "styles" for how children relate to their parent or care-giver in terms of closeness, distance. Attachment styles play a vital role in human identity formation and intimate relationships across the life-span (Fonagy, 1999). From an evolutionary point of view, the motivators for attachment include protection and continuation of the species. Its outcomes include love, belonging and warmth, given that the patterns of relating are consistent and affirming. It answers the question: How close do I feel in relation to the target (the family business)?

Attachment styles influence the process whereby people or phenomena become internalized, as "objects" in the mind. Thus "object relations" are created as intra-psycho representations of the relationships that exist between these people and phenomena (Klein, 1946). A young person's internalized representation of the family business can be viewed as an expression of attachment.

In any business-owning family one can expect next-generation members to exhibit a range of attachment styles, partly as a function of the different parenting regimes children are subject to, and partly as a function of individual differences among the children. How parents treat

children is a function of the heritable qualities of the child, as has been revealed by behavior genetics; that is, children differ in their ability to “switch on” the emotional warmth of carers (Plomin, 1994). Moreover, research on birth order suggests there are systematic differences in the orientation of children towards parents’ goals according to their positions in the family – firstborns being much readier to pursue faithfully and with ambition the goals of parents, whereas later-borns are more likely to rebel and find their own path (Sulloway, 1996).

The rule of primogeniture in family firms trades on this tendency, but unwisely in view of the behavior genetic research that shows that it is a matter of pure chance whether they possess any other qualities that fit them to run a business. From the next generation’s point of view, Birley (1986) found that all siblings in a business-owning family, not just the oldest, experienced a strong need to make a succession decision with regards to the family firm.

Emotional ownership ranges from strong attachment to detachment and from close identification to differentiation. Additionally, it can be characterized by positive and negative emotion. Table 2.1 outlines differing degrees of EO that can be observed.

We have found that business families have wide variations in their average levels of EO. Differences can also be found within the same family. In one of our cases, the four children exhibited quite different levels of EO. On one end of the spectrum, the elder middle daughter perceived her ownership as “very scary.” She associated it with “guilt”

Table 2.1 Four manifestations of emotional ownership in family firms

		Emotional Ownership	
		Strong	Weak
Direction of emotion	<i>Positive</i>	Deep sense of belonging and shared fates “I feel strongly about the family business: it makes me proud. The success of the business is my success.”	Superficial, happy go-lucky “I’m happy it’s there but I don’t care that much. It does not define who I am.”
	<i>Negative</i>	Disillusioned and rigid fusion “The family business gives me pain, but I can’t free myself from it. It is part of who I am.”	Superficial rejection “I’m not bothered with the family business, and I don’t feel like I’m part of it.”

and felt as though she had not earned it. In fact, she did not even consider herself as a “next-generation member” of the family business, but felt quite detached. She speculated that she might feel differently had she worked in the business. The youngest son felt disconnected in a different way. As the youngest, he had to wait ten years before he has access to his shares. He told us how he lacked a “real” sense of his ownership, he perceived it as “toy money” that he had never touched nor seen. One day he was simply told he owned part of the business, but “it didn’t change my opinion of it”; saying “it’s not my business, not my money.” The other two siblings had a stronger and positive emotional ownership. The younger middle sister was actively constructing an identity based on the business, wanting to take up a non-executive role. Her main concern was to be part of the decision-making, but struggled with lack of experience and deference to her parents as powerful figures in the business: “My dad has more experience, it is awkward [if you’re not the] same level, if you stumble. Dad is on top of the triangle, I look up to him.” Finally, the eldest son who worked in the business described that his sense of ownership of the firm was not motivated by money, but by making deals with people and enjoying work as part of a team. He said that the attitude in the family was not to “use cash frivolously” or be “flashy” but to reinvest and manage ownership respectfully. He considered his parents to be “brave” in that they had passed down shares to their children at a relatively young age: “we could have blown it all and said ‘Let’s have a party!’” As it were, the parents showed trust in the children’s ability for stewardship for the coming generations.

The development of emotional ownership

Routes to psychological ownership are described as three processes of association: (1) intimate knowledge of the object; (2) self-investment; and (3) control (Pierce, Kostova and Dirks, 2001). Knowledge is positively and causally related to rights and responsibilities, which links with information-seeking, stewardship and organizational citizenship. Self-investment means time spent, psychological energy, emotional energy and attention. These investments serve to preserve self-identity over time. Control implies having a say in the direction of the organization. This also applies as a route to EO, and is central for NxG members. Unlike knowledge and self-investment (both of which may be created or accessed informally through the family network), control is more difficult for the NxG to access or self-initiate without a role in the organization. Control is to a great extent externally regulated, since it

derives from authority associated with legal ownership, employment or having a voice/membership in the firm's governing bodies. Personal power may also grant young members control, though less predictably.

Next generation family members can assume psychological ownership of the family business despite a lack of actual control over it. Parents, other elders in the family, spouses or non-family trustees may be proxies for this control, as they act on behalf of the member with less control. In our case material, there were two examples where husbands of bloodline owners had developed a sense of emotional ownership. In one of these examples, the in-law husband's EO was quite strong. He felt as though his wife represented him and that his job was to support her in that endeavor. Although the shares were in his wife's name, he considered the ownership as "theirs."

Our research indicates that next-generation members want decision-making processes that are inclusive and built on procedural justice (Nicholson and Björnberg, 2007), thus reinforcing the need for agency in this group. Adopting such an approach facilitates EO even for those who are on the "outside."

When considering the routes to emotional ownership, different levels of the relationship between the individual and the business (Carroll, 1988) need to be taken into account:

1. *The actual relationship.* Is the individual on the "inside" or "outside" in terms of work, ownership or other relations? How are his/her closest relatives positioned with regard to the family business? Family members who work in the business have a more straightforward access to the knowledge, control and self-investment routes to EO. Having a parent or sibling as the leader of the family business may give a next-generation member more in-depth opportunities to get to know the family business.
2. *The transferred relationship.* The motivation to attach and identify with the family business relates to the need for emotional attachment and to identify with one's family. Are the family relationship patterns that are transferred and replicated across generations such that they promote attachment yet allow for individual freedom? What images of the family firm does the young person carry in her mind? These are a result of how the family interacts, and how the balance between work and family life is constructed. If the family business is perceived as the "thing that stole my parent away from me," it is less likely that the young member will develop a positive and strong emotional ownership.

Family and business are socially co-constructed, but vary in how closely they are interlinked. For some family firms, there is little if no separation between family and business. This is often the case in founder-owned businesses. In our sample, there was a small first- and second-generation owner-managed business in which the family members practically lived and breathed the business. For others, family and business are widely separated and the relationships are more instrumental. In the looser structures of more mature cousin consortia such wide separation is often a feature. Rather than risking the potential over-involvement of owner-managed firms, the larger and more mature firms risk EO becoming as fragmented and dispersed as their actual ownership. Their struggle is not to create boundaries, but to create cohesion and engagement where there might be disinterest and detachment.

Part II From adolescence to adulthood in the family firm context

Becoming an adult means many things. Economically, one is either in the process of acquiring socioeconomic capacity (e.g., as a student), exercising it (as a worker), or supporting it (as a carer). For many it also means creating your own family, in whatever shape or form. Growth means separation as well as bonding. Adolescence and early adulthood are both characterized by movement away from the family of origin and towards intimate relationships formed outside the family sphere.

Two observations need to be made about this process. First, one universal feature is the increasing divergence of parents' and children's interests. The Darwinian perspective tells us that at the heart of the parent-child relationship is a biogenetic conflict (Trivers, 1974). Parents desire continued influence over their genetic investment, while children increasingly see their own interests as singular and detached, preparing the way for them to choose how to invest in their own future offspring's destinies. Hence, we see the oft caricatured fights between parents and their adult children about whom they should marry and how they should live and work, including lifestyle choices, child-rearing and communication styles (Clarke, Preston, Raksin and Bengtson, 1999). Mostly, the conflicts are benign and readily resolved or accepted. If they are extreme, children just go their own way, freeing themselves from parental influence. Alternatively, they become enmeshed in a destructive and overly cohesive family dynamic. There are major cultural differences in how these domestic dramas are played out, but the themes are universal.

Now add a family business to the frame and the picture alters. If children are tied into the business by ownership, then it may be much less easy to escape parental control without having to contemplate seriously damaging their economic self-interest. Family businesses, in other words, test these relationships by forcing economic interdependence. In this context EO plays a key role. Normally, we conceive of EO as a positive force, helping to bind family members into the future of the firm. In this context this binding can be negative, and a source of conflicts. Many of the major conflict catastrophes to have visited family firms have come from family members with high EO and inconsistent competing visions for the firm (Gordon and Nicholson, 2008). Each claims to identity with and own the “soul” of the business.

A second observation is that what is “normal” in terms of family development has become much more varied – that is, less normative – in recent decades. Family structures in the West now have many different manifestations. Individual career and life patterns are less predictable. This perhaps is another factor underlining the importance of EO. It can no longer be simply predicted on the basis of what kinds of attachment one might expect for a person’s position in the family and life/career stage. In many cases it is much more “free-floating” or negotiable – the outcome of quite idiosyncratic forces and factors in each case.

However there are normative patterns which need to be examined.

Psychosocial development in adolescence, young adulthood and adulthood

Erik Erikson (1997) was a pioneer in delineating these patterns, outlining a comprehensive developmental account of human development over the life-span. The theory proposes eight distinct stages, each stimulated by a basic conflict and accompanied by a resolution task. Our focus here is on the fifth to sixth stages, from adolescence to early adulthood, since the majority of the next generation can be found in that age group.

The adolescent stage (12–18)¹ features *identity versus role confusion* conflict. Teenagers need to develop a sense of self, which is primarily accomplished via immersion in social relationships. Unsatisfactory resolution results in a weak sense of self and inability to be true to oneself. In the family business context, social comparisons take on a deeper meaning for the teenager. Awareness of other families, how they do things and what they have, helps the young person to either differentiate or identify as he or she is building her own identity. Issues that the family business brings, such as wealth and reputation in the community, become central

to how the adolescent constructs a sense of self. It is a matter of socialization into a local social context, and therefore depends on how embedded the family and its business is in a wider set of community ties. For the rich, this can be an isolating and somewhat unreal social milieu (Conniff, 2003), as we shall explore later.

Some family firms are aware of the hazards to emerging personal and professional identities, and seek to control them (as we observed above) by creating a strong independent socializing frame around the family and its business. In some cultures, this is compelling to the point of coercion – the next generation have little choice about their participation in family events. In Western family businesses there is typically a more voluntaristic ethos, with young members being invited to attend governance events (such as AGMs), ostensibly for the sake of creating realistic expectations and conveying a sense of family legacy. The transfer of legal ownership may also commence at this time, along with first exposure to experiencing the business via work experience. Thus EO is consciously forged in many firms.

In the transition from adolescence to young adulthood (19–35 years), Erikson sees the basic conflict as *intimacy versus isolation*. The diversity of contemporary experience make Erikson's boundaries less universal in our times, but he is right about the process. It is a sociobiological universal that the formation of close relationships (often romantic) is part of the process whereby the next generation distance themselves from the family of origin in favor of exogamous relationships, a potential source of conflict as we have seen earlier. Erikson points out that unsuccessful resolution of this task may lead to isolation, low self-esteem and anxiety, further hindering the formation of mature identity.

A centerpiece of this stage is the move into work life and career. In the family business context, it is where the first major decisions are made about becoming an employee or getting involved in the governance of the family business versus remaining an “outsider.” For the family firm, this creates the dilemma of how broadly it should define itself, especially in the rights and involvement of spouses and in-laws. This is essentially the “political” stage – where perceptions and interests have to be negotiated, aligned or reconciled for EO to be maintained.

The conclusion here is that young family members will come to view the family business in a new light, as influenced by the resolution life development stages. Family dynamics play a central role in how these young people relate to the family firm so let us now look more closely at how family dynamics may influence career development.

Part III Family dynamics and career development in early adulthood

The concept of career represents the intersection of identity with social structure. The life journey through work and employment is jointly determined by the forces within the person and by the forces and opportunities within the surrounding social structure of a person's life and times (Nicholson, 2000). The link between family dynamics and career development has been well documented in the literature (see, e.g., Zingaro, 1983). Career is truly a life-span task (Vondracek, 1998; Vondracek and Reitzle, 1998) starting in childhood, where images and expectations are forged. In adolescence and adulthood the career represents the promise of economic self-sufficiency and a source of fulfillment. The intersection of identity and social structure means that in the growing adult, careers are part of the invention and reinvention of self. Where they can, individuals forge working situations and structures that reflect their needs, abilities and biases. Many family businesses owe their origins to the force of personality shaping a business around an individual.

Especially relevant to our pursuit of the next-generation family experience, their career development and the establishment of EO, is a family systems perspective. This view has special value in that it "emphasises the importance of considering family members' interactional patterns and emotional dependencies in understanding young adults' career decision problems" (Lopez and Andrews, 1987: 39). In the sections following we draw on the work of Murray Bowen (1994) to explore issues relating to career development and succession in the family business context.

Career development: a family systems view

Bowenian theory (1994) has been successfully applied to explain career decision-making in young adults (Hartman, Fuqua and Blum, 1985; Larson and Wilson, 1998). In brief, the theory identifies emotion – principally anxiety – as the mechanism for transmitting relational patterns of closeness/distance between generations. Bowen elaborates around these twin poles to describe dysfunctional family processes of fusion, triangulation and intimidation. Fused families are emotionally reactive to one another, suffering from a lack of boundaries and too much attachment. Triangulation occurs when a third party (e.g., a child) becomes the focus of tension in the marital dyad. Intimidation results from rigid expectations and excessive control by parents, associated with a fear of loss of independence and autonomy.

Functional families can tolerate a high degree of variation in closeness/distance, and provide space for members to develop a *differentiated self* that is not dominated by family relationships. Differentiation of self refers to the ability to separate one's own intellectual and emotional functioning from that of one's family. This means forging a sense of self that is robust enough to withstand emotional forces in the family without being fundamentally compromised. Dysfunctional families react with anxiety to even small variations of closeness/distance, draining the energy that is needed for goal-directed and self-determined activity. It is not easy for young adults in such families to distance themselves by creating a career and life away from the family. Fusion and intimidation, mediated by anxiety, are clear predictors for career decision problems (Hartman, Fuqua and Blum, 1985) as is level of differentiation of self (Bordin and Kopplin, 1973). Difficulty in developing one's own identity thwarts the career decision-making process, which requires self-awareness, rational thought and low levels of anxiety (Hartman, Fuqua and Blum, 1985).

Fusion and the NxG

For example, in one of our cases, processes of fusion seemed to be at work. Rather than affecting the career decision-process *per se*, these had an effect on the identity development in the careers of the next generation. Two of the sons (one bloodline, one adopted) who worked in the business described themselves as "clones" of the founder, and that the father "molded" them. Pressures to emulate the father seemed to stand in the way of the occupational identity development of the sole bloodline son in particular. Because the family relationships were fused, the impossibility of this task did not occur to either of the sons. Interestingly, a similar lack of boundaries also existed in the business, where roles were not clarified.

The trajectory of a young adult from the family into the world of work is inevitably different for those who decide to work within their family sphere. Problematic succession patterns are more likely to occur in the presence of parent-child relationships that are "characterised by dependency and idealization, vacillation, and conflict and opposition ..." (Miller, Steier and Le Breton-Miller, 2006: 381). The family business may be equated with a parent-figure (often the father) to be destroyed, idealized or cherished (*ibid.*). In the case of fused families, a child who is smothered by parents, or indeed by the family business, finds little alternative but to accept or oppose. Despite numerous invitations to work in the business, the sister in the case example above rejected the

business because “it was always in her face” and dominated all family interactions. This shows that EO can be excessively high as well as too low, causing rebellion where families are overly cohesive.

Intimidation and the NxG

Intimidation in the family system often causes fear of failure to meet expectations. A successor in a family with high levels of power distance between parents and children may agree to take over the business leadership out of fear of rejection, and not because it was a personal proactive career decision. Forceful parenting can leave little room for independent thought and action, creating an uneasy combination of dependency and resentment. Individuals in such family and career situations are less likely to be able to differentiate themselves. Young members can actively distance themselves from the family firm because the expectations are too high and failure is too visible.

We came across an interesting dynamic in two of our cases that featured some intimidation and perceptions of power distance between siblings (intra-generational). In one of these families (a fourth-generation medium-sized business), the parents had gone through a painful divorce, which led to the departure of the father from the family. The eldest son, who also became the business leader, took on a “parent” role in the new family constellation. Complicated emotions stemming from the divorce had led to a rift between the eldest and youngest brothers in the family. The youngest boy felt that his brother had prevented him from building a career in the family business, despite his relevant experience and attempts to join through appropriate channels. In his view “power games” dominated the relationships. In that sense, the siblings were locked into uneasy interdependence. Interestingly, though, none of these difficulties had weakened the EO of either.

Part IV Special challenges for the NxG making a career in the family business

Young leaders in family firms are faced with balancing multiple roles and relationships as a family member, employee and possibly also owner. This adds another dimension to the already difficult process of shaping a career identity. In their study on the relationship between love and work attachment styles, Hazan and Shaver (1990) used Bowlby’s concept of “exploration” to characterize adult work activity. Like early childhood play and exploration, work is a major source of actual and perceived competence. The ability to explore freely and fully requires a

secure base. Hazan and Shaver use attachment theory to explain individual differences in motivation, relationships and approach to work. This approach is particularly relevant for young family members who have to juggle high competing demands from family and work relationships.

Individuals with *secure* attachment styles enjoy work without excessive fear of failure and are able to balance work and non-work demands. These individuals do not typically use work to satisfy unmet needs for attachment, and have high levels of general well-being. Contrastingly, *anxious/ambivalent* types are motivated by gaining the praise of others, and consequently fear rejection. Relationship concerns often interfere with their work. Finally, in the *avoidant* style work is used as a means of avoiding social interactions and close relationships. These individuals are more prone to workaholism and are often dissatisfied with their work.

The wearing of different hats

In Erikson's psychosocial development scheme, the dilemma between *identity vs. role confusion* is particularly pertinent for young family members starting a career in the family business. Managing the combined roles of family member, employee and shareholder may add extra pressure, which can complicate or retard the identity resolution task of these young people. To fit in with other employees and gain respect through yourself rather than as a family member is a difficult aspect of working in the family business, particularly when you first join.

Many NxG leaders also face living with a sense of isolation both at work and at home. They are often unable to confide everything to one person, because both family members and non-family colleagues all have some common interests and are thus not neutral in their roles. As we pointed out earlier, there can be role conflict *between* generations. A father-daughter dyad in our sample found themselves regularly clashing when working together – both having strong wills and similar technical orientation, but different approaches to authority and expectations of working hours. The “daughter-employee” and “father-boss” lines were continually getting crossed. Fortunately, the working relationship improved greatly when the daughter relocated to work for the firm in another country, allowing her much greater scope for the free exploration she needed.

Expectations

Among the many hazardous expectations the NxG are exposed to is a culture of overwork. Second-generation members are perhaps particularly

vulnerable. This life stage of a family firm is often a time of rapid growth, requires endless hours and huge dedication, often exacerbated by the founder's continuing pressure. The "workaholic" behavior of a founder is described in the case below by the next generation:

In board meetings [it has happened] that he's shouted – "you don't even work 12 hours a day!" – as if that's a bad thing. It's taken time to get over that. Did try it [working those hours] for a while and got miserable.

(second-generation working member)

In this case, both the NxG and the founder were able to accommodate each others' lifestyle expectancies, but in other instances we have seen the senior generation in the avoidant mode, submerged in excessive amounts of work. A sense that "the business took my father away from me" severely diminishes the NxG's level of attachment towards the firm, and thus drains their EO. However, some NxG also conclude that "if you can't beat them, join them." The three sons in one of our cases did just that, working alongside their father in 13-hour shifts, knowing that it would be very hard to find time with him otherwise. The daughter in the family detached herself completely, virtually disowning the family business.

Some female family members have no expectations in relation to the family business; viewing the family in a traditional model that includes the norm that "females stay at home with their children." In the following example, the difference between the girls and the boys goes back to the days when the kids were doing holiday work in the factory:

Whilst doing summer work, my brothers were expected to cycle to the factory – I was not, I was a girl – I went with my father in a car...frustrated back then – couldn't really...can't really see the difference...I was allowed to cycle around the countryside – but not to work!

(sixth-generation non-working member)

Where these assumptions are held, female members can find themselves excluded from working in the business.

Perceptions of nepotism

Several of our interviewees felt as if everybody was watching and judging them, both family and non-family. This type of situation may bring out

an *anxious/ambivalent* attachment style in some individuals, associated with fear of failure and a need to please and overachieve. Perceptions of nepotism, whether actual or in the mind, challenge the young person's professional identity, and consequently their self-esteem. For example, when one of our respondents joined the business, employees assumed that she had in-depth technical know-how of the business, purely because she was a family member. In fact, her knowledge was rather limited, and she had to face her shortcomings publicly.

Informants also sometimes mentioned discomfort associated with the power that family membership brings, especially when coupled with lower actual levels of authority and experience. One mentioned the challenge of knowing when it is OK to question decisions as a family member, without being perceived as encroaching on the other's territory. In this case, it was felt that the management "feels threatened by family members".

Individuals reported the felt need to set an example and work harder than non-family members, but even so, they felt that fair evaluation of their competence was elusive:

You never really know how good or bad you are – even if people fill out 360° feedback forms, some people will tell you what you want to hear. You have to live with that – some people think you got that job because of who you are. Only when you've worked with them for a while it's fine ... but, for example, in the district offices you find the opinion that "I missed out on a promotion" and that family business people expect a golden elevator to the top ... you have to be able to live with that – if you can't, you can't work in the family business.

(fourth-generation working member)

In another of our cases, perceptions of nepotism prevented at least one member of the next generation from wanting to become involved. On the one hand, family members were convinced that they had to join at the lowest level to avoid nepotism. On the other hand, they were exposed to embarrassment of status incongruence as owners engaging in low-level menial tasks. This feeling was often projected on to others – we were told that in the wider business it was perceived that simultaneous ownership *and* working in the company were somehow "inappropriate." Unfortunately, the next generation lacked guidance or support on how to navigate around this dilemma.

Part V Poor little rich kids: negative influence of wealth ownership on children and adolescents

Extreme wealth is basically bad for children (Pittman, 1985), inasmuch as it thwarts healthy parent–child relations and restricts social support. More generally, it could be said that any extremes are bad for children’s development. Whether rich or poor, children are children and have the same needs. The wealthy may have exactly as little knowledge of how the world works as the poor (Shafran, 1992). Many affluent parents bring up well-adjusted individuals; however, poor family functioning takes on a different shape when coupled with material abundance. Affluent families are as vulnerable as any in terms of mental health, but wealth has specific ramifications for how it is dealt with.

Affluence is associated with the following issues for the young: (a) pressures to achieve; (b) parental absence/lack of involvement and isolation from adults; and (c) lack of social aptitude/preparedness to interact with peers (Luthar and Becker, 2002; Luthar and Latendresse, 2005).

Achievement

In a successful family, the baseline for achievement can be set very high; sometimes unrealistically (Shafran, 1992). We have discussed some of the expectations associated with working in a family business as a family member. In addition, riches can also carry a range of social expectations. Wealthy children are faced with quite small margins for achievement, since their social progression has more or less peaked in the previous generation(s). Having witnessed the great success of their parents, how do children live up to such accomplishments?

Failure is very visible in such families, and young children sometimes dissolve under the pressure. Luthar and Latendresse (2005) found that among non-inner-city (US) adolescents, affluence was associated with higher intake of hard drugs and anxiety-depression, which they interpret as attempts to self-medicate. Valued peer attributes at the socioeconomic extremes were found to be negative and had an adverse effect on competence (scholastic achievements) or well-being (e.g., aggressive behavior or substance abuse).

Social isolation

Social isolation from peers and withdrawal is quoted as a common plight among the children of affluent parents (Luthar and Latendresse, 2005). Parental absence may be a result of long working hours and frequent traveling, depriving them of role models needed for identity

development. Fluctuations in adult affection and presence causes ruptured attachment styles and a less secure sense of self. Furthermore, rich children may be groomed and more accustomed to communicating with adults than peers, finding peer group milieus awkward and unusual. Children in very rich families may doubt whether their friends chose them for who they are rather than what they have.

As a young next-generation member, you are part of the family business brand and the looming inheritance whether you want it or not. This may contribute towards an ambivalent relationship with the business, something we noted in our respondents. For example, one of the interviewees said he was very proud of the business, but at the same time he kept his ownership secret from his friends, for fear of envy or being regarded as superior or different.

For those of our participants who actually considered themselves as wealthy, their resources meant freedom and the ability to have a certain lifestyle. However, inherited wealth may also raise issues of self-motivation and lead to feelings of unworthiness, particularly in those instances where no work has been done to merit it. They have to learn to earn it by being a good steward of it (Aronoff and Ward, 2002). Feeling unworthy leads to low self-esteem; this in some cases can be blended with a healthy dose of pride in the family business.

Issues for practitioners

The ultra-poor and ultra-rich attract similar negative judgments from society – often ascribed as being less moral and personally responsible for their plight/lack of happiness respectively (Luthar, 2003). Although wealth does not produce happiness, it certainly leads to envy (Pittman, 1985).

Despite material welfare, wealthy families may lack support structures. Even when in contact with service providers such as therapists or social workers, their plight can be viewed through stereotypical lenses. Practitioners may overlook or diminish their symptoms due to unconsciously held envy or contempt. For example, affluent women's complaints of physical abuse are reported to have been trivialized by therapists who assume she has the resources to handle it or leave the relationship. Consequently, referrals are not made (Weitzman, 2000).

Conclusion: emotional ownership and the family firm

The continuation of a family business depends on the next generation, whether they own or manage the business. In this chapter we have

looked at the future sustainability of the family firm by focussing on this link, which has the power to make or break the business. People often talk about this as succession management, as if it were a technical problem to be solved. Here we see it as a human problem of the growth and destiny of the next generation in family firms, and how this is nested in a complex web of family relationship dynamics, and subject to a wide variety of external forces.

We have used the summary concept of emotional ownership to capture the nature of the bond between the next generation and the business. It is, of course, not a fixed quotient, but a variable. It can rise and fall according as the individual grows and develops, and as a result of the actions of others and the state of the firm. Its existence is a necessary, but not a sufficient condition for the responsible ownership or committed employment that the senior generation might wish for. In other words, without it, there can be no meaningful contribution beyond perhaps what any hired-hand might bring. The attachment and identification contained in emotional ownership are the bricks and mortar of the unique culture of family firms – and thus its inimitable competitive advantage.

In this chapter we have tried to identify what may be the consequences, and what are the family dynamics that generate, sustain and sometimes destroy EO. What we have said little about, however, is what kinds of interventions can mediate these processes. A detailed outline of possible interventions is beyond the scope of this chapter. However, a biographical approach can offer a good framework for determining where such interventions may be best placed. Biography can be seen as a matter of “Destiny, Drama, and Deliberation” (Nicholson, 2007). Destiny comprises the forces over which one has limited control – one’s biogenetic identity, life milieu, family constellation, social class and so on. Drama is what comes unexpectedly and unbidden – the role models, the accidents, the serendipity of everyday life that reveals new options and opportunities. Deliberation is the time one spends pausing, considering such options and making life changing choices. These latter occasions are surprisingly rare – most of the time we are swept along by conveyor belts of institutions, relationships, occupations and social norms. However, deliberation can be engineered to good effect by the increasing access to the growing number of resources that exist in our society to support structured reflection – the professional advisors and counselors in the community. The counseling/consulting process has been critical in the development of many a family firm, and in the lives of many successful people.

In this chapter we have supplied, in effect, an agenda for such counseling to consider:

1. The Darwinian framework we have used can help direct attention to the prime sources of potential conflict and help to find overarching themes that can integrate and unite family interests. This means appraising the different needs of individuals according to their unique profiles of needs and abilities, family position and resource constraints.
2. The concept of emotional ownership can be a helpful path to insight about family members differing and changing relationships to the business. Viewing these ties from the perspective of identity + attachment needs can help to understand the dynamics of young people's needs in relation to the firm.
3. There are a number of recurrent dilemmas and conflicts that confront individuals in the journey to maturation from childhood. It is important to recognize that the battleground shifts over time. Of course the business is not standing still over this period either, which means that advisors need analytical as well as empathic gifts to help mediate the relationship.
4. Family dynamics can be seen as a set of complex games that are played out, featuring a delicate balance between the needs of the individual and the needs of the group. Family relationships are a negotiation between closeness and distance, continually shifting alongside the family and business life cycles, its destiny and drama. It takes a brave, insightful and intelligent advisor to be able to enter this arena and do more good than harm.
5. We have highlighted a number of specific issues that are quite unique to family firms that are raised for the next generation. These include role conflicts and ambiguities – the difficulties of accommodating different “hats” as owners, employees and family members. There is also, for young people entering the firm, the need for a strategy to cope with real or imagined perceptions of nepotistic advantage. Advisors can offer much support in facing such concerns.
6. Our final topic was the challenge of wealth. The relatively scant literature we found on this topic suggests this is an insufficiently considered problem. Nurturing a real sense of achievement and competence is a matter of approaching the individual and her situation with realistic expectations. Major cognitive reframing is needed for young people – and their parents – to feel they have meaningful challenges to pursue with commensurate recognition at the end.

Overall, in this chapter we have tried to open up a hitherto overlooked topic in the field of family business – emotional ownership and the next generation – in order to demonstrate how much the family firm depends on forces and dynamics that are in the lives of these young people, much more than they are in the firm.

Note

1. Please note that the ages listed are not exact but meant as indicators only.

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Part II

From Promises to Results

3

Power as Service in Family Business

Miguel Angel Gallo

Introduction

Traditional philosophy distinguishes two kinds of power: *potestas*, which is the power an owner has over the things he owns, or power obtained and maintained by force; and *auctoritas*, which is the power conferred upon a person or group of people on account of their professional competencies. A person may have both *potestas* and *auctoritas*, but in each case the power will come from a different source.

A family company is a community of people united as members of the same organization and sharing the same mission (Melé, 2007). The exercise of power as service in a community of people is based fundamentally on the exercise of *auctoritas*. To exercise *auctoritas*, a person needs to be professional and voluntarily moderate the *potestas* that is his by law.

Ownership of a family business: *potestas* and *auctoritas*

A family business, being a community of people and an intermediate institution in society, has a social function to perform. Traditionally, this social function has been thought to consist of “internal” social responsibilities and “external” social responsibilities, these being two aspects of the same reality.

Internal social responsibilities are usually classified in four groups, all of which are equally necessary for a company to act responsibly in every respect. A company’s four internal social responsibilities are:

- To provide society with products and services that serve human development.

- To create economic wealth by generating revenue from the difference between receipts and payments, and by distributing such wealth appropriately among the members of the community of people who have helped to create it, that is, the company's owners, managers and workers.
- To develop the human qualities of the people who form the community.
- To ensure its own long-term survival.

A company's external social responsibilities are thought to consist of helping to prevent erosion of the common good, that is, the good of all those who make up the social environment in which the company acts. Prominent among these responsibilities nowadays are the duty not to exploit people who are weak or defenseless and the duty not to harm the environment. In fulfilling its external social responsibilities, a company must respect the principle of subsidiarity, that is, it must support those best equipped to perform the necessary tasks most effectively. And to that end, it must use its specific capabilities as a business enterprise (Gallo, 2004).

Under the legislation applicable to most family enterprises, the right to make decisions concerning corporate governance belongs to the owners of capital, usually in such a way that an owner's *potestas* is in direct relation to his or her share of the capital. In other words, although we should not forget that a company is a community of people, the law gives *potestas* in a family firm to the owners of capital. It has been this way for centuries and major changes are not to be expected, among other things because countless companies in very different environments have performed their social functions reasonably well for many years within this framework.

The relationship between ownership and power is so important for corporate governance that most of a company's Articles of Incorporation (which is the contract between the people who pool their resources to achieve certain goals) are devoted to defining who owns the company and in what proportion, how a person can become an owner, what rights the different types of owner have and, increasingly in recent years, what conditions a person must meet in order to be – and in what circumstances a person legally cannot be – a shareholder.

Ordinary shares in the capital of companies usually have two types of rights attached to them: voting rights, that is, rights to vote in the company's governing body; and economic rights, that is, rights to a share of periodic earnings or the proceeds from asset sales. These two types of

rights can be legally separated, in which case certain people will hold the voting rights and others, the economic rights. The separation may be temporary or long term.

The owners of voting rights may enter into agreements which, if legally valid, oblige them to vote the same way on corporate resolutions. Again, such agreements may be established for one decision or several, for a single occasion or for an extended period.

When we talk about ownership of a family enterprise, we are talking about ownership of the company's assets, which are the instruments the company uses to do business. However, a company is much more than these instruments; it is a community made up of the people who work in it, the people who contribute capital to acquire the instruments the company uses in its operations and, indirectly, the company's customers and suppliers. The company's owners own the instruments but not the people, who are free and have no owner.

When we talk about power in companies, we should be talking about *auctoritas*, that is, the professional competence of those who hold power in order to lead the community of people to fulfill its specific social purpose. Legally, however, we act as if holding voting rights (i.e., *potestas*) automatically confers *auctoritas* or entails a firm intention to grant voting rights to those who do possess *auctoritas* by virtue of their personal qualities.

Owning something is commonly thought to mean being entitled to do as one wishes with that something. That is not true, however, in the case of ownership of shares in the capital of a community of people that has a social function to perform – a community, moreover, that only exists as a company because it has been authorized by society to fulfill the corporate purpose registered in the company's Articles of Incorporation. Shares may be sold, donated, transferred or canceled as permitted by the articles of association and the law.

More importantly, all property is under a “social mortgage” (Melé and Gallo, 2005) and respecting this social mortgage is one of the deepest justifications of the right to private property. The social mortgage requires that the owners of a family firm exercise their voting rights in such a way that the company fulfills its social function.

Lastly, especially in family firms, it must be stressed that although voting rights (*potestas*) may be transferred by inheritance, the professional capacity to govern and manage a company (*auctoritas*) cannot be transferred in the same way. Rather, it must be earned and developed by each person individually through personal effort.

Training for the exercise of power in family business *

The fundamental goal of training for the exercise of power in family business is to ensure that the owner acquires the necessary *auctoritas* to exercise *potestas* responsibly; and if that is not possible, to persuade the owner to appoint a representative who does have *auctoritas*.

The need for such training is especially acute in family businesses for a number of reasons. In family businesses, capital tends to be highly concentrated. For the first three or more generations, there is only a small group of owners, who have large shares of the voting rights. Such high concentrations of *potestas* imply a duty to achieve high levels of *auctoritas*.

Usually, the owners of family businesses are not gamblers who change their bets at every opportunity. Nor are they birds of passage who stay in the company for a while and then move on. As a rule, they are there for the duration. On the other hand, they often have little option, as it may be practically impossible for them to sell their shares.

A family business owner's equity interest in the family business may well be virtually the sum total of his economic assets. It is only natural, therefore, that he should wish to exercise his voting rights so as to protect what he owns. It is not so natural, however, that he should readily and fully appreciate that just as governance requires professional competence, safeguarding his property requires *auctoritas*. Because most people think they already know how to own things.

In a family business there are not only economic assets, but also moral assets, which are very important to people. These moral assets include such things as the family's good name or shared traditions. And each family member may enjoy these assets to the full without thereby diminishing any other family member's enjoyment of the same assets.

Lastly (and this is extraordinarily important precisely in family business), there is psychological ownership. By psychological ownership is meant the idea a person has of owning something (in this case a family business) because of being associated or closely acquainted with it, regardless of whether the person is a shareholder or not (Pierce, Kostova and Dirks, 2001). Psychological ownership makes some shareholders think they have certain special rights in the company, even though that is not the case. Training for the exercise of power must encourage positive psychological ownership and discourage unnecessary insistence on legally non-existent rights. Positive psychological ownership must emphasize instead the owner's obligations to the family business, in recognition of all that he or she has received from it besides the

economic benefits. It is important to instill a realistic attitude that will dispel any negative psychological ownership or any unfounded or damaging claims on the company that may infringe the rights of other members of the community.

The roles that owners play in a family business will vary, depending on the size of the company, the articles of incorporation, the family protocol, each person's share of the voting rights, company tradition and practice, each person's qualities and, most importantly, each person's intentions. In what follows we will discuss two of these roles, that of the shareholder and that of the director. After that we will discuss the role of chief executive.

Based on general experience, it seems preferable for a family business that its owners be, firstly, voluntary shareholders and, secondly, active and level-headed shareholders.

Doing a thing voluntarily is the best reason for wanting to do it well. Because a thing is voluntary does not mean it is a passing whim. Being a voluntary shareholder does not mean that the person opted to be a shareholder. It does, however, mean that, finding himself in the position of being a shareholder, he is determined to do it properly. By law, once a shareholder, or whoever gave the shareholder the shares, has paid the corresponding portion of the share capital, he has no more obligations to the company, only rights. This may be acceptable in other types of company, but whatever the law may say, it does not seem appropriate in a family firm.

An active shareholder is an owner who takes the trouble to acquire the necessary knowledge to understand the company's situation as fully as possible, that is, the changing competitive environment in which the company operates, the company's strategic position, the qualities of its management and employees, its financial position and so on. An active shareholder is one who attends shareholders' meetings, who prepares so as to understand the information he receives, debates constructively and votes the way he thinks best to ensure that the company performs its social purpose.

Therefore, in family business, if power is to be exercised as a service, efforts must be made to ensure that shareholders acquire the necessary knowledge and actively motivate them to do so. This is the very opposite of the attitude of family business owners and managers who want shareholders to be as inactive as possible, so that they can avoid having to give explanations, prevent intervention or criticism, and run the company on their own. They may even be convinced that this is not what is best for the company in the medium to long term; and yet they

turn what may be a temporary need for shareholder restraint into a permanent state of affairs.

A level-headed shareholder is one who is more interested in medium- and long-term results than immediate gain or short-lived successes that have no lasting effect. Level-headed also means being moderate in one's demands regarding information before meetings and the implementation of control systems. Level-headed does not mean refusing to decide unless one is wholly convinced, as often it is wiser to accept the opinion of better qualified others, even if one does not fully understand the arguments oneself. Nor does level-headed mean being unconcerned about profit or the share price; it does, however, mean that besides his own particular good, the shareholder will also be influenced by the common good in areas where the good of the whole takes priority over the good of the individual.

In light of the above, it would seem appropriate that the next generation become shareholders at an early age so as to be able to participate in shareholders' meetings, if only by taking the minimum number of votes permitted by the Articles of Incorporation "on loan," on condition that the votes be returned if the lender so requires or the borrower breaks the rules. General meetings can be an excellent place to learn from experience, and people learn better when they are young. Perhaps the criterion for holding voting rights and attending general meetings should be not so much age as a decent level of proficiency in the human virtue of discretion.

The above considerations also suggest that there is an age at which family members should retire as owners of voting rights (though they may retain token voting rights), as the qualities required to exercise power naturally dwindle as a person grows old; and it is important that power always be exercised responsibly.

If in order to exercise power as a service family business shareholders are required to be active and level-headed in the general shareholders' meeting, which is the highest body of corporate governance and the one that determines the owners' will, those who exercise the power of supervision over the company's activities must meet even stricter standards of conduct.

In what follows we shall be talking exclusively about the people who make up the board of directors, although what is said obviously applies equally to sole directors in cases where the family business has opted for such an arrangement.

The training that directors receive for the exercise of power must be aimed at making sure that the board actively and effectively fulfills its

main responsibility, which is to ensure that the family business performs its social function (Ward, 1991). The board will achieve this through various, more specific functions. These are:

- To supervise strategy formulation; strategy being the definition of the future situation the family business aims to attain in the areas of products and services, markets and customers, geographical scope, growth, vertical integration, and allocation of human and economic resources.
- To foster the development of managers; who are the ones responsible for strategy implementation, ensuring sufficient diversity of opinion (even though such diversity may be uncomfortable) and a sufficiently wide range of ages to facilitate succession.
- To guarantee complete, timely and accurate information on the company's economic and financial situation, and prompt delivery of this information to those who have the right to receive it.
- To ensure compliance with the law and the Articles of Incorporation, and to regularly submit the articles to review, proposing changes to shareholders as appropriate.

For the board of directors of a family business to exercise power responsibly, the board's functions and regulations must be set down in writing, so that they are known to the company's owners and are open to improvement.

Among the most important of these regulations are those relating to board composition. Board composition and renewal – for example, a shareholder's right to a seat on the board based on proportion of ownership, or a director's right to be re-elected for an unlimited number of terms – tend to be regulated by law. Whether the board of directors as a team (which it should be) acts correctly, however, while very much influenced by these regulations, nevertheless depends essentially on the qualities of the people appointed to be directors.

This is why particular care must be taken to choose the right people to be directors, the ones who know how to govern the company as a whole and are willing to give their time to it, and so provide the best guarantee that the community of people will be well governed. This is not to say that in a family business each person's share of the voting rights or the balance among different branches of the family should not be taken into account when choosing people to be directors. On the contrary, it is very important that this be done, and done well. It does, however, mean that such considerations must be weighed against – and

in the event of conflict of interest, overruled by – the criterion of choosing the best person for the job, even if he or she is not a shareholder.

The effort made by both sides – company and family – is decisive in striking the right balance. This includes the effort people make to qualify for directorship, which is a much more demanding qualification than that for being a shareholder. And the effort of devoting enough time to the duties of directorship.

The training to be a director is an intensive course in the design of corporate strategy; the design and implementation of management structures; the application of management systems to people in top-level positions; the use of, and return, on financial resources; company law and the company's Articles of Incorporation; and in the case of family businesses, typical issues such as the way businesses mature, the need for ongoing entrepreneurship, the importance of delegation and empowerment as the organization grows and the concomitant need for more effective integration, and the building of capacity for dialogue and conflict resolution.

In many family firms there are family members who work in the company as managers and, at the same time, are directors. People in this situation need to be trained to distinguish between activities and decisions that belong to the realm of governance, and activities and decisions that belong to management. In a family firm, blurring the boundaries between governance and management can cause rifts both in the family and in the company.

If power is to be exercised as a service, directors must devote time to governance activities. What's more, it must be "quality time," as they say nowadays.

A board of directors must act as a high-performance team, trained to prepare meetings very thoroughly, willing to make the effort to understand each team member's contributions, determined to collaborate to make the best decisions, and eager to improve their own capabilities and learn to do more and better, working as a team for the family business.

Learning to be a professional director is not easy, but clearly not impossible. Family businesses need to be creative in finding learning opportunities for family members, especially the younger ones. Apart from courses and seminars on corporate governance, these opportunities may take various forms: "apprentice directorships" in less complex subsidiaries or business units, for example; "simulated" or "shadow" boards made up of young family members, with meetings chaired by a real director and following a similar agenda to the main board meeting, but held one or two days later; extended guest attendance at board

meetings; shared directorships, rotated among various younger members of the family; and so on.

In family business there is a risk that the board of directors will end up becoming an “old folks home” – a five-star old folks home, it may be, full of people who were very capable and gave sterling service in their time, but an old folks home nonetheless. Just as it is important to consider setting a retirement age for family firm shareholders, all the more so for directors, even though it is not required by law.

In family-owned companies the board of directors is more vulnerable than in other types of company to the diseases that affect all teams: laziness and ignorance. Especially if the most powerful person in the company deliberately spreads these diseases. Directors start to show symptoms of ignorance when they stop receiving sufficient timely information. And it is well within the power of a managing director to make this happen. Laziness sets in when board meetings are repeatedly suspended, postponed or cut short. Again this is something a managing director can very easily arrange. Changing the date of a meeting when the other directors have very full agendas – which, if they are respected members of the business community, is likely to be the case – is equivalent to putting the meeting off, often for several months.

People who are willing to learn in order to exercise a profession responsibly will not only agree to having their qualities and performance assessed, but will actively seek such assessment in order to improve. Responsible exercise of power by the board of directors in a family business naturally requires regular assessment of the board as a group and of directors individually.

Senior, more experienced directors will play a crucial role in any such assessment. Assessing performance is neither easy nor comfortable. It must be based on clear criteria and sharing of opinions in the quest for objectivity. It takes great maturity to see assessment as an opportunity for improvement, rather than as subjective criticism that is to be rejected because the evaluator is uninformed and biased.

The temptation not to carry out assessments, and not to accept them constructively, is considerable. In fact, in the vast majority of family businesses directors are not subject to assessment. And yet, this is an issue that needs serious consideration in the interest of educating directors in the responsible exercise of power.

The most powerful person in the family business

Many family and non-family businesses have a chief executive, and often the chief executive is also the chairman of the board of directors.

In family businesses this person is likely to be the one who owns the majority of the capital, either the company founder or the founder's heir. This makes any transfer of power very unlikely in the short or medium term, barring serious accidents.

Getting this person – managing director, chairman and CEO, or whatever the title may be – to exercise power as service, and educating him or her to do so, is vital if a family business is to perform its social function.

The founder's enduring entrepreneurial success will have given him or her a certain *auctoritas*. The heir will have received voting rights (i.e., *potestas*) from his predecessor and initially may have sufficient *auctoritas* thanks to the support he receives from his parent and his own efforts to acquire the necessary professional competencies. In both cases, however, genuine *auctoritas* must be “maintained,” which is difficult.

Chief executives tend to remain in power in family businesses for a long time, often more than two decades. Studies of the life cycle of family businesses and business-owning families have shown that, during this time, businesses go through very different stages, and that each stage requires more and more sophisticated capabilities on the part of the chief executive.

In fact, practically all family firms need to repeatedly revitalize their businesses, as businesses inevitably mature after years of success. Like any organization, a family business must adapt its management structure to its strategy, and this means changing people, often including the founder's closest collaborators, changing the content of management jobs, and putting in place professional management systems. As they grow and develop, most family companies need to expand internationally, which is difficult when some family members have close ties with the local community. Lastly, in order to continue as family businesses and survive for generations, all family businesses must undergo succession in ownership, governance and management.

In order to revitalize mature businesses, adapt the management structure to strategy so as to avoid lasting crises, expand internationally, manage succession and cross the other bridges that every family business comes to in its life cycle, chief executives must make the right decisions. The high mortality among family businesses suggests that all too often they fail.

To exercise power as service, the most powerful person in a family business must not only take steps to maintain and develop his knowledge, so as to keep “up to date,” understand the company's strategic situation and be able to meet the challenges of competing in a changing

market; he must must also learn to understand the extraordinary influence his personal preferences have on everything that is done in the company and so establish procedures to voluntarily limit his own power.

A chief executive's diagnosis of his company's situation in its competitive environment provides the basis for the various strategic options considered when planning the company's future. This diagnosis is made by assessing market opportunities and threats and the company's strengths and weaknesses compared with competitors who are aiming to exploit the same opportunities and avoid the same threats. It is based not only on judgments of fact, that is, undeniable realities, but more importantly on value judgments, that is, personal assessments of the opportunities and threats and their importance for the company. These subjective assessments are inevitably influenced by the personal preferences of the executive, who uses his judgment. Thus, where one person sees an opportunity, for example, a chance for rapid growth, another will see a major strategic threat. The former may be influenced by a strong personal preference for making the company bigger and the latter, by a preference for keeping it the same size.

The influence of personal preferences is apparent not only in a chief executive's diagnosis of the situation, but also in his choice of response (from among the various possible, economically rational responses to the same opportunities, threats, strengths and weaknesses). People have a strong natural tendency to choose what they prefer.

The exercise of power as service requires that those in positions of power recognize the influence of their personal preferences and the subjectivity of their judgments. It also requires a willingness to be more objective and to accept that the community may require them, in the exercise of their strategic responsibilities, to do things that go against their personal preference.

The problems caused by personal preferences in family business is easier to appreciate if one considers that while environments and businesses change radically over time, people usually do not. And if they do, it may be for the worse, as they cling to preferences that may have been appropriate in the past but are no longer appropriate now. The people who hold substantial voting power tend to remain in the company for a long time and are particularly prone to this type of risk.

In light of the above considerations we can say that the people who hold most *potestas* should establish procedures to assess their personal preferences in order to decide how appropriate they are for corporate governance and reach more objective strategic judgments. In other

words, they must establish enduring ways of doing things that lead to voluntary moderation of their decision-making power.

Voluntary moderation of power is clearly the opposite of tyranny. It entails a permanent willingness to take other people's opinions at full value and change one's mind, which in corporate decision making is equivalent to making important decisions on a collegial basis and respecting decisions made collegially.

There are various ways of actually implementing voluntary moderation of power in family firms. It will depend on the individuals and their circumstances. There are very informal ways that do effectively moderate power, while other, highly formal ways turn out to be mere window dressing and pretence. As always, true moderation depends on the intentions of the person who holds power.

Of the various formal ways of moderating power in family businesses, experience suggests that two are particularly useful. One is to establish a collegial governing body such as a board of directors, or equivalent, to perform the functions described in the previous section. This body should be made up of people who are capable of forming opinions that take different personal preferences into account. The other is to separate decisions that are decisive for the company's future and in which the company intends to adhere to the principle of collegial decision-making from decisions (usually lower-level decisions) in which the collegial governing body need not or ought not be involved. This distinction is important because it indicates not only moderation of power but also a determination not to neglect responsibilities.

Anyone who sincerely and judiciously establishes a collegial governing body and, at the same time, shrewdly selects the decisions that must be decided collegially and loyally fulfills both commitments clearly intends to make good on the promise to moderate his power. To demand this of a person who has both *potestas* and *auctoritas* is to demand excellence in conduct – yet excellence is a prerequisite of good governance in a community of people.

Transfer of ownership: governability

The right to transfer personal property to successors is a natural right of the individual, just as society is entitled to legislate on and establish general frameworks for such transfers.

In a company, people transfer shares of stock, that is, voting rights and economic rights. The transferer may also own certain tangible and intangible assets that are used by the family business under contract;

such assets are transferred with their associated rights and obligations. As we have said repeatedly, the company is a community of people. Shares confer ownership of the instruments people use; the people themselves are free beings and cannot be transferred.

In family business it is important to understand, when designing rules for the transfer of these instruments, that one has a responsibility not to damage the underlying capabilities that allow the company to perform its social function, part of which, as we said, is to guarantee the company's long-term survival (which is not to be confused with staying in the same business, as businesses mature, or with keeping the same form of organization, as organizations become obsolete).

That is why the rule, in regulating the transfer of shares, should always be to actively ensure that the company remains governable in the future. "Always" is used here in the sense of "as far as possible," which is usually quite far, as nobody can be asked to do the impossible. And "actively" because the tendency to leave one's successors to sort things out and not make life difficult for oneself is all too human, as also is the tendency to perpetuate one's own influence, establishing a tyranny that can last for generations.

The conception of power as service implies that transfers of shares should be regulated and implemented in a way that guarantees the company's governability in the medium term and lays the foundations for governability over the long term. Power as service cannot be conceived as something only for today and tomorrow.

According to a perennial philosophical aphorism, personal improvement with regard to ownership of material goods must be built on an underlying attitude of "having in order to be, rather than being in order to have," that is, "possessing material goods in order to become a better person" rather than "being a person in order to possess more and more material goods." This aphorism is not contrary to the popular saying that "it is better to philosophize than to get rich, but for someone who does not have a shirt it is better to get slightly rich first, before philosophizing." So, to help ensure governability, the first imperative is to train future owners who will receive a large share of the voting rights to be willing to make decisions on a collegial basis and understand the social mortgage that attaches to ownership, as this willingness and understanding are specific manifestations of "having in order to be."

The second imperative is to ensure that the distribution of voting rights in the next generation, that is to say, the balance of share ownership, does not prevent or hamper decision-making or lead to decisions that create conflicts of economic interest between owners.

A company quickly becomes ungovernable if a deadlock between two 50 percent blocks, or allied pairs of 25 percent blocks, or even the fear of such a deadlock, paralyzes decision-making for any significant length of time. Decision-making paralysis and governability cannot coexist. Even when there is no deadlock, a company can become ungovernable if the law or the company's Articles of Incorporation or a share syndication agreement requires a majority that is difficult to achieve, either because in practice it is equivalent to a requirement of unanimity (as when voting rights are split three ways and a 75 percent majority is stipulated) or because a minority vote large enough to block decision-making has been given to people who behave unreasonably, see revenge as their right and intend to take their revenge, even at the expense of the common good of the community of people, of which their own good is a part.

The distribution of voting rights creates conflicts of economic interest when voting rights are transferred across companies with closely related business activities. This happens when assets or operations that should remain united in the long term for the good of the business as a whole are split into different companies: one holding company for the buildings, for example, another for the brands, another for the logistic resources and so on. Some people are given majority voting rights in one of the companies and others, minority rights, and vice versa in another company, so that the economic interests of the various groups conflict, as higher revenues and higher profit for one group mean higher expenses and lower profit for the other. In circumstances such as this, each party will end up exercising its voting rights in its own favor.

The three situations just described arise more frequently than one might imagine in family businesses and are a significant cause of mortality in the second and third generation. It is surprising that capable entrepreneurs should ever imagine that the threat of deadlock, the danger of powerful minorities or the risk associated with cross-shareholdings will somehow hold the company together when their successors come to power. The history of mankind shows that unity imposed from without never lasts long, and that disunity leads to disintegration. Unity in an organization arises out of a common desire to join forces in an undertaking and trust in other people's qualities and intentions.

The exercise of power as service requires that the people who hold a large proportion of the voting rights take the necessary care when transferring those rights to guarantee, as best they can, the future governability of the family business.

Transferring voting rights to people who are not committed to exercising them prudently is a mistake. Voting rights must be transferred to

those who are willing to acquire the necessary professional training, that is, those who intend to complement their future *potestas* with *auctoritas*. This can be a technically and emotionally difficult undertaking for an owner, as there are many barriers to be overcome. One such barrier, in some countries, is wealth transfer laws that require a distribution according to rules established centuries ago that may be appropriate where property consists of livestock and relatively simple possessions, but not where it consists of instruments used by communities of people such as family businesses, which are complex to govern. Or emotional barriers such as having to assess the qualities and intentions of heirs, and perhaps having to exclude one or two of them. And not least of all, the barrier of having to explain all this sufficiently in advance, that is, before the heirs find out from the will, which usually leads to irreconcilable confrontations.

Responsible transfer of ownership with voting rights in family businesses requires a clear understanding that equity is not equivalent to equality. Equality means dividing a thing in equal shares among the parties, whereas equity means respecting the proper exercise of voting rights and seeking exchanges of wealth in order to achieve a balance of economic rights.

Those who have the obligation to transfer substantial packages of voting and economic rights should give serious consideration to the possibility of separating economic rights from political rights, setting conditions for accession to voting rights, temporarily transferring voting rights to institutions that will pass them on to qualifying heirs at a later date, establishing formulas to break deadlocks, and protecting minority shareholders.

Concluding remarks

The exercise of power as service is fundamental for family businesses to continue to perform their true social function. It requires an understanding of the essential difference between the instruments that the company uses and the company itself as a community of people. The owners are owners of the instruments; they can never be owners of people.

Nor should the *potestas* granted by law to the owners of a family business be confused with personal *auctoritas*. *Potestas* can be transferred, bought and sold, but *auctoritas* must be earned by developing personal qualities.

Responsible transfer of ownership requires that the heirs be trained to be active and level-headed shareholders and, in some cases, capable of

performing the duties of directorship, and possibly also those of chief executive, to a high professional standard.

The exercise of power as service demands that every effort be made to transfer power in a way that guarantees and promotes the future governability of the family business.

Note

- * The exercise of power in business has been conceptualized with various models (Clarke, 2004), here it refers to the model of “social responsibilities.”

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4

A Classification Scheme for Family Firms: From Family Values to Effective Governance to Firm Performance

Pramodita Sharma and Mattias Nordqvist

It is not news anymore that a large majority of business organizations in the world are family firms. For researchers to build cumulative knowledge and for practitioners to know which of the research findings apply to their family firms, it is important to find effective ways to classify these ubiquitous firms. Drawing upon stakeholder theory and the classic three-circle model of family firms, we develop a broad-based classification system for these firms, based on the extent of family involvement in business. This classification can be used to distinguish family firms from other organizational forms, as well as amongst different types of family firms. Further, we argue that performance in different types of family firm is likely to be dependent on a fit between the guiding values of a family and the governance structures in place. Three case studies help us to bring these ideas to life, leading us into a discussion of implications for research and practice.

Today, not only do we know that some of the largest and oldest firms in the world are family controlled,¹ but so are a majority of their smaller and medium-sized counterparts that adorn the streets of our economic landscape and provide employment to a vast proportion of the global workforce (Iferra, 2003; La Porta, López-de-Silanes, Shleifer and Vishny, 1999). Thanks to the significant efforts of pioneering scholars around the world, it's not newsworthy anymore to share that family businesses dominate the economic landscape of the world.² For any new field of study, the first task towards developing legitimacy is to convince scholars that they are interested in a research area that is relevant to practice

and leads to puzzling empirical phenomenon (Lindblom and Cohen, 1979). Family business studies has accomplished this first mission, as an increasing number of scholars are finding these firms an exciting research site to create and refine theories to help tackle organizational problems. Researchers from multiple disciplinary backgrounds are discovering that family businesses provide a rich and vast arena for studying fascinating human behavior (see review articles by Chrisman, Chua and Sharma, 2005; Sharma, 2004). It is intellectually stimulating to discover the causally ambiguous and imperfectly imitable competitive treasures hidden in these firms and to understand how best to master the destructive forces that lie bare just beneath the surface (cf. Barney, 1990; Habbershon and Williams, 1999).

Having convinced ourselves and others of the ubiquity of family firms, the next two questions that quickly emerge are: How are these firms different from other organizational forms? Are there differences within family firms? Since the inception of this field of study, these challenging questions have consumed significant energies of scholars. Today, it is generally accepted that family firms are distinguished from other forms of business organizations because of the significant *family influence* on the vision and strategic direction of a business (e.g., Chua, Chrisman and Sharma, 1999).

Although family members have a significant influence in ALL family firms, even casual observations suggest that these firms are a rather diverse group. For example, a restaurant that is wholly owned and managed by members of a family is significantly different from the family firms like Carrefour and IKEA with multiple owners and layers of management. Even in such large dynastic firms, significant variance in the extent and mode of family involvement can be found. Firms like Carrefour, Cargill, and Michelin are owned and managed by multiple members of an extended family while others, like Copcisa, IKEA and S. C. Johnson and Son, have a single controlling owner and leader. Still others like Barilla, H&M, Hewlett Packard, and Uriach exert family influence through a combination of ownership and board memberships. Thus, family firms can vary significantly along dimensions such as size, age, industry and the extent and mode of family involvement in the business.

Aware of such fundamental differences in family firms, scholars have made attempts to capture the heterogeneity in these firms (e.g., Davis, 1982; Dyer Jr., 1986; Hollander, 1983; Lansberg, 1988; Ward, 1987). Recent attempts have aimed to develop scales to measure varied levels of family influence in a business (e.g., Astrachan, Klein and Smyrnios,

2002; Klein, Astrachan and Smyrnios, 2005). In spite of these developments, a large majority of research on family businesses still treats these firms as a single entity and their true complexity remains veiled. Both from practice and research perspectives, scholars question whether findings from one set of family firms could be applied to other firms with significantly different core attributes (Melin and Nordqvist, 2007; Sharma and Nordqvist, 2007). The quest for an effective classification system for family firms continues.

In this chapter, we join scholars in their pursuit to develop effective ways to capture the diversity of family firms. Drawing from the tenets of stakeholder theory, we extend the utility of the classic three-circle model of family firms to develop a classification system that differentiates firms into 81 categories, 72 of which can be variations of family firms. This classification system not only helps distinguish family from non-family firms, it also helps categorize family firms based on the mode and extent of family involvement in business. However, as our interest lies in distinctions within family firms, this chapter is largely focussed on related discussion. Following guidance from contingency theory, we propose that performance in different classes of family firms will depend on a fit between the guiding values of a family, extent of family involvement in business, and the governance structures used (Gresov, 1989). Three brief case studies are found helpful to illustrate the developed ideas. In sum, then, we advance three related arguments in this chapter:

- Family firms are not all the same. They differ along important dimensions, such as the family members' involvement in ownership and management.
- Based on varied levels of family involvement in ownership and management, these firms can be classified into 72 categories.
- Long-lived family firms are the result of a fit between family values and governance structure, since such fit makes it more likely to reach desired performance goals.

In order to address these arguments the chapter is divided into five sections. In Section 1, we share a brief recap of literature aimed to capture the varied levels of family involvement in a business. By tracing the historical development, it becomes evident that in spite of some of its limitations (which we discuss), the three-circle model is an effective means to capture the extent of family involvement in a business. In Section 2, we develop a classification system for firms based on the

extent of family involvement in management and ownership of a firm. Precepts from stakeholder theory are used to extend the utility of the three-circle model, leading us to the development of stakeholder maps for firms. These maps help to classify business organizations into 81 distinct non-overlapping categories, 72 of which are variations of family firms. Our focus remains on within-family firm distinctions. Section 3, is the theory building section, where we discuss how the relationships between family values, extent and mode of family involvement in business, and adopted governance mechanisms can influence family firm performance. In Section 4, three case examples are discussed that help demonstrate the utility of the classification scheme developed in Section 2 and theory developed in Section 3. The concluding Section 5 elaborates on the future research needs and practical implications of the stakeholder mapping technique, classification scheme for family firms, and relationships between values – family involvement – governance structures developed in this chapter.

Section 1 Capturing the family influence in business

Following the principle that “a picture is worth a thousand words”, family business scholars have used pictorial depictions to capture the extent of family influence in business. As family business brings together two distinct social systems of family and business, each operating on its own logic, the earliest models typically took shape as overlapping or interacting systems. Appendix A provides an overview of the pictorial developments aimed to capture the family influence in business over time.

From a triangle to overlapping circles. The voyage to discover and portray the extent and nature of family influence in business started when Peter Davis and Douglas Stern (1981) introduced an “integrative systems perspective”, using a triangle to depict the interactions between family and business systems. They argued that these two separate systems need to be integrated through special management efforts. Based on principles of organizational and family systems theory, they discussed processes and mechanisms that set the boundaries for, and regulate the interaction between, the family and business systems.

Shortly after, two doctoral dissertations of John Davis (1982) and Barbara Hollander (1983) built on the idea of interacting systems and found the usage of overlapping circles to be an effective way to explore the bivalent attributes of family firms. Davis (1982: 14–15) used three

overlapping circles to illustrate the connections in family, ownership and management/employee memberships, leading to seven possible sectors. He argued that these overlaps are the distinctive feature of family firms as they lead to unique challenges and advantages. More recently, this uniqueness of family businesses is being referred to as the “familiness” of a business (Habbershon and Williams, 1999).

In an attempt to capture the temporal dimension of the family business system, Hollander (1983) combined concepts from systems and developmental theories. Using an integrative model of family business, she argued that the overlapping systems of family and business exist in and interact with the environment. Moreover, the life-cycle development of individuals, family and business cut across the interactive system overlaps. These foundational works set the stage for further related discussions in the field, both in terms of overlapping systems and their evolution over time (e.g., Churchill and Hatten, 1987; Donckels and Fröhlich, 1991; Lansberg, 1983, 1988; McGivern, 1989; Tagiuri and Davis, 1982/1996).

By the mid-nineties, the three-circle model was being used extensively by family business scholars and practitioners. Gersick, Davis, Hampton and Lansberg explain that:

the reason the three-circle model has met with such widespread acceptance is that it is both theoretically elegant and immediately applicable. It is a very useful tool for understanding the source of interpersonal conflicts, role dilemmas, priorities, and boundaries in family firms. Specifying different roles and subsystems helps to break down the complex interactions within a family business and makes it easier to see what is actually happening, and why.

(1997: 7)

From overlapping to winged circles and cubes. The seeds for thinking about changes in the life-cycle stages of individuals, family and business in the context of systems overlap had already been sown (e.g., Hollander, 1983). This led to significant efforts directed to understand the evolutionary changes in culture (Dyer Jr., 1986), work relationships between father and son at different stage of their life (Davis and Tagiuri, 1989), and colliding life cycles of owners and their firms (Hoy, 1995/6). Ward (1991: 220–1) elaborated on the stages that evolve on the dimensions of ownership (Founders, Sibling partnerships, Family dynasty) and management (Entrepreneurship, Professionalization, The holding company).

Building on these earlier works and their extensive experiences with family firms, Gersick and colleagues (1997) attempted to capture the

co-evolution of the three systems of business, ownership, and family by using three axes to represent the developments over time. This three dimensional developmental model is presented in Appendix A. The business axis develops from start-up, to expansion/formalization and maturity stages. The family axis moves through four stages: young business family – entering the business – working together – passing the baton. The ownership axis starts from controlling owner, moving through sibling partnership, into the cousin consortium stage. Through this model, each overlapping circle of previous models seems to have developed wings that help to explore the progression of family firms over time as a function of the co-evolution of the three subsystems. Much of the “common wisdom” of the nature of family firms, such as the existence of simultaneous roles, strong shared identity and values, a life-long common history and emotional involvement stems from the conceptual power of these conceptual models.

In an attempt to measure family influence along the three dimensions of ownership (*Power*), management (*Experience*), and family (*Culture*), Astrachan and colleagues (2002, 2005) developed and validated the F-PEC scale of family influence. Niermelä (2003: 8) has attempted to capture the three dimensions of this scale through a cubic representation (Appendix A). In another variation of the developmental model, Miller and Le-Breton Miller (2005: 6) observed that long-lasting family firms focus on four driving priorities that they describe as *Command*, *Continuity*, *Community* and *Connection*. While these authors do not elaborate these four Cs along the dimensions of the three-circle model, it takes only a short stretch to argue that the 4Cs extend from the three dimensions of ownership (*Command*), management (*Continuity*), and family (*Community* and *Connection* as these relate to relationships with internal and external stakeholders of a firm).

Shortcomings of three-circle model. Reality is complex. Visual models aim to represent this complexity and help authors’ to present their arguments (Sutton and Staw, 1995). However, models are invariably approximations of the changing and complex realities they attempt to depict (Whetten, 2002). The three-circle model is no exception. While it has proven to be significantly influential in helping understand the complex reality of the overlapping systems of family and business over time, it has attracted some valid critiques too.

For example, Klein (2000) described it as being too simplistic because it neglects other possible subsystems that may influence family firms. Chua, Chrisman and Sharma (1999) noted the limited applications of

the model, as it cannot explain the performance outcomes of system interactions in family firms. Melin and Nordqvist (2007) observe that it foments a false view where similarities between family firms are over-emphasized at the cost of their differences.

In spite of these criticisms, however, it has been argued that the full potential of this elegant and parsimonious model has not yet been achieved. Sharma (2004) argued that the three-circle model could be extended for both research and practice if it is related to a wider theoretical framework, such as stakeholder and contingency theories. From this perspective, the model is powerful as it depicts the key stakeholders and their different roles in the family and the firm over time (Lansberg, 1988). Following these observations, in this chapter we extend the three-circle model explicitly through the lens of stakeholder and contingency theories.

Section 2 A classification system for family firms

Miller and Friesan (1984) observed that fundamentally there are two different, although complementary, approaches to create a valid and reliable classification system for organizations. These are conceptually based *typologies* and empirically driven *taxonomies*. While the earliest attempts to understand the variations within family firms were conceptually driven (e.g., Davis, 1982; Dyer Jr., 1986; Ward, 1987), more recent efforts have been data-based (e.g., Astrachan and Shanker, 2003; Heck and Trent, 1999; Klein, Astrachan, and Smyrnios, 2005; Westhead and Cowling, 1998). To supplement these efforts, in this chapter, we focus on developing a conceptually driven classification system, build theory to propose a fit between family values – governance structures and firm performance, and subject developed ideas to preliminary test by using three case studies.

According to Chrisman, Hofer and Boulton (1988: 416), a classification system should be so constructed such that it helps to sort entities of interest into mutually exclusive, internally homogenous, collectively exhaustive and stable categories. That is, it should not be possible to assign an organization to more than one category or class at a given time (mutually exclusive), members of a class should be more similar to each other than to members of other classes (internally homogenous), every organization must belong to an existing class (collectively exhaustive), and assignment of entities into classes should not vary by person (stability). They suggest further that classes or categories should be named so as to allow for ease of identification.

Developing a conceptually based classification system is essentially a three-step process. The first and foremost step is to identify *key characteristics* that apply to all entities of interest and measure important within-group similarities and between-group differences (Darwin, 1958/1859). Second, based on variations along identified key characteristics, *categories or classes* are created so that entities in one class would be sufficiently similar to each other along key dimensions, while being significantly different from entities in other classes (McKelvey, 1982). The last step is the actual *assignment of entities* of interest into created classes. The discussion below elaborates on each step as we progress towards our classification system.

Step 1 Identification of key characteristics. As we are interested in developing a classification system that will help distinguish family firms from non-family firms, and within different categories of family firms, we need to identify key attributes that are shared by all business organizations. Two dimensions of ownership and management used in the three-circle model are fundamental characteristics of all firms. Family firms have been distinguished from non-family firms because of family involvement in business. Thus, the family dimension is likely to help differentiate between family and non-family firms. This suggests that three dimensions of the three-circle model – *ownership, management, and family* – can prove helpful in classifying firms so as to distinguish between family and non-family firms, and within categories of family firms.

Step 2 Creating stakeholder categories for family firms. Freeman's ideas on stakeholders provide a foundation for creating categories to classify firms. He defined stakeholders as "any group or individual who can affect or is affected by the achievement of firm's objectives" and identified 16 generic stakeholder groups³ (1984: 47). However, his list did not include family members as a distinct stakeholder group. In an extension of the stakeholder concept to family firms, Sharma (2001) distinguished between internal and external stakeholders. Those involved with a firm, either as employees⁴ (receive wages) and/or owners (shareholders) and/or family members are referred to as *internal* stakeholders. Others not linked to a firm through employment, ownership or family membership, but who can influence the long-term survival and prosperity of a firm are referred to as *external* stakeholders (ibid: 257).

By using overlaps in three key variables of ownership, employment and family membership, the three-circle model differentiates seven

categories of internal stakeholders based on whether they are playing one, two or three different roles simultaneously. Each internal stakeholder, that is, owner and/or employee and/or family member, can be placed in one and only one of the seven areas in the three-circle model (Figure 4.1). On the other hand, one or more individuals can occupy each of the seven areas.

Step 3 Assigning individuals into categories. A firm's *stakeholder map* is a visual representation of the position of all internal stakeholders at a given time. It is developed by placing each individual internal stakeholder of a firm in the appropriate area of Figure 4.1. When all internal stakeholders are placed in their respective areas, it is possible to determine both the role/s played by each member, and the number of members playing each of the seven roles. Just as each firm has a unique organizational chart, it will also have its own distinct stakeholder map. While the former aids in understanding the structure and processes used in a firm, the latter can

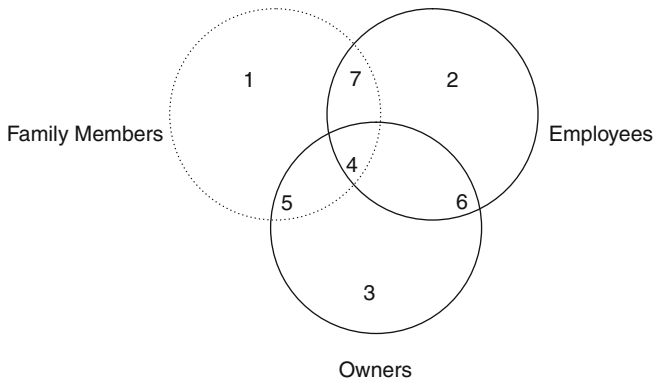


Figure 4.1 Seven possible roles of internal family firm stakeholders

Notes:

1. Family members (not involved in business)
2. Non-family employees
3. Non-family owners (not involved in operations of the business)
4. A family member owner and employee
5. A family member owner (not involved in operations of the business)
6. An employee owner (not a member of the family)
7. A family member employee (not an owner)

FAMILY MEMBERS = Individuals in areas 1 + 4 + 5 + 7

EMPLOYEES = Individuals in areas 2 + 4 + 6 + 7

OWNERS = Individuals in areas 3 + 4 + 5 + 6

help to understand the roles, perspectives, needs and concerns of a firm's internal stakeholders (Gersick et al., 1997). Legends can be used to highlight other variables of interest such as gender of internal stakeholders, senior and junior employees, members of immediate and extended family, large and minority shareholders, and so on.

As an example, a stakeholder map for **Nick's Landscaping Services (NLS)** is presented in Figure 4.2. NLS is a partnership between Nick Jenkins, his wife Jane, and their friend Peter. While Peter and Nick work in the business, Jane is a non-active owner. Jenkins's two older children, a boy and a girl, work in the business, but the younger three don't. NLS also employs five other employees, two of whom are managers.

Classifying firms using stakeholder maps. Firms can be classified based on the number of members occupying each of the seven areas in Figure 4.1. While all firms will have at least some individuals in the three circles of family, employment and ownership (areas 1, 2, 3), the overlap areas 4, 5, 6, 7, may not all be fully occupied in all firms, thus providing a basis for distinguishing between firms. For example, if all owners and employees are unrelated through family relationships, the areas 4, 5

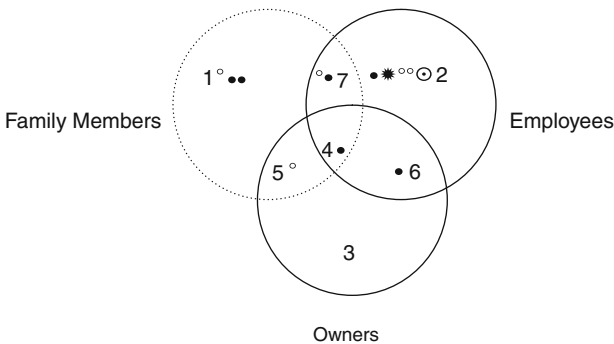


Figure 4.2 A stakeholder map for Nick's Landscaping Services (NLS)

Notes:

- Male members ◊ Female members
- * Male managers ◊ Female managers

1. Three youngest children of Nick and Jane
2. Five non-family non-owner employees (includes one male and one female manager)
3. Nil
4. Nick
5. Jane
6. Peter
7. Two eldest children of Nick and Jane

and 7 will be null sets indicating non-family firms. Such firms can vary by size measured in terms of number of employees (areas 2 + 6), concentration of ownership as indicated by the number of individuals in areas 3 + 6, and whether there are employees with ownership stock by reviewing the occupants in area 6.

If all family members involved in the operations of the business also hold ownership status, they will belong to area 4, leaving areas 5 and 7 as null sets. On the other hand, multiple individuals can occupy each of the four overlap areas. Thus, areas 4, 5, 6, 7 can each have zero, one, or more occupants. Not only can the occupancy numbers be represented as a stakeholder map, they can also be summarized in the form of a *stakeholder identification code* – $[4_{(0, 1, M)}; 5_{(0, 1, M)}; 6_{(0, 1, M)}; 7_{(0, 1, M)}]$. While Figure 4.2 represents the stakeholder map for Nick's Landscaping Services, the Stakeholder Identification Code (SIC) for this firm is $[4_1 5_1 6_1 7_M]$.

Mathematically, based on the number of possible occupants in each of these four overlap roles, firms can be classified into 81 ($3 \times 3 \times 3 \times 3$) distinct categories with SICs ranging from $[4_0 5_0 6_0 7_0]$ to $[4_M 5_M 6_M 7_M]$. A complete listing of these categories is presented in the Appendix B. This list helps distinguish between family and non-family firms. For example, it is difficult to imagine families with no ownership (active or silent) in the firm being able to cast a significant influence on the firm. Thus, firms where both areas 4 and 5 are null sets, have very little likelihood of being family firms. This suggests 72 categories of family firms instead of 81 theoretically identified categories in this classification.

While the above classification provides a comprehensive list of categories of firms based on extent and mode of family involvement in ownership and management of a business, three questions come to mind: (i) Which of these categories is more or less frequently found? (ii) Why do some firms choose more or less involvement of family in a business? (iii) Do varied levels of family involvement influence performance? First is an empirical issue that needs collecting data from large samples of firms in different parts of the world so as to determine the more or less prevalent forms of organizations. This task is left for future research. However, based on current literature, it is possible to develop arguments related to the second and third questions – a task undertaken in the next section.

Section 3 Values, governance structures and performance

Our overall thesis, summarized in Figure 4.3, is that the level of family involvement in a business or *firm category status* indicated by the

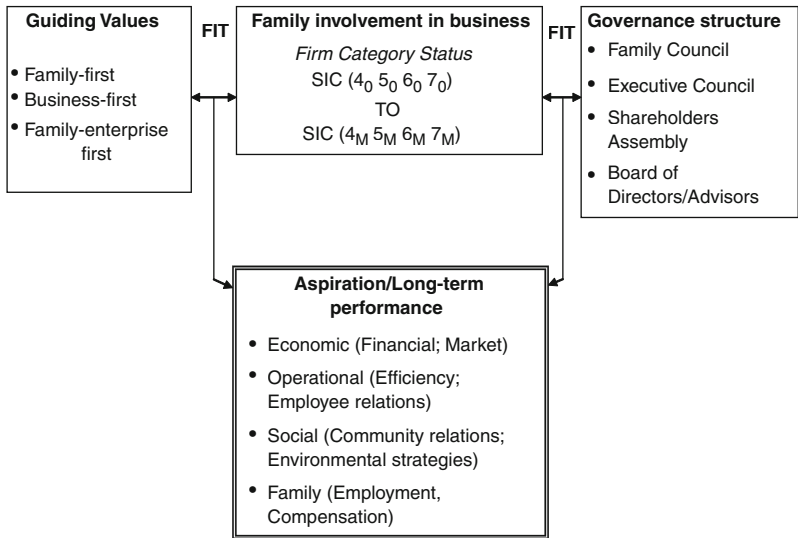


Figure 4.3 Performance = FIT between family values, family involvement and governance structures

stakeholder identification code in Appendix B (SIC) is influenced by the underlying family values. In turn, this status influences what might be appropriate governance structures for a firm. Firms with a FIT between underlying values, firm category status, and chosen governance structures, are more likely to enjoy performance advantages, in comparison to firms that lack such coherence. In other words, in firms without a good fit between values – family involvement in business – governance structures might be committing the folly of hoping for A (guiding values) while being structured to achieve B (cf. Kerr, 1975). This section elaborates on these ideas.

Family values. Values are the underpinnings of human action. They are the “social principles, goals and standards... (that) define what the members of an organisation care about” (Hatch, 1997: 214). Often seen as moral or ethical codes, they provide the foundation to judge what is right, wrong or desirable. Ranson, Hinings and Greenwood (1980) have argued that values guide our mental maps determining what is desirable in terms of an organizational domain of operations, key organizing and governing practices and performance criteria. Therefore, in order to understand the character and workings of different categories of family

firms it is important to examine the underlying values of a family (cf. Greenwood and Hinings, 1993).

The role of values on the behavior of family members has been studied in great detail (e.g., Asakawa, 2001; Barling, Kelloway, and Bremerman, 1991). It is understood that values are transmitted through generations and define acceptable norms of behaviors and relationships among family members (Berger and Luckman, 1967). The influence of family values on the business is widely acknowledged (e.g., Arregle, Hitt, Sirmon and Very, 2007; Dyer Jr., 1986; Ling, Zhao and Baron, 2007) and has been tied to the longevity of family businesses (Koironen, 2002; Miller and LeBreton-Miller, 2005). Although family members may not share all values and have different priorities, there are some guiding values that are most prominent in a family and/or its business (Hall, Melin and Nordqvist, 2001).

Similar to non-family firms, leaders of family firms have to contend with the multiple and often conflicting needs and demands of their key stakeholders – owners and employees. In addition, they must satisfy the legitimate needs of their family members, who may be involved in the business as current or potential owners and employees. Building upon these ideas captured by the three-circle model and drawing from his experiences with family firms, Ward (1987: 142) observed that any family engaged in a business needs to answer the basic question: *Whose interests should come first – those of the business or those of the family?* He suggests that the underlying values of a family help resolve this issue. In turn, the resolution shapes a consistent response to matters such as business participation, ownership distribution and compensation. Using this basis, he classified firms as – *business-first*, *family-first* and *family-enterprise-first*.

Families guided by *business-first* orientation support what they believe is best for the company – its customers, shareholders and employees. Sound business principles govern decisions regarding hiring, compensation, business growth, exit and so on. In contrast, followers of *family-first* orientation believe that the family's happiness and togetherness supersedes all else. Decisions in such firms favor family equality and unity, even when such equality comes at the expense of a company's future. The third orientation – *family-enterprise-first* seeks a balance between family- and business-first orientations. Followers of this philosophy strive to make decisions that simultaneously provide for both the satisfaction of the family and economic health of the business. The underlying belief is that such balancing act, while challenging, is essential for the long term continuity of both family and business systems.

Ward's (1987) conceptualization of the three fundamental orientations of family firms provides a useful framework to re-examine the classification developed in the last section. Firms with family-first values are likely to employ multiple family members both in ownership and management positions. Thus, variations of 4_M firm category status in Appendix B are likely to be guided by family first orientation. Those following business-first orientation are likely to fall in variants categories of 4_0 as they are guided by what is best for the business and thus least likely to have same family owners and employees. The family-enterprise orientation is likely to fall in the middle category with variants of 4_1 as a balance between family and business focus is being sought. However, at this stage of early conceptualization, the above are only preliminary thoughts that need further refinement and testing using empirical data. The fundamental point we make, however, is that the guiding family values will determine the nature and extent of family involvement in a business and the firm category it falls in our classification system.

Governance structures. Family firm governance can be seen as a system of structures and processes for long-term efficient directing, controlling and accounting of a family firm (Neubauer and Lank, 1998). Both stakeholder theorists and family business scholars seem to agree that for effective governance, organizations should develop structures that routinely help to understand the needs and concerns of different stakeholders (e.g., Freeman, 1984; Ward, 1991). In the context of family firms, scholars such as Gersick and colleagues (1997), Miller and Le-Breton Miller (2005), Ward (1987), prescribe the adoption of four types of governance structures to voice different perspectives: (a) Family council (to discuss family related issues); (b) Executive council (to discuss employee related issues); (c) Shareholders assembly (to discuss owner related issues); and (d) Board of directors/advisors (to discuss the overall strategic direction of the business). Although one or more of these structures has been found useful in different family firms, it is not clear whether all structures are necessary for governance supporting the prioritized performance goals in all family firms. In fact, a limitation in the literature on family firm governance is the common assumption that all family firms should organize their governance in the same way (Melin and Nordqvist, 2007).

Drawing on stakeholder theory and the concept of value, we argue that family values regarding the relative role of business and family are likely to influence the extent and mode of family involvement in

business. This, in turn, is likely to determine the appropriateness of specific governance structures (c.f. Hinings and Greenwood, 1987).

It is generally agreed that family business managers can benefit from the objective counsel of legitimate outsiders (e.g., Christensen, 1953; Danco, 1975). The prescriptive literature strongly suggests that the presence of an active board influences the quality of decision-making in family firms (e.g., Gersick et al., 1997; Lansberg, 1999; Ward, 1991). The key factor is the degree to which the advisory board is **active** both in frequency of meetings and influence over the strategic direction of a business. However, Corbetta and Salvato (2004) observed that not all active boards contribute equally to firm performance in family firms. Based on the heterogeneity of these firms discussed in this chapter, we argue that only family firms where key stakeholders have an interest in growing their firm will nurture an environment of openness and flexibility to outside advice. In such instances the influence of outsiders will be valued and an active board will reach its full potential. Otherwise, even a board with external advisors that meets frequently is likely to become a rubber-stamp board rather than a strategic influencer of a firm. Thus, family firms guided by business-first values are more likely to benefit from outside boards in terms of firm performance than those guided by family-first orientation.

On the other hand, for firms guided by the values of family-enterprise first, key stakeholders are motivated to keep the firm within the family for a longer period while maintaining an active presence of family members in the ownership and management roles in the business. Such firms are likely to invest significantly in the development of their members and benefit from governance structures aimed to inform and discuss business related issues with family members. In addition to an outside board of directors, family councils are likely to enable effective functioning of such firms.

Firm performance. It has long been recognized that firms pursue multiple objectives (e.g., Drucker, 1954). Approaches such as “triple bottom line” (Elkington, 1987) and “balanced scorecard” (Kaplan and Norton, 1992), have been successfully used to assess the health of organizations on multiple dimensions – economic (e.g., financial, market), operational (efficiency, employee relations) and social (e.g., community relations, environmental) dimensions (cf., Richards, 1986).

In addition to these business-related objectives, family firms often strive to achieve family-related objectives such as providing employment for family members, grooming of heirs, accumulation of family

wealth, sustaining family's reputation in the community and so on (Craig and Moores, 2005; Lee, 2006; Tagiuri and Davis, 1992). In some family firms, researchers have found the achievement of these objectives takes precedence over the business-oriented objectives (e.g., Dunn, 1995; Lee and Rogoff, 1996), while in others business related objectives are primary (File, Prince, and Rankin, 1994). Based on our discussion thus far, these seemingly conflicting findings seem quite understandable as family firms are heterogeneous with some categories primarily guided by family-first orientation, others follow business-first values, and still others are prompted by family-enterprise first values. Performance aspirations of each category of these firms are likely to differ significantly.

This suggests the need for using different criteria to evaluate the success or performance of family firms as appropriate criteria for firms with different guiding values is likely to be different (cf. Greenwood and Hinings, 1988; Hiennerth and Kessler, 2006). As depicted in Figure 4.3, we argue that firms with a coherence between guiding values, extent and mode of family involvement, and adopted governance structures are likely to enjoy higher performance on dimensions of interest to them (Sharma, 2004). To illustrate these ideas, the next section briefly discusses three case examples.

Section 4 Different pathways to "success" in three family firms

It has become evident by now that family firms have many fundamental choices to make regarding the extent and mode of family involvement in a business and the governance structures they might adopt. Our thesis is that firms where these choices are well synchronized with the guiding values of the family are more likely to enjoy successful performance, although success is not similarly defined in all family firms. The case examples below explore these different family orientations. These three cases are but illustrative examples drawn from our general research and teaching experience. Much more research needs to be conducted in order to investigate deeper each category in Appendix B and our thesis that firms where family involvement in a business and governance structures are well synchronized with guiding values are more likely to perform well.

AgriTechnologies Ltd. This is a medium-sized family firm jointly owned by six members of the Jenkins family: the founders Rowan and Sue Jenkins, and their children Chris, Andy, Bill and Kate. All four children

work in the firm, though the co-founders have now retired. While there are eight children in the third generation, only one of them, Louise works in the firm. AgriTechnologies employs 595 non-family employees, 15 of whom are managers.

The family prefers to retain full control over their firm. They are hesitant to grow too big or too fast so as not to risk losing family oversight of the firm. All family members are encouraged to work in the firm and an informal decision-making style is valued. The Jenkins's are active in their community and support the local sports clubs and schools at different levels. The family values are carried on in the care rendered to employees, although it is made explicit that the ownership and key management positions are to be retained by family members. In terms of governance structures, the family has an informal family council that meets whenever there is a need to discuss a specific issue. The board of directors is mainly there to fulfill legal requirements.

Based on Figure 4.1 and Appendix B, the Stakeholder Identification Code for this firm is [4_M5_M6₀7₁]. As is evident by the number of family members involved in ownership, the day-to-day operations and managerial positions, this firm is guided by *family-first* orientation. The prioritized performance in this firm can be described as a mix of economic, operational and social outcomes. Transforming the formal board of directors into an arena with a majority of non-family members pushing for more "rational" and "business"-like orientation towards growth and expansion, and less resources spent on the local community is not likely to be efficient in this firm. The non-family board members may push the firm's development in a direction that is not in line with the owner-family's prioritized performance goals. Moreover, if all decisions are taken outside the board, the contribution of the board as a governance structure will be limited, leading to frustration among outside board member that lend not just their name to the firm, but are also formally accountable. As the family grows, it may make sense to formalize the family council with regular meetings in the future to inform a wider group of owners and family members about the performance of the firm, and to consider more active participation of the board.

SoBro Solutions. This is a large publicly listed firm. Thirteen members of the third generation of the founding family collectively control 60 percent of the ownership. Three of these family members serve on the board which also includes two representatives of the minority owners. The senior management team is lead by a non-family CEO, who also owns shares in the firm. His senior executive team consists of 42 non-family

executives and one family manager – Lance Somerset. 75 of the other 1050 employees also own shares. In all, there are 3565 shareholders in this publicly listed firm.

The firm still carries the majority owner's name and proudly cherishes its reputation for superb customer service, excellent relationships with suppliers, and its rating as one of the most desirable companies to work for in the entire country. Most members of the founding family are involved in philanthropy and community-based activities. An active family council ensures these issues receive careful reflection and the voice of various family members gets heard. The firm has an active and formal board of directors with several independent board members. While profitability and increasing stock price are important performance variables for the owners and managers in this firm, family members also put emphasis on social (e.g., philanthropy) and family (e.g., reputation) performance outcomes.

The corresponding Stakeholder Identification Code for SoBro Solutions is [4₁5_M6_M7₀] and the firm is an example of a *family-enterprise-first* orientation. The founding family prides its success in having maintained its status as an independent, active business family within the industry of the firms' founding. Their desire to retain family control through ownership and profitability is more important than growth and expansion. They are therefore less prone to taking risks. However, this is moderated by two of the minority owners active in the board and the non-family CEO who wants quicker growth and expansion in order to increase the short-term value of the firm. The board plays a crucial role in this firm as it provides an avenue for the firm to be progressive in business, while still maintaining family values. The family council is also very important as an arena for the family members and owners to be informed about and discuss the development of the firm towards achieving their prioritized performance goals.

Schwarz Media Corp. This is a third-generation firm partly owned by five members of the founding family. While collectively these family members own 65 percent of the stock, none of them is actively involved in the management of the firm. The board of directors is composed of three representatives from the family, two from the private equity firm, the CEO and two independent board members – one of whom Chairs the board. The non-family CEO is responsible for the day to day operations of the business and she is a non-family member. She is supported by a team of seven senior executives, only one of whom is a descendent of the founder; 25 percent of the business is owned by a private equity

firm and the remaining 10 percent is in the hands of two top managers (the CEO and the CFO). The firm has 234 employees.

Both the owners and the top management place highest priority on firm growth through internationalization and new product development. Long-term financial performance objectives drive key decisions of the firm. The aim is to run the firm as a “professional, attractive and international media corporation.” In all decisions they focus on what they think is best for the company and its key stakeholders – its customers, shareholders and employees. Both internally and externally they are careful to communicate that it is sound business principles that guide decisions regarding hiring, compensation and strategic decisions. The family ownership is rarely mentioned in the communication.

The corresponding Stakeholder Identification Code for Schwarz Media Corp is [4₀5_M6_M7_I]. The firm is an example of a *business-first* orientation. With six meetings a year, the board is a key arena for strategic decisions and systematic monitoring of performance. There is also an executive council that meets twice every month to discuss both operative and strategic decisions on a more continuous basis. Finally, the yearly shareholders’ assembly is an important venue for sharing information between all the owners and their representatives regarding the firm’s fulfillment of the financial performance targets.

Section 5 Conclusions and implications

If family firms are the most common form of business organization in the world ranging from mom-and-pop stores to the largest publicly traded firms such as Carrefour, H&M and Ford, there are bound to be significant differences amongst these firms. However, in today’s rapidly growing research literature on family firms, the inherent heterogeneity of the family firm population is often downplayed. Without a classification system to sort out different types of family firms, it is difficult to have confidence in our research findings that may be based on samples that are a hodge-podge of different types of firms. Moreover, there is no way to determine the extent of applicability of research findings.

Although family business scholars have devoted significant efforts to find ways to distinguish between family firms and capture these distinctions pictorially (Appendix A), a fine-grained classification system has not yet been developed. In this chapter, drawing upon stakeholder theory and extending the utility of the three-circle model where each circle represents, family membership, ownership and management of a firm, we develop a classification system based on the extent of family

involvement in ownership and management of a firm (Davis, 1982; Freeman, 1984). The stakeholder mapping technique, which involves placing each individual internal stakeholder of the firm in the appropriate area of the three-circle model, is applied. Based on the number of individuals occupying the four overlap areas of Figure 4.1, family firms can be classified into 72 distinct categories, each with its unique identification code (Appendix B). Further, we theorize that performance aspirations are likely to vary for different categories of family firms based on whether their fundamental values regarding the relative roles of family and business lead them to a family-first, business-first or family-enterprise-first orientations (Ward, 1987). Drawing upon contingency theory, we argue that firms with coherence between guiding values, extent and mode of family involvement in business, and governance structures used are more likely to achieve desired performance objectives than firms that lack such consistency (Greenwood and Hinings, 1988).

Practical implications

The ideas presented in this chapter have immediate as well as long-term implications for family firm owners and managers. The classification system reveals 72 different types of family firms based on the extent of family and non-family involvement in the management and ownership of a firm. This is a first attempt that provides practitioners with a basis to understand the finer distinctions between their firm and other family firms. By developing a stakeholder map for their organization, family firm owners and managers can determine the category in which their firm falls, as compared to other firms in their industry, region or research study. By identifying and communicating their guiding values, they can further understand their type of firm and better determine what types of governance structures are more likely to contribute to their preferred performance outcome. This makes it easier for practitioners to understand whether findings of a research study or advice from a consultant or management book apply to their situation or not.

The technique of stakeholder mapping reveals a snapshot of the internal stakeholders of a firm at the present time (T_0). This map can be useful while preparing for succession or transfer of active management/ownership roles in a firm. Family firm advisors and/or current owners can use these maps to understand the perspectives of internal stakeholders of a firm. Based on their vision for the future of the firm, each key internal stakeholder can be asked to develop future stakeholder maps for the firm at time T_1 . A comparison of these maps will reveal the prevailing

differences in vision and aspirations for the firm – an important finding in itself. Each stakeholder can be asked about their most important values, opening communications aimed to develop the most acceptable map for the future and to identify the guiding values for the collective. Once the future roles for key stakeholders and the guiding values are determined and agreed upon, appropriate governance structures can be put in place. Depending on the guiding values and future performance aspirations, suitable performance measures can be adopted and monitored.

Implications for research

At a time when we are experiencing a rapid increase in family firm research, the importance of finding effective ways to distinguish amongst these ubiquitous firms cannot be overemphasized. The classification system developed in this chapter provides a mechanism to differentiate between family firms of different sizes as measured by number of employees, those with high or low concentration of ownership, and with varying amounts of family involvement both on management and ownership dimensions. Thus, it can be used to clarify and develop operational definitions of various organizational forms of interest such as small, family and new firms.

The stakeholder mapping technique developed here aids in distinguishing between four different types of owners, four levels of family involvement related to the business, and two types of non-family employee involvement related to the business. While these distinctions allow for researchers interested in different topics to distinguish between firms in their studies, this map can be modified for other research interests, as well. For example, scholars interested in understanding the role of outside investors or venture capitalists in firm creation and management can choose to focus on firms in categories that represent varying levels and mixes of outsider and insider investment. Others interested in the role of gender in firms, or relationships between junior employees and managers, or between majority and minority owners, or silent versus active owners, or immediate and extended family, can develop stakeholder maps using different legends. Figure 4.2 provides examples of usage of legends for identifying members of different gender and differentiating between junior employees and managers.

This classification system can be used to further understand the broader classifications presented in literature. For example, it provides 27 variations in firms with family-first, business-first or family-business-first orientations. Although empirical studies will need to be conducted to fully understand which of these finer distinctions are significant or not,

there is certainly a need to rethink and refine the currently existing broad-based classifications being used. Existing research findings will need to be re-examined to determine the types of family firms to which they best apply. When designing new research studies, this classification scheme can be used to determine the scope of the study and limit it to one or a few types of family firms.

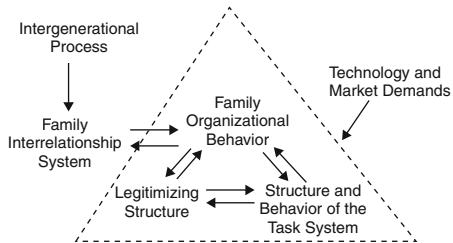
It would be desirable to find a small number of categories that encompass a large proportion of the population. This would allow many organizations to be classified using only a few distinguishing attributes, and then permits "the prediction of many other organizational features or relationships simply by making reference to the configuration" (Miller and Friesen, 1984:12). Sharma and Nordqvist (2007) represents one such attempt. They take a configurational approach and focus on family values along two dimensions of property rights and the role of the business in family as the basis for a typology of 12 types of family businesses. More efforts along these dimensions are needed to ensure the full potential of understanding about family firms from research energies devoted by scholars is achieved.

The conceptual arguments captured in Figure 4.3, need to be subjected to empirical tests as well. These are conducive to large-scale data collection and analysis. Such efforts can benefit from scales developed in family business literature (Astrachan, Klein and Smyrnios, 2002; Astrachan and Shanker, 2003; Heck and Trent, 1999; Westhead and Cowling, 1998), but can also benefit from scales developed in family studies, organizational behavior and business strategy literatures.

By collecting data regarding the number of individuals occupying each of the seven sectors of Figure 4.1, as well as regarding the guiding values it will become possible to determine what types of family firms are more commonly found in different countries. Data related to types of governance mechanisms in use and firm performance on various dimensions can then be used to determine the relative performance and longevity of various types of family firms and the effectiveness of governance structures. We conclude this chapter with an invitation to you and other colleagues to join us in our collective search for discovering patterns amongst family businesses around which to build our descriptive insights and prescriptions.

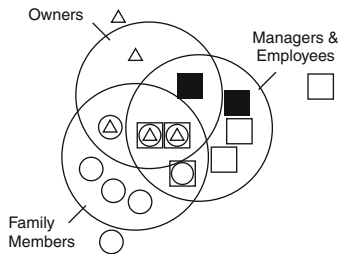
Appendix A Pictorial development to capture family business system overlaps over time

A



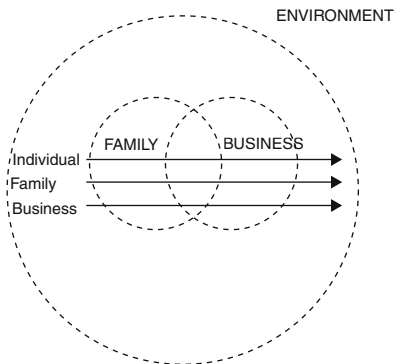
Source: Davis and Stern (1981: 211).

B

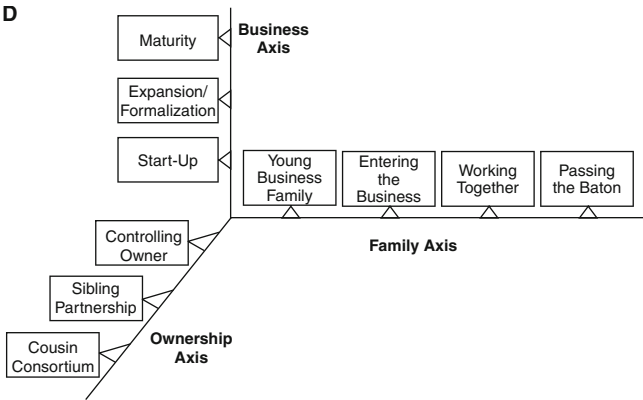


Source: Davis (1982:14–15).

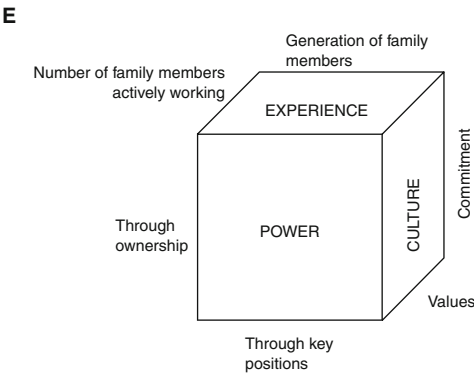
C



Source: Hollander and Elman (1988: 159).



Source: Gersick et al. (1997: 17).



Source: Niemelo (2003: 08).

Appendix B 81 Possible stakeholder identification codes for firms

4 Family Owners and Employees	5 Family Owners (non- employees)	6 Non- family Employee Owners	7 Family Employees (non- owners)	Stakeholder Identification Code (SIC) [* Non family firms]
0	0	0	0	* 4 ₀ 5 ₀ 6 ₀ 7 ₀
			1	* 4 ₀ 5 ₀ 6 ₀ 7 ₁
			M	* 4 ₀ 5 ₀ 6 ₀ 7 _M
			1	* 4 ₀ 5 ₀ 6 ₁ 7 ₀
			1	* 4 ₀ 5 ₀ 6 ₁ 7 ₁
			M	* 4 ₀ 5 ₀ 6 ₁ 7 _M
		M	0	* 4 ₀ 5 ₀ 6 _M 7 ₀
			1	* 4 ₀ 5 ₀ 6 _M 7 ₁
			M	* 4 ₀ 5 ₀ 6 _M 7 _M
	1	0	0	4 ₀ 5 ₁ 6 ₀ 7 ₀
			1	4 ₀ 5 ₁ 6 ₀ 7 ₁
			M	4 ₀ 5 ₁ 6 ₀ 7 _M
		1	0	4 ₀ 5 ₁ 6 ₁ 7 ₀
			1	4 ₀ 5 ₁ 6 ₁ 7 ₁
			M	4 ₀ 5 ₁ 6 ₁ 7 _M
		M	0	4 ₀ 5 ₁ 6 _M 7 ₀
			1	4 ₀ 5 ₁ 6 _M 7 ₁
			M	4 ₀ 5 ₁ 6 _M 7 _M
	M	0	0	4 ₀ 5 _M 6 ₀ 7 ₀
			1	4 ₀ 5 _M 6 ₀ 7 ₁
			M	4 ₀ 5 _M 6 ₀ 7 _M
		1	0	4 ₀ 5 _M 6 ₁ 7 ₀
			1	4 ₀ 5 _M 6 ₁ 7 ₁
			M	4 ₀ 5 _M 6 ₁ 7 _M
		M	0	4 ₀ 5 _M 6 _M 7 ₀
			1	4₀ 5_M 6_M 7₁ Schwarz Media
			M	4 ₀ 5 _M 6 _M 7 _M
1	0	0	0	4 ₁ 5 ₀ 6 ₀ 7 ₀
			1	4 ₁ 5 ₀ 6 ₀ 7 ₁
			M	4 ₁ 5 ₀ 6 ₀ 7 _M
		1	0	4 ₁ 5 ₀ 6 ₁ 7 ₀

Continued

Appendix B Continued

4 Family Owners and Employees	5 Family Owners (non- employees)	6 Non- family Employee Owners	7 Family Employees (non- owners)	Stakeholder Identification Code (SIC) [* Non family firms]
			1	4 ₁ 5 ₀ 6 ₁ 7 ₁
			M	4 ₁ 5 ₀ 6 ₁ 7 _M
		M	0	4 ₁ 5 ₀ 6 _M 7 ₀
			1	4 ₁ 5 ₀ 6 _M 7 ₁
			M	4 ₁ 5 ₀ 6 _M 7 _M
	1	0	0	4 ₁ 5 ₁ 6 ₀ 7 ₀
			1	4 ₁ 5 ₁ 6 ₀ 7 ₁
			M	4 ₁ 5 ₁ 6 ₀ 7 _M
		1	0	4 ₁ 5 ₁ 6 ₁ 7 ₀
			1	4 ₁ 5 ₁ 6 ₁ 7 ₁
			M	4 ₁ 5 ₁ 6 ₁ 7 _M (NLS)
		M	0	4 ₁ 5 ₁ 6 _M 7 ₀
			1	4 ₁ 5 ₁ 6 _M 7 ₁
			M	4 ₁ 5 ₁ 6 _M 7 _M
	M	0	0	4 ₁ 5 _M 6 ₀ 7 ₀
			1	4 ₁ 5 _M 6 ₀ 7 ₁
			M	4 ₁ 5 _M 6 ₀ 7 _M
		1	0	4 ₁ 5 _M 6 ₁ 7 ₀
			1	4 ₁ 5 _M 6 ₁ 7 ₁
			M	4 ₁ 5 _M 6 ₁ 7 _M
		M	0	4 ₁ 5 _M 6 _M 7 ₀ SoBro
			1	4 ₁ 5 _M 6 _M 7 ₁
			M	4 ₁ 5 _M 6 _M 7 _M
M	0	0	0	4 _M 5 ₀ 6 ₀ 7 ₀
			1	4 _M 5 ₀ 6 ₀ 7 ₁
			M	4 _M 5 ₀ 6 ₀ 7 _M
		1	0	4 _M 5 ₀ 6 ₁ 7 ₀
			1	4 _M 5 ₀ 6 ₁ 7 ₁
			M	4 _M 5 ₀ 6 ₁ 7 _M
		M	0	4 _M 5 ₀ 6 _M 7 ₀
			1	4 _M 5 ₀ 6 _M 7 ₁
			M	4 _M 5 ₀ 6 _M 7 _M

Continued

Appendix B Continued

4 Family Owners and Employees	5 Family Owners (non- employees)	6 Non- family Employee Owners	7 Family Employees (non- owners)	Stakeholder Identification Code (SIC) [* Non family firms]
	1	0	0	4 _M 5 ₁ 6 ₀ 7 ₀
			1	4 _M 5 ₁ 6 ₀ 7 ₁
			M	4 _M 5 ₁ 6 ₀ 7 _M
		1	0	4 _M 5 ₁ 6 ₁ 7 ₀
			1	4 _M 5 ₁ 6 ₁ 7 ₁
			M	4 _M 5 ₁ 6 ₁ 7 _M
		M	0	4 _M 5 ₁ 6 _M 7 ₀
			1	4 _M 5 ₁ 6 _M 7 ₁
			M	4 _M 5 ₁ 6 _M 7 _M
	M	0	0	4 _M 5 _M 6 ₀ 7 ₀
			1	4 _M 5 _M 6 ₀ 7 ₁ AgriTech
			M	4 _M 5 _M 6 ₀ 7 _M
		1	0	4 _M 5 _M 6 ₁ 7 ₀
			1	4 _M 5 _M 6 ₁ 7 ₁
			M	4 _M 5 _M 6 ₁ 7 _M
		M	0	4 _M 5 _M 6 _M 7 ₀
			1	4 _M 5 _M 6 _M 7 ₁
			M	4 _M 5 _M 6 _M 7 _M

Notes

We are grateful to Josep Tapies for inviting us to contribute a chapter to this book being published to celebrate the Fiftieth Anniversary of IESE. We appreciate the funding support received from the Handelsbanken Research Foundation of Sweden, Social Sciences and Humanities Council of Canada, and the FOBI Scholars Program of Grand Valley State University. We thank Sandra Castellanos for helping prepare Appendix A.

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1. For a list of world's oldest and largest family firms, please see: <http://www.familybusinessmagazine.com/>
2. For an overview of the evolution of family business studies, please see Sharma, Hoy, Astrachan and Koiranen (2007).
3. Owners, Employees, Unions, Customers, Consumer Advocates, Competitors, Suppliers, Media, Environmentalists, Governments, Local Community Organizations, Political Groups, Financial Community, Trade Associations, Activist Groups, and Special Interest Groups (Freeman, 1984: 25, 55).
4. The term "employees" is used broadly and includes ALL levels of employed workforce in a firm.

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5

How Values Dilemmas Underscore the Difficult Issues of Governing the Large, Enterprising Family

John L. Ward

As family-owned enterprises leave the sibling partnership form of ownership and enter the cousin collaboration form of ownership,¹ the governance system typically faces a substantial, radical change. Ownership needs to address many, new, difficult issues. How a family decides these difficult issues depends on how they resolve fundamental values dilemmas.

The nature of change

The situation for large, later generation families is marked by four significant changes. Foremost, more and more of the family owners are not executives of the enterprise. In fact, inevitably more family members will become governors rather than operators. Therefore, representation and selection and preparation and compensation of family members for particular roles becomes a central, critical governance task.

Table 5.1 illustrates the typical transformation of several dimensions of governance as a business owning family evolves from a sibling partnership to a cousin collaboration. In short, the governance system converts from an informal one led by a *team* of owner-operators, to a formal one led by a *system* of family governors. But, of course, it isn't that simple, as will be examined by 20 difficult issues outlined later.

A frequent second fundamental change faced by older families is that they often have added other enterprises to their governance duties – perhaps other operating companies, perhaps a family foundation, and/or a family investment company, and/or a family office. And, with their larger family size and broader scope of interests, they will commonly

Table 5.1 Governance transformation

	Sibling Partnership	Cousin Collaborative
Leadership Positions	Partitioned among family members so each has own turf	Open for any qualified person – including non-family
Family Involvement	Everyone has a role; all senior roles taken by family members	Not everyone is interested or qualified for a roles
Representation	Each branch is represented in governance and decision-making	All positions are “at large” positions regardless of branch politics or branch preferences
Governance Preparation	On the job, after the fact	A program run by the family council before selection to governance roles
Evaluation	If any, very informal and based on work style	Formal system based on merit and results
Family Compensation	Presumed equal, variations based on negotiations among siblings	Merit system based on external market data
Family Leadership	Ill-defined; informal	Defined positions and formal selection
Decision-Making	Consensus	Democracy – including non-family outsiders

have established a family council – some form of family leadership and governance.

Figure 5.1 shows a most complex and comprehensive picture of such a situation. Note particularly the many possible alternative places family ownership may express its voice. Note also the decision to operate with more informal committees or more formal boards or councils that would call for charters.

If a family has a portfolio of diverse enterprises, I refer to it as an “Enterprising Family.”² While a portfolio of interests complicates the governance system, it also provides more opportunities for more family members to contribute in different ways while expressing their different talents and values. As will be noted next, finding ways for more people to participate in the governance system offers advantages as well.

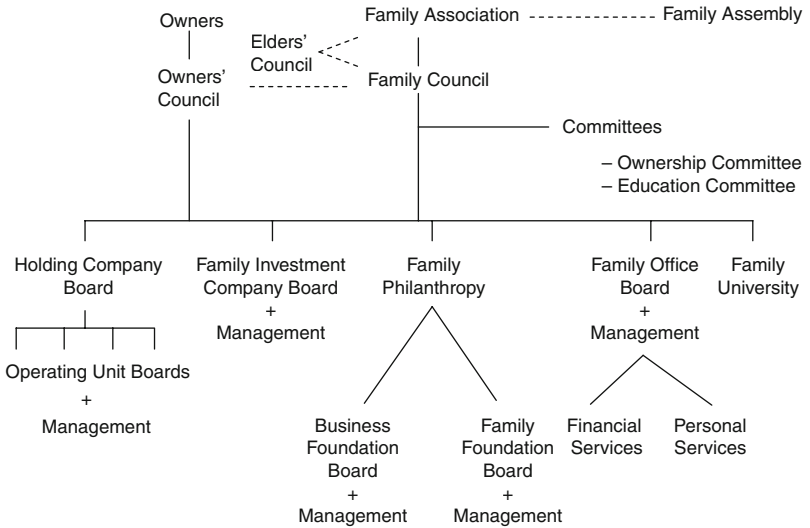


Figure 5.1 Governing the enterprising family

More participation opportunities is valuable as the most significant change is that the family members become more detached, emotionally, from their enterprises over time and over generations. Members are typically less connected to the founding spirit and to the founding values. With less natural emotional connection, motivating members to play active governing roles becomes more difficult and more important.

The fourth fundamental change is that the specific function of *ownership* becomes increasingly important. With more and more people with the primary title of “owner” and with the size of the ownership group growing beyond just those on the governing boards, there is more need to clarify the roles, responsibilities, privileges and boundaries of owners, *per se*. These “owners” may not only be of the family business, but of all the institutions of the enterprising family.

Table 5.2 outlines the prescriptive course to a family for change as it evolves from a business owning sibling partnership to a cousin collaboration of an enterprising family.³

Governance and ownership

The four basic changes just presented imply three models for governance that become much more important as the family grows larger and

The following are the common challenges facing family businesses as they evolve from a sibling partnership to a cousin collaboration.

Table 5.2 From siblings to cousins

Sibling Generation Perspective	Cousin Generation Perspective
Several Family Branches	→ One Large Family
Individual Operating Fiefdoms	→ One Business Actively Governed
Business as the Glue for Unity	→ Business as a Means to Support Other Motivations for Unity
Family Business	→ Enterprising Family
One Form of Family Involvement	→ Multi Forms of Involvement
Equality	→ Merit and Inequality
Family Leads Business	→ Important Non-Family Leadership Roles
Business Leadership Equals Family Leadership	→ Separation of Family & Business & Governance Leadership
“Operating” Ownership	→ “Active” Ownership
Supportive, “Advisory” Board	→ Critical, “Fiduciary” Boards
Internal to the Business Family Office	→ Separate Family Office
All Family on Family Council	→ Representative Family Council
Exclusive Emphasized Values	→ Inclusive Values Emphasized
Informal Family Governance Education	→ Formal Governance Education
Expectation of Commitment	→ Voluntary Commitment
Unanimous (Near) Consensus for Decision Making	→ Democratic Decision-Making
Business Gives Charitably	→ Family Gives Philanthropically

its interests more diverse. First, it becomes more obvious that each domain of an enterprising family needs a comprehensive system of governance. This can be illustrated by extending and adapting the classic “three-circle model”⁴ as follows, in Figure 5.2.

For each domain, a leadership organization is developed and a charter or constitution of roles and responsibilities.

As mentioned earlier, the particular role of “ownership” becomes pronounced in the cousin collaboration. The ownership group becomes larger and needs formal organization. The interests of family members who are

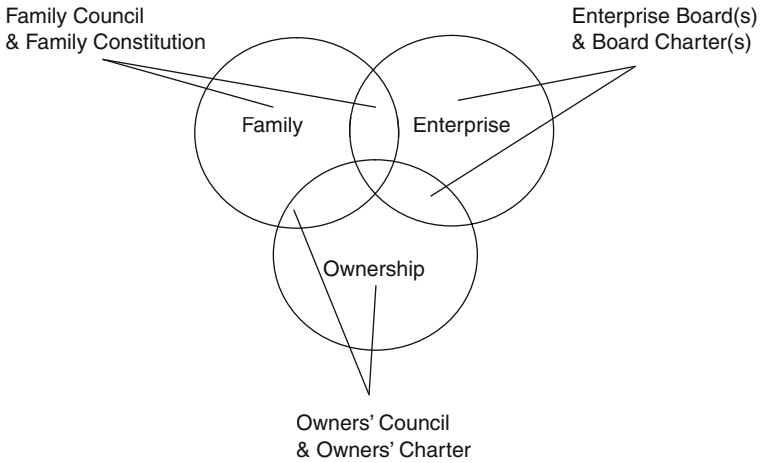


Figure 5.2 Governing the three circles of interest

not managers and those who are often become more contentious. The variations in percentage of ownership among the members grow. And, the meaning of ownership needs to become better considered and articulated if it is to overcome the loosening of bonds through time.

Where ownership organization and leadership take place becomes a critical topic. As shown in Figure 5.1, ownership voice can be brought together at the operating company board, at the holding company board, with the family council, via an “Owners’ Council” or with an ownership subcommittee of the family council. Wherever located or however labeled, it is a second important framework is the Owners’ Council concept.

Thirdly, I propose the model of an Owners’ Charter to articulate the owners’ roles and responsibilities. Table 5.3 outlines the desired elements of a comprehensive Owners’ Charter. The Owners’ Charter is proposed distinctly from the Family Constitution which governs the family as a whole. As families grow and age, as previously noted, considering the total family and the owning members of the family particularly offers more clarity. Of course, when the governance of the domains are fully developed, they can be separate or combined and labeled in any way a family may choose.

With the fundamental changes from growth and time in mind, and with the three models just described in mind, the Difficult Issues of Governance can be examined. For each of the 20 issues to follow, the

Table 5.3 Owners' charter

Owners' Roles and Responsibilities

- Why are we committed?
 - What are our expectations as owners?
 - How do we add value as owners?
 - What is our structure of ownership?
 - How do we make decisions as owners?
 - What is our vision for our enterprise?
 - What is the design of our board?
 - What are our roles and responsibilities as owners/beneficiaries?
 - How do we hold ourselves accountable?
 - How do we prepare ourselves and the next generation for ownership?
-

values dilemmas underscoring the issues are identified. Then an approach to resolving these values dilemmas will be proposed.

The "difficult issues"

There are many practical, predictable problems that arise as a large, enterprising family writes or revises its governance system. These problems have no simple or single solution. They are, in fact, paradoxes – rather than problems. They are dilemmas to deal with rather than clear-cut decisions to make.

What sways a family one way or another on these "difficult issues" is its fundamental values. That in itself adds difficulty as families don't usually have one set of monolithic, unanimously held values as they pertain to these governance issues. It is presumed, however, that there is typically a leaning one way or the other by the plurality of family. That leaning can provide some solution to the questions. But just simply following that plurality tendency for these issues will often underappreciate the other point of view, a point of view that has value too. Doing so will also seed inevitable future conflict. Saving the day, happily, is that healthy families value diversity of perspective and can endure or thrive through significant differences of opinion.

These predictable governance design problems pertain to each enterprise of the enterprising family system; they are as applicable to an operating business as they are to the family foundation or the family council, for example. Following, and summarized in Table 5.4, are 20 "Difficult Issues," framed as questions that all large families must address.

Table 5.4 The “difficult issues”

Twenty Difficult Governance Issues

1. Who are the members?
 2. How to choose members for governance?
 3. What criteria to use?
 4. How to vote?
 5. How to make decisions?
 6. How much information to share?
 7. What conclusion to communicate?
 8. What motivates participation?
 9. How to recognize and reward governors?
 10. How to assure accountability?
 11. How to support involvement?
 12. How to draw the line between ownership and management?
 13. How to enforce decisions?
 14. How to amend decisions?
 15. What philosophy of leadership works best?
 16. Where to focus responsibility?
 17. Who to include in decision-making?
 18. Who pays for what?
 19. How much individual security to provide?
 20. How to share rewards?
-

1 Who are the members?

There are many views on who even participates in the governance system. Are in-laws eligible to be owners? Either way, are they included in shareholders' meetings? Even family assembly meetings? If they are part of the family assembly, may they vote? May they serve? It gets more complicated, of course, with divorced in-laws – as they are very influential parents of the next generation. Many families embrace legally adopted children. Most families struggle with stepchildren, most particularly adult stepchildren.

Fundamentally, it seems, the resolve of membership centers on the family's value of inclusiveness or exclusiveness. Relatedly, is the family's perspective an intimacy of membership or an enthusiastic welcoming to be a large, diverse family.

2 How to choose members for governance?

From among whoever are the members, some, of course, must be chosen for particular roles, such as, for example, to represent the family's ownership on the business board of directors or to chair the family council.

The critical issue is whether it is a selection process or an election process. Is a method established to fill roles without risking an election with “winners” and “losers”? Families, more than other organizations, have an aversion to someone losing. Yet, others would argue, “that’s life” – and election democracy is the most inherently fair process.

Selection methods can be by whoever volunteers. Or, it can be a ladder of progressive responsibilities (i.e., the first vice president becomes the next president of the family council). Or, the incumbents, however selected, select their successors. Some selection systems are completely random rotations, or by age, or rotation within each branch to present the selections to the full family.

Some families, favoring election, find ways to lessen the risks to those not elected. They may vote by secret ballot, keep results private, possibly even keep who was willing to be on the ballot confidential.

The dilemma of selection versus election carries with it the dilemma of merit or representation. Merit usually favors elections; representation prefers selection rotation.

3 What criteria to use?

As just noted, families can emphasize meritocracy for eligibility to compete for a role or as the expressed value communicated to the electorate as they consider candidates. For the business board, for example, business competence or governance experience or decision-making expertise can be criterion for consideration.

If merit is taken to its full extreme, two other issues arise. Incumbents have a growing advantage because of their experience. Or, it can well be argued, that rarely are any family members fully the most qualified for a governance leadership role if compared to the universe of candidates external to the family.

Reflecting back, very often in-laws may well be the most merit worthy, but excluded from membership for some roles. Embraced by many families, representation has several advantages. This value encourages personal growth and learning; it tightens the bond of more people to the enterprise; it builds trust between the family participants and the governance system. Representation also suggests the value that family is valued, *per se*.

Merit or representation resolve adds weight in the decision of limited terms of service or unlimited terms. Merit suggests the latter.

As with all the 20 dilemmas, there are compromise solutions. Some positions or seats can be by merit and others reserved for representation. Or, a pool of qualified candidates, by acceptable merit criteria, can be developed from which the eligible rotate.

Merit or representation usually also provokes the family to face the fundamental value of whether they define themselves as “one family” or a “confederation of branches.”

4 How to vote?

If there is an election, and almost ultimately there is for directors to the business board, there is the question of whether votes are counted on a per share basis or on a *per capita* basis. In other words, is it one person/one vote or are votes weighted by economic interest in the family's economic enterprises?

In some cases, for many families, this seems simple: Vote per share for the business governance roles and per person for the family governance roles. But, in fact, rarely is the demarcation so clear. If the family council makes a budget for supporting family meetings, family fun, ownership cohesion and commitment, there is an implicit “tax” on the larger shareholders to include the smaller or non-owners.

Family councils will often provide guidance to the business governance system. In those cases, should the family council itself be elected by shareholding? Often more complex, is the governance of the family office. Rarely are all expenses billed particularly to each user based on their individual use. There is very commonly some shared costs for the benefit of all family members equally, regardless of shares held or assets invested. Families label this question, “How do we cope with disproportionate benefits?”

At the base of these debates is the value of favoring membership or ownership. Some try to co-opt this issue by endowing the funding of such shared services or benefits in earlier generations. Others do so by putting the enterprise into a trust or foundation that members of the family don't, in fact, technically own or control.

What's fair? What were the founders' intentions? The questions are often central to the discussions.

5 How to make decisions?

As in any democracy, there is the question of how to balance the rights of the majority with the interests of the minority. Families, especially family-first families, have a special care for the minority, the underdogs. In addition, membership in the family isn't, really, psychologically optional nor wished for as optional. Therefore, with less freedom, the minority can feel and be even more abused.

Yet the ultimate protection of the minority, unanimous consensus, has obvious practical limits. So, where to seek a compromise? Some

definition of supermajority (i.e., 60 percent, 75 percent, etc.)? Or some process with a conscientious effort to seek consensus before enough time or consideration has occurred to call for a divided vote. Another compromise adopted by families is to have different voting rules for different issues. An interesting knot occurs when the question is asked, "By what vote is a decision deemed to be of a different class?"

At the base of this issue are also the value dilemmas of fast or slow, efficiency or effectiveness. Many believe that fast and efficient often weaken support and implementation. Others believe the family and its enterprises need the benefit of fast decision-making to cope with a rapidly changing world.

6 How much information to share?

Earlier the question of transparency or privacy was noted regarding family election results. There are several other applications for this question: Should family shareholdings or compensation be shared freely with whom? What deliberations should be recorded and disseminated to whom?

Family council proceedings almost always have sensitive "human resources" issues. Board meeting discussions and who voted how are of keen interest to family owners not on the board. Is a family member's performance evaluation as the CEO or board chairman a matter private to the board, or a board committee? Most, not all, would say "yes." But what about the evaluation of family members serving as business directors? How does the electorate know the performance of directors – especially if they are excluded from observing board meetings?

Transparency and privacy are both fundamental values, particularly in the world of private enterprise. Other less intense applications are the openness of meetings, the distribution of minutes, the specific breakdown of votes – most sensitively in the Nominating Committee or the Family Human Resources Committee. How can an individual manage their expectations or grow in their self-awareness without full unvarnished truth? Of course, that answer depends, in part, on the emphasis of the value of individual responsibility or collective responsibility and on the assumption about the ability of adult humans to grow and change.

7 What conclusion to communicate?

The question of disclosure or discretion was just explored with respect to personal feedback and collective awareness. It is relevant, too, in a critical governance issue among family owners and directors on the board and the members of executive management.

Often the admonition to family business owners is to “speak with *one voice* to the board and, especially, to management.” Nothing can confuse and disquiet management more than to hear opposite wishes and expectations from amongst the owners. Clearly management doesn’t want to referee such differences – and is rarely competent to do so. Further, management, or the board, doesn’t want to hold a referendum on every issue.

On the other hand, there can be great value in knowing that there are divided views. Without knowing so, new solutions won’t be prompted or future problems won’t be anticipated. Rumors and speculation supplant facts.

Is it better to communicate unity or diversity? Part of the answer is how much do the principals trust each other? If there is high trust, the disturbance of diversity is worth the benefits. If there is low trust, then unity comforts.

8 What motivates participation?

Analysis of governance systems, in politics or other organizations, commonly inquires about the level of engagement. Widespread participation is a barometer of governance strength and resilience. There are two views on motivating participation. Many families preach that participation is an incumbent responsibility, even a duty, in exchange for the privileges of wealth and power and special opportunity. Others view participation as only meaningful and sincere if it is voluntary, of free choice economically and psychologically.

Another way of exploring this question is to consider if stewardship is an opportunity or an obligation – a benefit or a burden. Relatedly, is the individual free to define stewardship in their own way, or is it a collective responsibility, requiring acculturation and family norms of conduct?

Different families will see these questions differently. The interpretation and application of the motivation for participation is reflected in the quality of the work governors contribute. The felt burden of stewardship often reflects itself in member burnout, the weariness from demanding duty. Yet without a sense of conscientiousness, governance roles will also go vacant, particularly the challenging or subtle leadership roles.

Either way, it seems, is an excuse for lack of appreciation. If one takes leadership eagerly, that role is thanks enough. If they do so from expectation, they don’t warrant appreciation. This lack of recognition among family members, perhaps for other psychological reasons also but either way, adds to the burnout from governance tasks so frequently noted by large, complex families.

9 How to recognize and reward governors?

The motivation to participate, as just discussed, is largely determined by how one defines their reasons. It is also importantly influenced by the extrinsic reward system. Should family governors be paid, should they have economic incentives tied to performance? For many families this is tricky terrain. “Best (and common) practice” says to pay family board directors, not in the management of a profit-seeking business, as if they were independent, external directors. After all, they work as hard, take time away from other life duties – often at personal economic sacrifice.

But, if the family is dynamic and complex, new issues arise. Should family observers, trying to prepare themselves for good governance contributions, receive some compensation for their time? Does the compensation of family business directors create some perverse perceptions and incentives to favor serving on the business board over so serving on the family’s foundation board or family council? This issue becomes intense if family business directors can receive substantial economic rewards from stock option plans often used to attract and align non-family directors.

Some families pay the family council leader. Others have honorarium fees for attending various family governance committee meetings and so on. Very few choose to offer directors’ fees to the governors of the family’s philanthropic activities. Yet the philanthropy may be more central to the family’s long-term success as a family *and a family in business* than the business.

Maybe all service should be offered for altruistic reasons. Aren’t the rewards of membership through special social networks, personal reputation and identity, and a secure sense of belonging only diluted by debating compensation schemes? Of course, family member economic security and available administrative support for living a more complex daily life factor into the resolution of compensation. Is assuring family governors of such support a value of the family?

10 How to assure accountability?

Accountability, *per se*, is a widely endorsed value. Accountability when the consequences affect many constituents, the family’s security and reputation, and the legacy for future generations is all the more deeply felt. More so if family members are selected on merit and are recognized for their services.

Yet accountability in a family system isn’t completely straightforward. Family reporting to family and family evaluating family can threaten

the primary goals of family harmony and unconditional acceptance. Discriminating feedback has often led to generations-long branch war.

Perhaps a safer way to provide family accountability is to employ external consultants to gather and report the feedback anonymously. This assumes humans seek to grow and learn and embrace such information. Or perhaps the feedback has to come exclusively to a select family Nominating Committee to lead any necessary changes in roles and responsibilities.

Some families believe direct, open feedback is important for accountability and transparency and, also, providing the vulnerability that builds family trust. Which path threatens the quest for family harmony more – explicit accountability or private coaching?

11 How to support involvement?

Filling governance roles for an enterprising family consumes a lot of time and, especially, emotional energy.⁵ Sometimes an individual may serve on multiple boards or councils or committees. Commonly, these are unpaid efforts – or the remuneration hardly supports a career commitment to family governance.

What makes it possible? Perhaps only those with the circumstances to afford voluntary commitment will get involved. But that may limit a meritocracy or sought for representation. Perhaps a support system – the Family Office – is available to help with many of life's time-consuming requirements (i.e., tax filing, bill paying, household employment, travel planning, etc.).

As families consider this option they may find themselves torn by the value of self-reliance – even the work ethic – and fears of dependency. Or, many understand, such support assures excellence in the critically valuable functions of governance and aids family members to have the time for other meaningful vocations.

12 How to draw the line between ownership and management?

Privately controlled enterprises have the advantage of the power of a tight connection between ownership and management. Fast decisions, unconventional decisions and passionate decision-makers offer great returns. On the other hand, family owners, empowered by their emotional attachment to the business, can also overstep their boundaries and meddle in management – even threatening the ability to attract great managers.

A simple, popular adage is, “nose in, fingers out.” But that line isn't as clear, nor permanent, as one might wish. Being close to management permits proactive versus reactive governance decision-making – actions

before a problem rather than after it is reported. Being proactive suggests that owners are part of strategic decisions, rather than monitors of the results.

Many family owners are vigilant to protect against overstepping roles, arguing that professionalism demands clear boundaries. But, for the most part, the “line” shifts as a function of the tenure of management, the trust in management and the recent performance results of the enterprise. Clarity and flexibility can be in conflict. Should family governors focus on the process of decision-making or on the results?

13 How to enforce decisions?

Families, particularly of different cultures, see this question very differently. The rules of governance can be documented in a legal contract or in a moral pledge. In fact, “the rules” may not be rules, they may be only principles or values.

A moral pledge seems more “family friendly.” A contract seems more professional. At the base, of course, is whether people believe that social relations govern people’s behavior more successfully or whether contracts, with explicit sanctions, are more realistic. Adaptability, to be discussed next, is also part of the debate.

More and more, it appears, families look for a mix. They put heavy, first emphasis on moral principles. They use legal agreements mostly just for the shareholders’ agreement regarding stock ownership rights.

To seek the right balance, some families make a meaningful, public ceremony of signing the constitution at coming-of-age celebrations. Others de-emphasize the stiffness of legal provisions by explaining they are only necessary formalities recommended by others as “best practices.”

Certainly, articulating understandings in formal, legal language assures clarity of thought and efficiency of passing on rules and expectations. More emphasis on moral principles encourages families to assure more values-based dialogue.

14 How to amend decisions?

Effective Family Constitutions not only struggle with the enforcement question, but also with how to address amendability of agreements. Strong arguments can be made for constitution policies to be firm, even permanent. After all, their purpose is to resolve uncertainty and to regulate behavior. Constitutions, too easily changed, have no substance.

On the other hand, the reality for enterprising families is that it seems everything surrounding their policies is changing. How does one confidently predict the family’s future needs, tax laws, business requirements and social norms? The astounding complexity of mixing family

and business makes almost any constitution imperfect from the start. Relative ease of amendment, many would say, keeps the constitution relevant and durable.

Is something more durable if it is flexible and adaptive? Or, if it is clear and firm? Sometimes, when an earlier generation has doubts of the family's intentions and commitment to the business or philanthropic foundation, they prefer a strict and legal shareholders' agreement. Other times, the earlier generation fears such a strict and legal agreement will drain family enthusiasm for its enterprise and family learning from re-examining the original assumptions. Succinctly, each generation must decide how much it wants to control the next or even more distant generations.

A frequent compromise is to make the constitution and its governance provisions fixed for the generation that drafts it, but, through "sunset" type provisions or a limited lifetime of the constitution, the succeeding generation needs to develop its own. This not only provides a future opportunity for amendment, but also facilitates future generations to experience the process of developing its own rules and structures. One lesson: if there is an expiration date of a trust agreement or shareholders' agreement, start the process of replacement several years before the deadline.

Another parallel decision for amendability is what vote it takes to approve an amendment. Should the majority required be large or small? Should one branch be able to stalemate change or not? Obviously, the family political circumstances when the constitution was first developed influence these decisions and early compromises for family unity and harmony often become the seeds of later conflict and rigidity.

15 What philosophy of leadership works best?

Governance systems have the fundamental responsibility of defining the process and the criteria by which to select future enterprise leaders. Each governance system has embedded in it the preference for leadership selected by democracy – where the system is, in effect, the leadership – or whether leadership is anointed and protected by a few. The latter approach assumes a strong, powerful leader is necessary to keep an enterprise entrepreneurial and secure. The former approach assumes popular support is important for leadership credibility.

A leader from among a family is challenged if they have lots of power for a long time. There seems an inevitable jealousy by at least some toward the few. Strong leaders eventually face unpopular decisions. With their effectiveness, they receive public personal attention. Both outcomes lead

to families wanting a more comfortable, inclusive leader. The problem is, it typically seems, the comfortable, inclusive leader leads the enterprise to mediocrity. Then the governors wish for a bolder, revitalizing leader.

Of course this cycle is not without even larger potential risks. The “benevolent dictator” can so offend the owning family that huge conflict breaks out. Or, the “benevolent leader” can be wrong and without protective checks and balances.

To increase the odds of a great personal leader, the selection process is by a few who are highly business-proven and who are secure enough to take selection risks and to protect the leader from constant popular referendums. To maintain ownership support for the enterprise and to assure the legitimacy of the governance system, wide participation in a democratic process seems better.

It’s a very difficult question to address the relative risks and returns of different forms of leadership – greatly compounded by the fact that the process is relatively constant while the circumstances will likely change significantly.

16 Where to focus responsibility?

All organizations must confront the question of balancing centralization and decentralization. For a large enterprising family governance system, there are choices about which responsibilities best belong to the shareholders’ assembly (or for foundations, the membership), or to the owners’ council, or to the holding company board, or to the subsidiary boards. The size of the family influences these choices, as does the diversity of business units or of philanthropic or investment focus areas.

But much of the choice is one of preference or beliefs. Some families value the simplicity, orderliness and clarity of centralization. Others value the benefits of wider participation and greater expertise of decentralization.

As in all organizations, there is often a cycle, as in the choice of leadership just discussed, gyrating over time between more or less centralization. But there are also tendencies one way or the other. More inclusive, democratic, trusting families tend to favor decentralization. More controlling families and those with a belief in strong leadership tend to favor centralization.

Reconciling the two orientations are families with several family enterprises whereby they can assure lots of family participation spread over the several entities and, therefore, tolerate more centralized governance of each.

17 Who to include in decision-making?

One of the most fundamental decisions families must make is how much to trust outsiders. Might the family trust a non-family CEO, or a non-family chairman, or independent outside directors on its boards? These questions pertain not only to a family's business, but even more subtly and tellingly to the family's foundation and family office. In these enterprises, the use of outsiders is less known and the family feels an even more heightened sense of privacy.

How much a family entrusts outsiders is partly a reflection of the pragmatic circumstances of their culture. More often, it is a reflection on the family's past experience with trust. If bad experiences with trust in outsiders occurred to the family's security in early days, trusting others may not be a family value.

Compromises are often sought, as trust is a concern, yet the benefits of fresh, objective perspectives are also appreciated. Some families use "advisory boards" or advisors to family councils or committees as such an approach. Related to the ability to trust in non-family governors are questions of self-sufficiency versus dependency on others and preference for wider family participation versus selectivity on merit.

18 Who pays for what?

"Business-first" families are commonly reluctant to draw any business resources to fund any family activities, at the extreme they even conclude that shareholders should pay their own expenses for attending shareholder meetings. More "family-first" families seek to encourage family interest and participation by funding all costs, even transportation and fun reunions, which they believe strengthen emotional commitment and the willingness to sacrifice for the business.

The decisions are more complicated in funding family assembly social gatherings, family office review meetings and family foundation site visits. There is rarely a cost-sharing system that doesn't have some impossible to determine collective benefits versus personal responsibility ambiguity. What should be personal responsibility and what should be collective responsibility? Often the actual monies aren't very material. But the symbolism of who pays for what becomes central and, often, highly debated. Any compromises may seem more like compromise to principle than an attempt at fair resolution.

19 How much individual security to provide?

Is personal financial security a crutch or a liberation of engagement and commitment? Does the personal financial security of all lessen the

likelihood of family conflict or not? Does security drain people of motivation and competence or support than to fulfill their dreams and use their talents best?

Some families believe they have better governance if all are secure. Motivation is sincere. Commitment is voluntary. Others feel that personal dependence and security create attitudes of entitlement and less accountability. Compromising these beliefs is difficult as financial security is so relative to each person. And what motivates different people, or not, is so complex and different.

One perspective ascribed by many is that whatever one's view is on this issue becomes a self-fulfilling prophecy.

20 How to share rewards?

Perhaps on no question is a family's value of individuality or collectively tested more than on how to share the rewards of success. Should those more directly involved in the success benefit more, or should the rewards be shared more collectively? The more income or wealth disparity within a family, the more debates are raised on parity among family and justice as owners.

Many make conscientious efforts to separate the issues: executives are paid at market rates; so, too, are directors. Shareholding families receive dividends that are industry appropriate. To enforce these effectively requires trust in outside resources – consultants, financial advisors and independent directors. Doing so also presumes a transparency of personal compensation that many families find uncomfortable. There's always the question of how much reward family shareholders should receive for their sacrifice of diversification.

Some compromises include assuring market-based cash compensation, but no extra equity incentives for family governors. Others feel they can be generous with family dividends in absolute money without compromising the company's retention of capital for growth, given the size of the family.

There is an analogue of equity compensation and dividend policy in the business for the family's investment company. Should family who direct collective family money expect a "carried interest" in the performance results of alternative investments? This issue as much as any sparks family breakups.

* * *

A summary of these many values dilemmas is presented as Figure 5.3.

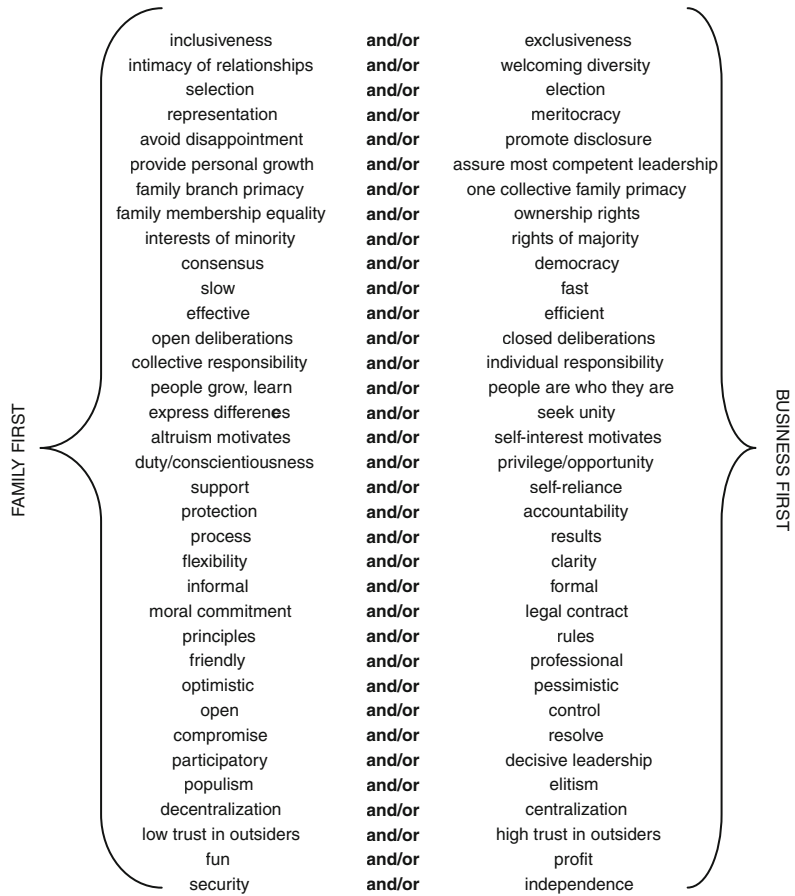


Figure 5.3 A summary of the values dilemmas

One overarching way to classify and demarcate these dilemmas is to suggest that one pole of thought carries the deep-seated value of “family first” and the other pole carries the equally felt “business first” value. Or, said another way, when facing these 20 governance issues is the assumption that if you protect the business, the family will benefit? Or is it if you protect the family, the business can continue and prosper?

As with all the dilemmas discussed, one would like to be able to answer: “Yes, both sides are true!”

Table 5.5 The most difficult of the 20 difficult issues

	Family Owners	Non-Family Execs and Directors
• How to support involvement?	1	
• How to draw the line between ownership and management?	2	1
• How to assure accountability?	3	2
• How much information to share?	4	3

The 20 “difficult issues” presented are distilled from consulting experience and educational surveys. Surveys over the past three years of nearly 100 enterprising families offer the following results to indicate which of the 20 are the most challenging.⁶ (See Table 5.5.)

The results show the top rankings by family owners and also the opinion of their non-family executives and directors.

These surveys also highlighted two structural challenges. One, very complex one is how to define the distinct roles of the family at large and of the family who are owners. For both family owners and for the non-family executives and directors, a key issue that was widely felt is: “How to acculturate independents to the family business governance milieu and family business culture?”

Resolving the “difficult issues”

Figure 5.3 listed the many values dilemmas that are at the base of the 20 Difficult Issues. As that enumeration concluded: Aren’t both poles of each dilemma attractive? Is it possible to have the best of both sides of each dilemma?

Those are the questions of Dr Todd Johnson in his “polarity management” method to addressing dilemmas.⁷ To me, addressing the most challenging issues in family business is learning to cope with fundamental dilemmas – the most basic of which is “family first” or “business first”.

In addition to the values dilemmas list underscoring the governance problems of large, extended, diverse, enterprising families, families in business face other classic human dilemmas.⁸ For example:

Tradition	and/or	Change
Prudence	and/or	Risk

Liquidity	and/or	Growth
Familial	and/or	Professional
Roots	and/or	Wings (for the next generation)
Commitment	and/or	Freedom
Collectivity	and/or	Individuality

There are several approaches to managing dilemmas like these. One is to seek a compromise between the two views. Often that is acceptable; often it is unsatisfactory to both points of view. Another approach is to alternate between leaning to one pole or to the other. This seeks to yield a fair balance over time.

A third approach is to find separate locales to emphasize each point of view. For example, in several of the “Difficult Issues,” one philosophy was practiced in the family council and the other philosophy was practiced in the business board.

A fourth approach is really an attitude: rather than resolving the dilemma, attempt to keep both sides as open as possible as long as possible. Though there is uncomfortable ambiguity with this approach, often, over the long term, the dilemma resolves itself into a single synthesizing solution that captures the best of both points of view. When that’s possible, the dilemma is no longer a problem, it becomes a paradox – with a solution that not only embraces both poles of the dilemma but that symbiotically strengthens both poles, for interdependent benefit.

A common example for business families is to reconceive the change versus tradition dilemma as not one or the other, but as the realization that change can be, often is, the tradition. Another example is addressing loyalty versus freedom. Many families reason that the more freedom it grants its members, the more loyal – in the best way – they become. And, that reciprocated loyalty encourages others in the family to be free individually *and* loyal to the family.

The Polarity Management approach of Todd Johnson provides tools to keep the subject open, to avoid one-sided divisiveness when the issue is fundamentally a dilemma (with two truths). The longer the resolve is left open, the more benefits from both points of view are possible and the greater the prospect of finding the “win-win”, the symbiotic synthesis of both truths. Of course, keeping both sides open not only creates tension from ambiguity, it can also lead to earning the worst of both perspectives.

My interpretation of the powerful tool is simply three steps:

1. For each pole, each side of the dilemma, identify the advantages and disadvantages. This step helps assure that it is, in fact, a dilemma.

Further, it comforts the family debate to appreciate each others' views and the complexity of the issue.

2. For each side of the polarity (i.e., centralization–decentralization), identify the action steps that can maximize the benefits of each. This drawing out as much of the best of both is much more constructive and beneficial than to pursue a “winner takes all” argument.
3. Third, for each side of the polarity, also identify the signs that too much of the disadvantages is being realized from over emphasis of that pole. Early warning signals of mutually agreed upon disadvantages are wisely, and relatively easily, heeded.

Closing remarks

As families grow into a large cousin ownership group, with many or most not involved in operations, but all holding the interests of ownership, special, difficult governance issues arise. These governance issues are further complicated if the business-owning family evolves into an enterprising family with a portfolio of varied interest and family institutions.

Underscoring the challenges to address these difficult governance issues is the realization of dilemmas of seemingly conflicting values. Recognizing that these values dilemmas have two-sided legitimacy takes family conflict to a constructive stage. Approaching these differences with the tools of Polarity Management and a fundamental family commitment to the long term turns problems into resolvable paradoxes. Needless to say, the starting point is to identify the underlying values dilemmas and to respect their differences.

Notes

1. A sibling partnership, usually in the second generation of ownership, is commonly a group of 2–6 owners who, for the most part, are active in the business. A cousin collaboration typically includes 10–20 or more family owners, most of whom do not work in the business.
2. See John L. Ward, “The Ultimate Vision for Continuity”, *Families in Business*, September/October 2003: 78–9, for more on The Enterprising Family.
3. See John L. Ward, *Perpetuating the Family Business*, Basingstoke, Palgrave, 2005, for more on the evolution from sibling partnership to cousin collaboration.
4. John A. Davis, *The Influence of Life Stage on Father–Son Work Relationship in Family Companies*, dissertation, Harvard University. (The first presentation of the three-circle model on pp. 14–15.)

5. "Why Are Family Meetings So Emotionally Draining?", essay by John L. Ward, 2007.
6. The surveys were conducted with Ivan Lansberg at the Kellogg School of Management's "Governing the Family Business" program, 2005, 2006, 2007.
7. Barry Johnson *Polarity Management: Identifying and Managing Unsolvable Problems*, PhD, HRD Press, Amherst, MA, 1992.
8. I am grateful for the important contributions of Amy Schuman, co-principal of The Family Business Consulting Group, for much of the thinking in this section.

Part III

Finding the Right Structure

6

Toward a Typology of Family Business Systems

John A. Davis

While all family business systems can be described using the Three-Circle Model (see Figure 6.1), they also vary enormously. Family businesses range from the smallest and simplest to the largest and most complex businesses. Business families range from small, closely related groups to large, distantly related clans. Family business ownership groups can involve one person to hundreds of family members, have a mix of active and passive owners, and be privately held or publicly owned. The combinations of various business, family, and ownership types produce a potentially huge number of different kinds of family business systems. There are, of course, other ways to characterize family business systems. Family companies include the youngest to the oldest businesses on the planet. They are found in every corner of the world and in virtually every industry.

The large variation in family business systems can be both exciting and exasperating to family business researchers. A wide range of family business systems provides researchers with a virtually endless list of interesting and important research questions. At the same time, having many different kinds of family business systems requires that researchers carefully qualify the scope of their research (i.e., my research deals with these topics and these kinds of systems) and increases the need to customize advice to firms and families (since it may not apply to all kinds of systems).

Variety in any field of study also necessitates a way of classifying the object of study (birds, rocks or family business systems) – to simplify the number of types – which helps researchers explain them and communicate about them. The family business field has responded to the existence of many different kinds of family business systems by developing typologies to classify them. Over the last two decades, two categorizing methods for family business systems have emerged: (1) typologies that

distinguish these systems on the basis of particular system characteristics (see Table 6.1) and (2) developmental typologies based on the stages of various elements of the family business system, including the founder, the family, the business, and ownership (see Table 6.2).

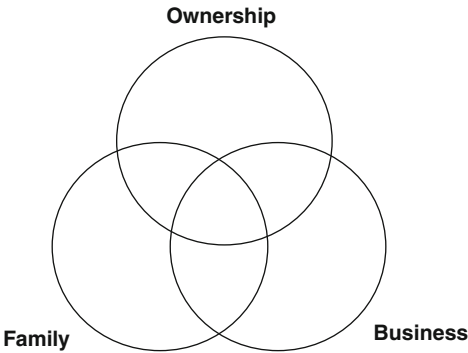


Figure 6.1 Three-circle model of the family business system

Source: Tagiuri and Davis, 1982

Table 6.1 Typologies based on system characteristics

Author(s)	System Characteristic	Family Business System Types
Levinson (1983)	Psychoanalytic characteristics of family business system	(a) family traditional (b) family conflictual (c) entrepreneurial
Beckhard and Dyer (1981)	Degree of family involvement in family business	(a) royalist (b) family-owned – mixed management (c) family-owned – professional management
P. Davis (1983)	Intentionality and proficiency of family business	(a) high-achievement (high-high) (b) stymied (high-low) (c) survival (low-high) (d) failing (low-low)
Holland and Boulton (1984)	Type of relationship between family and business	(a) prefamily (b) family (c) adaptive family (d) postfamily
Dyer (1986)	Organizational culture	(a) paternalistic (b) <i>laissez-faire</i> (c) participative (d) professional

Table 6.2 Developmental typologies

Author(s)	Stages Used in Model
Hershon (1975)	Stages of the management style by generation running the family business: paternal or authoritative, fraternal or collaborative, and collective.
Danco (1975)	Stages in the behavior of the founder-entrepreneur: wonder, blunder, thunder, and plunder or sunder.
Davis (1982); Davis and Tagiuri (1989)	The quality of work relationships as a function of interactions between the life stages of fathers and sons.
Peiser and Wooten (1983)	Intergenerational goal congruency as a determinant of organizational effectiveness.
Hollander (1984)	The effectiveness of interactions among family, business, and environment as a function of congruence among individual, family and business stages.
McWhinney (1984)	Organizational instability as a consequence of simultaneous transitions among individual, family and business developmental stages.
Churchill and Hatten (1987)	Business stages: existence, survival, success, take-off and resource maturity.
Ward (1987)	Individual, family and business developmental stages.
Ward (1991)	Ownership stages: founder, sibling partnership and family dynasty. Management stages: entrepreneurship, professionalization and holding company.
Gersick, Lansberg and Davis (1990)	Family generations and stages of organization development in family foundations.
Holland and Oliver (1992)	Family business stages, including owner-manager, shared family control and non-family ownership.
Gersick, Davis, McCollom and Lansberg (1997)	Family stages: young family in business, entering the family business, working together and passing the baton; ownership stages: controlling owner, sibling partnership, consortium; business stages: startup, growth, maturity, decline.

These typologies have helped researchers and practitioners deepen their insights into these complex systems. The developmental typologies have also encouraged the field to view these systems through the lens of developmental stages. But it is fair to say that none of these

frameworks has been adopted as a paradigm by the field, probably because each of these typologies focusses on a narrow range of explanatory variables. A more comprehensive way to categorize family business systems would help develop a standardized language in the field (still sorely lacking), and help researchers attend to more of the system features that influence their success and survival. In this chapter, I recommend those features of a family business system that I believe should be included in a typology of family business systems, and where appropriate, enumerate the stages of the dimension. By doing so, I hope to stimulate a conversation in the field that can lead to a broadly accepted classification framework for family business systems.

Context factors

Some factors that help us distinguish family business systems have to do with the context of the family business system. Researchers and others routinely label family business systems according to their industry – for example, as a retailing or real estate family businesses. Industry context orients us in any meaningful discussion of a family business system; it would be confusing to discuss a family business system without this information, and for important reasons. The industry of a family business determines to some extent the business challenges facing the company, its key success factors, and its resource (human, technological, financial) needs. A metal fabricator, a catering service, and a pharmaceutical laboratory would vary on these factors to some extent. Certain characteristics of an industry significantly influence the business's performance and the family's ability to maintain ownership control of the business: in particular, the length of product lifecycles in the industry, the rate of technological change in the industry, industry pressures on the business to reinvest and grow quickly, the profitability or cash flow strength of the business, and the turnover and intensity of competition in the industry. If it is important to understand what a family business needs to do to be competitive and survive in business, one should understand these industry factors.

While the same family business issues (concerning management succession, shareholder conflicts, employment and compensation of relatives, etc.) seem to arise in all industries, these issues can manifest in different ways in different industries. The practices that help manage these family business issues also are quite similar across industries, although these too can be adjusted according to the industry. Until the

field develops a meaningful categorization of industries (e.g., do capital intensive industries affect family business systems in different ways than non-capital intensive ones?) researchers should at least be careful to identify the industry of the family business system, and note industry characteristics that influence system behavior.

Researchers and others also routinely identify the nationality (or social culture) of a family business system. A business family and firm's national, regional, and ethnic cultures, and to some extent the family's religion, influence six factors that have some bearing on behavior in the business and the family: a family and business's reliance on hierarchy to make decisions, the favoritism toward males or older individuals for leadership roles, comfort with open disagreement or conflict, the ability to address issues through direct communication in the family or business, a family's desire for (or insistence on) togetherness, and the freedom given to the next generation in choosing a career, mate or lifestyle. One should pay attention to cultural and religious factors and incorporate them in any attempts to address issues or change behavior in the family and its business. While one would probably find very similar family business issues in a Japanese Shinto, Italian Catholic, and Bahraini Muslim family business system, a consultant would likely facilitate change in these systems in different ways. In other words, culture and religion must be considered in trying to change the system, but these factors are usually only a modest influence (I like to say a "15 percent factor") on behavior in family businesses and business families. It would feel negligent to omit the nationality (less so the religion) of a family business system, but it usually does not aid one's analysis much to recognize the family businesses as Indian, Scandinavian, Arab or American, or business families as Muslim, Christian or Buddhist.

Local conditions, including local laws, also affect the behavior of a business or family. Consider the impact of the Indian law regulating how much the managers of companies can earn. Three brothers in New Delhi, who jointly owned a family company that had several businesses, refused to be held to these restrictions and supplemented their legal managers' salaries with benefits from the companies they separately ran. The problem was, they did not trust one another and did not establish a transparent way to track how much each brother was taking from the company he ran. So each brother's wife ended up watching the other brothers' wives to see what they bought, what jewelry they wore, and what vacations and other benefits their families enjoyed. Spying led to accusations, which resulted in more family tension and fragmentation

and further complicated efforts to manage this sensitive issue. This messy situation was influenced in small part by the local law but was largely due to the lack of transparency and accountability found in many family business systems, and the same sibling and in-law behaviors found everywhere in the world. Here too, we would have to admit, it is responsible to see how local conditions affect family business system behavior, but not to expect that they account for much variance in behavior.

Features of the family business system

Several features of a family business system seem to reliably differentiate behaviors in these systems; some of these features are commonly noted in describing family business systems, but others not.

The age or generation of a family business system is always something to note because the passage of time has a fundamental influence on family business systems. The age or generation of the family business, business family, and ownership group (these are usually but not always the same), obviously influences the history and experience of the system. It usually positively correlates with the size and complexity of the business, family, and ownership group, and with the momentum of the system. With each passing generation, a family and a business add more business and family history. Layers of positive history build positive momentum that makes it easier to be seen as a winner and to win allies and supporters. (Of course, the inverse is also true.) The generation of the business and the family also influences the reputations of both. A fourth-generation family business and business family typically have done more to either build or detract from their reputations than a second-generation family business or business family usually can.

On the other hand, the age of a family business system does not always strongly correlate with important structural characteristics of the family business system. For example, a fourth-generation family business with a sole owner can be very similar to a founder-stage family firm. So one cannot assume very much *just* from the generation and one should supplement the generation of the system with other categories of information that further distinguish these systems. I propose that the other important categories to consider are its purpose, size, complexity, locus of control and developmental stage (see Table 6.3). I will describe the family business, ownership group, and business family, in turn, according to these dimensions.

Table 6.3 Family business system features

Feature	Business	Ownership	Family
Purpose	Purpose of the business according to the family and family owners	Purpose of the family owning the business	Purpose of the business family
Age	Generation of the business	Generation of family owners in control of the business	Generation of family in control of the business
Size	In terms of assets, employment, sales	Number of family owners	Number of business family members
Complexity	Number of departments, divisions, subsidiaries, and diversification of the business: focused, diversified around a theme, widely diversified	Mix of types of owners: Family Family and private investors Family and non-family managers Family and public shareholders	Complexity in family structure: Nuclear (multiple nuclear) Sibling Cousins Branches (clan)
Locus of Control	Family role in management: Family only Family supported by non-family Family and non-family Non-family in charge Non-family only	Controlling owner(s): Sole owner Only actives Actives in control with passives Joint active-passive control Passive control with actives Only passives	Family leadership model: Patriarch/matriarch First among equals Co-leaders Random Non-family
Developmental Stage	Stage of each major business line: Startup Growth Maturity Decline	Ownership relationship to the business: Operator Supervisor Investor	Stage of family adaptability: Generation Regeneration Complacence Decline

Business categories

Purpose. The purpose of any enterprise influences its behavior and other characteristics. For a system composed of a family, business and ownership group, we need to understand the purpose of the business, according to the business family; the family's purpose for owning the business; and the purpose of the business family itself. For a family business system to function well, these purposes need to be aligned.

While a business family typically wants its business to achieve a number of goals, it is possible to identify the core purpose a family has for its business. Most family businesses clearly emphasize one of these four purposes based on the needs of the family and the success of the business: to provide income for family members in this generation, to be an entrepreneurial venture for this generation, to be an economic activity that should be perpetuated in the family, and to be an institution to be maintained and protected by the family:

- **Economic provider.** Many family companies all over the world – like small and, especially, subsistence family shops, farms and craft businesses – exist just to provide for the family members. The family has no intergenerational commitment to the business and the senior generation may or may not try to pass their business to the next generation. When the children are raised and the income needs of the senior generation are met, these businesses usually are closed, although they may be continued if the business aligns with ongoing family needs.
- **Entrepreneurial venture.** For some business families, the business is an entrepreneurial vehicle for the senior generation, to create wealth or to achieve other goals of the business owner, but the family owner has no plans to transition the business to the next generation. Not all founder or entrepreneurial businesses fall into this category and they would only be family companies, according to our definition, if two or more family members had a significant influence on the business. These companies may grow to be substantial, but when the entrepreneur is finished with the business, the business is generally sold or closed and the next generation members are free to launch their own careers or start their own businesses.

Family companies with these purposes are not inclined to become multi-generational family businesses. But some family companies are expected to last for more than a generation:

- **Multi-generational economic activity.** The third and very common purpose for a family business is to be an economic activity that

is passed to the next generation when circumstances permit and the company meets certain family needs, including family pride.

- **Institution.** The fourth purpose for a family business goes beyond being an important economic activity for the family. In these rather rare cases, the family (and usually the employees and other stakeholders) regards the business as an institution – an established organization that is a public trust – and they believe that this business must be maintained because society needs it. It could be a bakery that the village relies on or the *New York Times* that much of the world relies on. In most cases, the family believes that it must continue to own the business because it is the guardian (and usually the only reliable guardian) of this public trust. Family business institutions generally only occur when the business is very prominent and successful and the business family incurs high status or material reward through its ownership.

It is important to note that as the purpose of the family business moves from an income vehicle to an entrepreneurial venture to an economic activity to perpetuate to an institution, the family's long-term commitment to the business increases.

Size and complexity. The size and complexity of a family business are important to track. Most family companies are small and have one business focussed on one or a small number of products or services. Some involve two or more businesses, either owned separately by the same family or owned by the family's holding company (a company that makes nothing, but holds the shares of other companies). Over time, successful family companies often grow from smaller, less complex organizations into larger, more complex ones. Most of these companies stay tightly focussed on one line of business as they grow, but become somewhat more complex by adding layers of management and departments or geographical divisions. Other family companies grow by diversifying into other lines of business when they run out of growth opportunities in their current businesses or want to give new leadership roles to family members, as is often the case in the Middle East, the Indian subcontinent and in Latin America. Diversifying for these reasons may or may not pay off for the business or the family.

Locus of control. The next way to categorize the family business involves the family's role in managing the business, which is a measure of the family's influence over the company and its connection to it. Four main types of family business management teams exist: family managers only,

family managers supported by non-family managers, family and non-family managers equally managing the business, non-family managers running the business with some family involvement, and non-family managers only. As a business becomes larger and older, non-family managers become more active and important in the management of the family business. The switch to only non-family managers is rare. It can happen anytime in the life of a family business, but occurs mostly after the second generation, and generally accompanies a change in the owners' involvement with the business, which will be discussed.

Developmental stage. Finally, one can describe the stage of a family business by noting the developmental stage for each of the company's products or lines of business. Each product area for the company can be thought of as a separate business; each has four potential stages of development: start-up, expansion, maturity and decline. In the start-up stage, a product or line of business attempts to be accepted by customers and become cash positive – have more cash regularly coming in than going out of its coffers. Most businesses begin at the start-up stage. In fact, the most common type of business in the world is probably the subsistence business in the start-up stage or barely beyond the start-up stage.

When a product or line of business receives market acceptance and generates positive cash flow, it moves from start-up to the expansion stage. Businesses generally expand because the rising tide of the industry is lifting all boats, because the business is selling something that makes it particularly attractive to customers, or for both reasons. The expansion stage can go on for a long time, generations actually, if the product life cycle is long and the business remains responsive to the market. Most of the oldest family businesses in the world sell products that have very long product life cycles like wine, agricultural products, hospitality or construction. Regardless of the reason for growth, expanding businesses require a particular kind of management and financing that permits the organization to keep up with growth.

A business might be able to expand forever, but typically, sales growth slows and can level off and the organization changes little – the business matures. While these conditions might seem dull, mature businesses can be successful and quite profitable if they are cost conscious. Competition in mature industries generally sets demanding standards of quality, customer responsiveness and price, and winning against these high standards is challenging and can be very motivating.

The stage after maturity is the decline stage when sales, employment and the equity value of the business generally fall, sometimes precipitously.

Unless the owners want to close the doors to the business when they retire, the point of business is to prevent the company from declining, which requires diversifying into other products that can grow and continue to support the company. Keeping a company alive, in other words, is related to properly managing each of the products and services it sells as well as the business's ability to move from one product or service to another to avoid the entire company going into decline.

Each stage of growth has distinct management and financial requirements, which places certain demands on the family and ownership group. Some families pull together to start up a business, but do not have the management expertise, interest or financial ability to support it in later stages. Some family businesses diversify into several products. If these products are in different stages of growth, as they often are, the diverse requirements of these varying businesses can strain both the business and the family. For example, a family may want to compensate equally the three brothers that run a start-up, expansion and mature businesses within the family company, but have difficulty justifying that on business grounds. Or, retained earnings from the mature business may need to be reinvested in the other two companies, but that could aggravate rivalries among the siblings. Clearly, the family and ownership group need to support the particular management requirements of the business, or the business needs to be designed to be compatible with the realities of the family and ownership group.

Ownership categories

The ownership structure of a family business (who owns how much of what "class" of stock or other forms of ownership) can take many forms, and the form it assumes has profound effects on the future of the business and family. The decision about who will own the business effects other business and family decisions (who will be the CEO or family leader, for instance). Decisions around ownership in any generation set the company on a path where the implications can be felt for generations.

Family business ownership groups are distinguished in a number of ways. They can have different purposes. They can remain small or grow to hundreds of owners. They can be homogeneous or very complex groups, composed of just family managers of the business, combine active and passive family owners, involve only passive family owners, add non-family employees, and include non-family investors or public owners. The family ownership group, itself, can be a nuclear family and can include sibling owners and their families, or cousins and their families, reflecting the complexity of the business family structure. Finally,

ownership groups vary according to the family's relationship to the business: is the family an operator of, supervisor of or an investor in the business? Each variation of ownership has its own particular types of strengths and issues.

Purpose. Family owners of businesses can be distinguished by their central purpose for owning the company: for the rights to income that ownership grants, the ability to control and determine the direction of the enterprise, to be able to protect and perpetuate their family's legacy, and having membership in a "society" or special group defined by the ownership of the business. Owners of a family business might want to have all of these benefits, but usually one of these goals is paramount to the ownership group. As the owners' desire to protect and perpetuate their legacy and then to be part of a society becomes paramount, the stability of the company and the family's commitment to the company becomes more secure.

Size. Ownership of the family business may remain concentrated in one or a few persons over generations. More often, ownership becomes increasingly diluted over time, going from one owner to his or her children and then to cousins by the third or fourth generation. In little more than 50 years, a family ownership group can become huge. In some family business systems there are periodic buyouts of family owners, but buyouts in business families are rare.

As ownership groups grow from one to a few to several, then many, assuming that the owners are dividing the voting shares in the company, each owner has less influence in the ownership group, business and probably the family. Reduced voting power means an owner is less likely to block or disrupt the group's decisions; it can also mean that each owner feels less important and connected to the business. In addition to the size of the ownership group, one needs also to note the kind of owners in the group. Smaller ownership groups not only tend to be easier to keep informed but also tend to have more sensitive family relationships, have greater individual power and to be more volatile. Larger ownership groups generally require more effort to keep them informed and to coordinate decisions but they also tend to have less sensitive relations (because of cousin owners) and less individual power and so tend to be less volatile. Each type of ownership group needs a particular style of management to be effective.

Complexity. Most family companies around the world are entirely owned by members of the family, with no outside ownership. Some

family companies have minority owners besides the family. A friend or silent partner of the founder of the business sometimes makes an initial investment in the business. These shares are usually bought back by the end of the first generation or at the beginning of the second. A small number of families bring in investors to build the business; these investors usually must be bought out within several years or the business is sold or taken public. Sometimes key non-family managers in the company will own some shares. This is a rare occurrence but is becoming somewhat more common as companies compete to attract managerial talent. In some US companies, employee stock ownership plans sell company shares to the employees as a group.

Typically, an investor who is not employed in the business is not interested in holding a minority interest in a privately held family company because such an interest does not permit an influential voice in how the business will be run or how earnings will be allocated. Since most investors insist on control to invest in a private company and most owners of private companies do not want to relinquish control, the outside market for growth capital for a closely held company or to sell an individual's minority shares is quite limited. Unless one can find an outside buyer for an individual's or the company's shares, there is only an "internal" market for the stock. That is, the shareholders can buy and sell shares only with one another.

With no outside buyers for a family company's shares (who, by buying new shares, could add to the treasury of the company), the business must support itself through profits, bank debt, loans and deferred compensation from family members, other types of internal and external financing (asset based loans, ESOPs, etc.) and investments from other companies or groups (e.g., joint venture arrangements). If the company's reinvestment requirements and shareholder liquidity needs can be met in these ways, there are significant benefits to remaining strictly private. In some cases, however, the internal capital market for family companies limits a family company's growth and profit opportunities.

A relatively small number of family companies "go public" every year. In the US, UK, France, Hong Kong and other developed economies a small but steady number of family companies take the plunge with initial public offerings (IPOs) each year. In the late 1990s, stock markets in several developing countries such as Mexico, Brazil, Chile and the Philippines boomed and attracted many family businesses. Most family businesses that enter the public market sell only a minority interest (generally 20 to 40 percent) in their businesses, thus retaining family

control. In some cases, the shares that are traded publicly have no votes or fewer votes than the shares retained by the family.

Most family companies are not big enough or do not have the growth prospects to attract outside, especially public, shareholders. Some family companies *are* big or dynamic enough but *choose* to remain private. In fact, family companies like Levi-Strauss have gone to considerable lengths to buy back publicly held shares to regain the benefits of being privately held.

The motivations for remaining private are many. The major ones are for the owners to be able to make decisions quickly and to operate more secretly with the competition, being able to control the direction, management and culture of the organization, and having the authority for owners to flexibly compensate themselves. Because control of the business is so important to family owners, they are generally very reluctant to expand ownership and dilute their personal or their family's ownership control.

In some large, public companies, where ownership is diffuse and the family's shares constitute the largest voting block, a family might be able to control the company with a small percentage of the shares because they can elect the board of directors. The Marriott family, for instance, owns only 20 percent of Marriott International but has effective ownership control of this corporation.

Although outside ownership in a family company is relatively uncommon, when it occurs it generates a distinct set of issues. One involves balancing the family and outside shareholders' interests, especially in terms of financial returns. Public owners, especially institutional investors, and other non-family investors are generally more interested in short-term financial results while family owners typically seek more long-term financial results and emphasize other benefits such as status in the community or pride in the company. When external investors join the family owners, the board of directors, which must mediate these competing interests, must be constituted to achieve fair representation for all parties.

To maintain family shareholder loyalty with the presence of outside owners, the family must believe that this is still the family's business. This is more easily achieved when the family is still the controlling shareholder group. Even when this is the case, the family must feel it has a strong hand in the direction of the business. This might be achieved through family representation on the board, especially in the Chairman's role, but generally also requires family representation in top management, especially the CEO position. To maintain family

shareholder loyalty, it also helps to have a cadre of capable family employees who might become future business leaders. Of course, with significant outside owners, the family usually must support choosing the most competent successor for CEO regardless of ownership status, including from among non-family candidates. This is generally a very difficult step for a family to take.

Locus of control. Beyond noting the complexity of the ownership group, it is necessary to understand who among the owners has ownership control. There are several typical of controlling ownership groups: there is a sole owner of the company, there are only active owners, actives control the business but there are also passive owners, control is held jointly between active and passive owners, passives control the business but there are also active owners, and finally, there are only passive owners. Who has ultimate control within the ownership group and who is powerful within the group influences the priorities and risk appetite of the owners and of the family business.

Control of a family business involves both ownership control and management control. In a family business, the family-owner-managers of the company generally try to keep the ownership control of the company in the hands of the family, and the management control of the business with the family-owner-managers. Sometimes, ownership and management control is accomplished by having the actives (family-owner-managers) hold voting shares and the passives (family-owners) hold non-voting shares. Sometimes the actives are given the right to vote the trust(s) that control(s) the voting shares for the entire family. Most often, the actives maintain their management control by virtue of their being in the company with the advantages of knowing the business and having the information to make decisions.

In situations where the actives do not have firm ownership control of the company, it is essential that the actives build effective coalitions with their passive brethren. The loyalty of family shareholders to the family business is influenced by their trust in the family-owner-management of the company, shareholders' pride in the company and acceptable tangible rewards from the business. These factors determine if the shareholders want to retain their ownership of the company, and if the family-owner-managers will retain management control of the company.

The ability of the family-owner-managers to keep the family-owners satisfied with their management and loyal to the business depends on the actives' perceived competence and how the passives view their shareholding. Passives' view of their shareholding depends largely on

how distant – geographically or psychologically – they are from the family business. As passive family members move away from the founder generation in time, or as they move away from the business in physical distance, or in psychological distance, they are more likely to view their shareholding as a financial investment for which they want a market-level return. A third-generation shareholder who grew up in a town far away from the business and who has had little contact with his/her cousins who run the business, or who feels his/her branch of the family has been mistreated by the family, will be more likely to treat his/her shareholding like an investment. A second-generation shareholder whose immediate family works in the business, and who grew up visiting the business and hearing it talked about over dinner, will be more likely to view his/her shareholding as a sentimental asset that needs to be nurtured and passed on. It clearly helps management to have shareholders who view their role as responsible members of the “family team” who lead and steward the company. Shareholders are likely to fall into both camps, as family companies move into the third or later generation.

Developmental stage. There are three types of family business, defined by the involvement of the family with the business: Family Operator firms, Family Supervisor firms and Family Investor firms. The intensity of a family’s involvement with its business, and the family’s attachment to the business, influence the performance of the family and the business. If relatives are strongly attached to the organization, they can be united in their goals for it and in their willingness to contribute to it and this attachment can strengthen family bonds. Ultimately, this attachment can define a sense of mission for the organization that non-family companies rarely match.

Family Operator firms, also known as *family-owned and managed businesses*, are those family companies where family members run day-to-day operations of the business and generally do other important jobs in the business. Because the family has ownership control and ultimate management authority, it can determine business culture, objectives, strategies and policies. Family Operators definitely touch the Work of the business and are typically highly committed to the company and its culture and loyal to the employees. Most family businesses start in the Family Operator category and remain in this category until they sell or close the business.

A small number of family companies are Family Supervisor firms, where family members are not involved in day-to-day management but

still lead the business, perhaps through the role of chief executive officer or chairman of the board, but at least through the involvement of one or more family members on the board of directors. These leadership positions and ownership control gives the family a high level of influence over the company's direction, culture, strategies and policies. Because families in this category do not interact much with employees, loyalty to employees is more abstract and less personal. Family loyalty is focussed more on the culture of the business. While some family businesses start as Family Supervisor types, more often they start as Family Operator types and move into the Family Supervisor category. For this reason, Family Supervisor firms tend to be second or later generation and larger family companies. Most publicly traded family businesses are in this category.

In Family Investor firms, the family treats its company or companies as an investment and the family's role as being asset managers. The family has ownership control of the business and family members could be active on the board, but typically they have minimal board involvement. Family Investor firms are typically owned by holding companies with controlling investments in a number of businesses.¹ I find all sizes and ages of firms in the Family Investor category. Some family companies evolve from Family Operator or Family Supervisor types to this category, while other family businesses start here.

Family businesses may start and remain in any of these types. Or they may start in one category and shift to another type over time. Indeed, some shift to another type and then shift back to their original type. The starting point is the choice of the founder, generally a personal preference. After the founder, the choice of family involvement with the company is influenced by several factors: is there a strong family tradition to maintain an intense family involvement with the business?; does the family continue to produce one or more top managers of the business?; and does the business environment force the business to grow beyond what the company can self-fund out of cash flow? If the family tradition encourages active involvement with the business, the family continues to produce business leaders, and the company can fund its growth with its own cash plus debt, the company will probably remain a Family Operator type. On the other hand, the weaker the family's ability to manage the business, the weaker the family tradition about the business or its commitment to the business, the greater the pressure to grow the business but the weaker the ability to self-fund growth, the more likely it is that the business will shift from the Operator to the Supervisor and then to the Investor category.

Most business families that leave the Family Operator category generally lessen the intensity of the family's involvement with the business, probably reduce the family's commitment to the business, and move several steps closer to selling their business.

With so much riding on the intensity of a family's involvement with its business, how does one gauge it? The intensity of involvement families have with their businesses varies as described in the following table (see Table 6.4). Most Family Operators are intensely involved with their companies. While a Supervisor or Investor type family could have an intense involvement with a business in a few respects (ownership, board leadership, and future ownership plans) the overall intensity of involvement (across all the categories of involvement) is generally significantly lower than family involvement in the Family Operator firm.

For families that are intensely involved with their companies, the owning and running of these businesses is not just an investment or a job – it is a way of life. The business is a constant companion in family gatherings, the subject of many if not most family conversations, the focus for many family careers, a major measure of family status and a vital part of the family's identity – how family members define themselves. The business regulates the life of the business family. It largely determines when they have dinner, how they will spend their weekends and vacations, who will be invited to get-togethers at the family house and how status among family members will be determined.

Depending on the generation of the company and length of the family's association with it, the business takes on particular meanings for members of the owning family. For Family Operators, especially in early generations, the business is typically regarded as a part of the family and relatives often can have strong feelings about it. To a founder-father it often represents a wife, mistress, child or an extension of himself. For a son or daughter, especially if they grew up with the firm, the company is the father's creation or mistress and the child becomes its guardian, sibling or suitor. In a family system where there is adequate security and abundant nurturance, the family company will not as likely be perceived as a threatening rival or interloper. However, in a family where there is a prevailing struggle for security and a perceived lack of emotional resources, the family firm may be perceived as a displacing family member who takes away status and resources from real family members.

Strong attachments can have other negative effects on the family. Discussions about company responsibilities, success and organization control can to highly charged emotional confrontations. Relatives can become fierce rivals for the possession of this nurturing symbol.

Table 6.4 Intensity of family involvement with business

Type of Involvement	Intensity of Family Involvement			
	Strongest			Weakest
Family ownership of the business	Complete Ownership	Majority ownership and control	Minority ownership and control	Investment stake in the business
Family employment in the business	Family members occupy most key operating positions	Family members occupy some key operating positions	Family members employed but not in key positions	No family employees
Family leadership of operations	Family members lead operations	One family member leads operations	Family co-leads operations with non-family managers	Non-family managers lead operations
Family leadership of board	Family board chair with other influential family board members	Family board chair but no other influential family board members	Non-family leadership of board but family representatives on board	No family board members
Family plans to transition ownership and management	Family plans to transition ownership and leadership role(s) to next generation	Family plans to transition ownership and employment role(s) to next generation	Family plans to transition ownership to next generation	Family has no plans or opportunity to transition company to next generation
Sense of family tradition with the business	Strong sense of tradition	Some sense of tradition	Beginning sense of tradition	No sense of tradition
Family orientation to business	As a lifestyle and identity for the family	As an institution to protect and be a part of	As a long-term asset to own and manage	As a short-term asset to own
Meaning of business to family	Strong personalized attachment	Weak personalized attachment	Object or image to protect	Means to an end
Family identification with business	Family is the image of the prominent business	Clear family association with business	Weak family association with business	No family association with business

A business leader can fight to maintain control over the company and seem to love the firm more than he loves his children.

The most intense and personalized family attachments to a company occur in the first and second generations. Later generations can also feel personalized attachments to the organization, but this occurs less frequently. Over generations, if a family remains committed to owning a company, the family sees the company less like a living thing and more like an institution to be protected. As the family grows less committed to the company, the meaning of the company to the family tends to become more instrumental – a means to an end.

Business family categories

Business families (which we need to remember include the business owners and their dependants) also vary widely in terms of their age, purpose, size, complexity, locus of control and developmental stage. Over generations, business families typically become larger and more complex, their leadership (locus of control) moves from a patriarch or matriarch to joint leadership, and the family struggles to maintain its industrious edge. One business family might be described as a founder-generation, small, nuclear family with modest complexity, led by a patriarch at the generating stage; another might be classified as a third-generation, medium-sized, cousin family with moderate complexity, led by a team of branch leaders, at the complacency stage. A business family's purpose can also change.

Purpose. Business families can be distinguished by their emphasis of one of these four purposes:

- Economic survival and security of family members
- Economic and social advancement of family members
- Perpetuation of a group that has a common activity
- Being an institution to be maintained.

Each of the purposes can subsume the previous purposes. A Korean grocer family might be most concerned with the economic and social advancement of family members, having satisfied their economic survival and security concerns. The Rothschild family has become an institution, independent of its businesses, and their family purpose is to maintain this family institution with its reputation, economic resources and social status. If the family becomes an institution, its business activity may or may not be necessary for the family's survival as an institution. However, if the business and family are co-identified, as is the case with the Rothschild family, this co-branding helps perpetuate the business.

Size and complexity. If ownership in the business is concentrated with one descendant in each generation, a business family will remain a nuclear family – relatively small with modest complexity. But ownership tends to be passed relatively equally to children in each generation, meaning that as a business family extends over generations, it tends to grow in size and in family complexity. The single nuclear family of the first generation becomes a few nuclear families still connected to the original family, and then descendants organized in the branches of the second generation, and then sometimes organized into finer branch identities. This natural progression is captured in the family stages: nuclear family (or multiple nuclear families in Islamic culture), siblings and families, first cousins and families, distant cousins and families (often called a clan). A small number of family relationships expand to numerous types of family ties – parent-child, sibling, in-law, cousin, uncle-nephew, grandfather-granddaughter, and so on. A member of the business family will mostly be concerned about family life in his or her nuclear family, but because of business ties, this increasingly complex web of relationships assumes greater saliency. How an uncle feels about his son can impact the inheritance plans for the entire next generation; how the brothers' wives get along can influence the choice of the next company president.

Locus of control. Of course, a family's ability to maintain its sense of purpose, manage its complexity and stay united is influenced by its leadership. Different leadership structures evolve as families grow and become more diverse. Found mostly in nuclear families or families with adult siblings and their families, a patriarch or matriarch is the most centralized and powerful form of family leadership. A patriarch and matriarch – who may lead a business family individually or jointly – draw their power from their family roles, their ownership control, and usually from their leadership of the family business. These positions give the family leader legitimacy, authority, reward and coercive power. When a patriarch or matriarch exists in a large cousin family, the leader is usually a grandparent-business leader-controlling owner. In other cases, the patriarch may not control the business, but the family is closely connected and has an agreed way to choose family leaders.

The next most powerful business family leadership model is the first-among-equals leader. This leader, found mostly in sibling teams and sometimes among cousins, is usually an elder sibling or cousin-business leader-major owner, who relies on the support of his partners to exercise power. I have seen a few situations where the first-among-equals family leader is a major owner, but not a business leader and serves to balance the power of the family member who leads the business.

Families can also have co-leader relatives, besides husband and wife teams. Usually the co-leaders are leaders of their respective family branches, important owners and senior managers or board members of the family company or other important family activities, such as family philanthropy. When co-leaders are aligned on goals and principles and prefer to lead together, this can be a very powerful leadership model. When co-leaders are not aligned in these ways, this can be an unstable and destabilizing arrangement for the family and business.

Alternatively, a family can exhibit a random leadership pattern, where leadership comes from various individuals at various times, with no consistent sense of direction or stability in family decision-making. Often, this leadership confuses and divides a family. Families in decline, in any generation – like a flickering light bulb – often exhibit this pattern.

Finally, a family can abrogate its own leadership to non-family professionals. Sometimes non-family board members and executives of the family business, non-family family office leaders and other non-family advisors (lawyers and financial advisors) fill this role. In some cases, the non-family professional is a true friend of the family and, like a regent, protects the interests of the family and develops the next generation to assume leadership responsibilities. In one case that made the newspapers this year, lawyers in charge of the family trust kept a prominent business family in a divided, dependent position, unable to exercise control of their business or to create coherent family policy.

While leadership in any of these forms can be helpful or harmful, knowing what type of leadership is in place in a family is the first step to understanding how it is functioning.

Developmental stage. Families, like businesses, have life cycles. They have a generation stage and then have opportunities in each succeeding generation to learn from their successes and mistakes and regenerate their successful qualities. Some business families are founded with qualities that create a foundation for later success – what I term the Generation Stage. Later generations may build on this advantage and learn to regenerate the success factors that keep the family industrious. This process can continue indefinitely. Those families that do not regenerate typically slip into a period of complacency, resting on their laurels, living off of past achievements and ignoring the warning signs of decline. Those families that do not change their behaviors generally go into decline. Decline is not immutable, however. Some families, like the Rothschilds, rebound in later generations. The key indicators of each stage are in the table below (see Table 6.5).

Table 6.5 Family stage characteristics

Family Stage	Sense of Being a Family with a Purpose	Ability to Recreate Family Dream	Ability to Learn from Successes and Mistakes	Sense of Duty to Family	Commitment to Family and Business Principles	Hard Work and Self-Improvement	Innovative, Principled, Trusted Leadership	Priority of Wealth, Comfort, Status
	• Create things of lasting value • Support the family's enterprise			• Create things of lasting value • Support the family and family's enterprise • Represent the family well • Ask for little financial aid				
Generation Regeneration	Strong Strong	Strong Strong	Strong Strong	Strong Moderate to Strong	Strong Strong	Widespread Widespread	Present Present	Low Low to Medium
Complacency	Moderate	Moderate to Weak	Moderate	Moderate	Moderate	Varies	Not Present	High
Decline	Weak	Weak	Weak	Weak	Weak	Limited	Not Present	High

From categories to family business types

These business, ownership and family categories create a way to classify any family business system. Each category is technically a choice. The business does not have to become large or diverse. The ownership group and business family can remain small. The family can maintain certain attitudes and practices that allow it to regenerate itself in each generation. Given the millions of family business systems, there are undoubtedly systems with every combination of business, family and ownership categories described here.

But, almost all family companies fall into eight discrete types.

Type 1 Economic provider family business

- Family Operator Type
- Control: one or more family members owns and leads the business, usually no passive owners or non-family owners
- Business Purpose: Economic Provider where the business is to serve current family needs. The family has no long-term commitment to the business; the business may be continued by the family if the business meets ongoing family needs
- Business Size and Complexity: typically small and simple
- Business Family: supports business so it can support the family; often tries to launch other careers, businesses and investments for family members

Type 2 Entrepreneurial venture family business

- Family Operator, Supervisor or Investor Type
- Control: typically one or more family members own and lead the business; usually no passive owners, but may have non-family or public owners
- Business Purpose: Entrepreneurial Venture, where the family has no long-term commitment to the business; the business may be continued by the family if the business meets ongoing family needs
- Business Size and Complexity: varies
- Business Family: interested but not committed to the business; supports other activities for family members (other careers, businesses, investments, civic or philanthropic activities, etc.)

Type 3 Private owner-manager family business

- Family Operator Type

- Control: only family owner-managers – generally one controlling owner or sibling partners, and usually no non-family owners
- Business Purpose: usually a Multi-Generational Economic Activity; efforts to recruit and develop one or more family successors; family commitment to business depends on trust, pride and money factors
- Business Size: typically small to medium sized
- Business Complexity: typically low
- Business Family: one or a few nuclear families, highly involved with the business; may or may not encourage other activities for family members (other careers, businesses, investments, civic or philanthropic activities, etc.)

Type 4 Private active-controlled family business

- Family Operator Type
- Control: one or more family owner-managers controlling and leading the business, with passive owners and perhaps non-family owners
- Business Purpose: usually a Multi-Generational Economic Activity; efforts to recruit and develop one or more family successors; continued family commitment depends on trust, pride and money factors
- Business Size: typically small to medium sized
- Business Complexity: typically low
- Business Family: family involvement in the business strongest in actives' nuclear families; family commitment depends on trust, pride and money factors; family members active in a variety of careers, businesses, investments, philanthropic activities, etc.

Type 5 Private passive-controlled family business

- Family Operator Type
- Control: one or more family owner-managers lead the business but passives control it
- Business Purpose: usually a Multi-Generational Economic Activity; efforts to recruit and develop one or more family successors; continued family commitment depends on trust, pride and money factors
- Business Size: varies
- Business Complexity: typically low
- Business Family: family involvement in the business strongest in actives' nuclear families; family commitment depends on trust, pride and money factors; family members active in a variety of careers, businesses, investments, philanthropic activities, etc.

Type 6 Private non-family managed family business

- Family Supervisor or Investor Type
- Control: ownership control by passives; one or more family members generally control the board and the family ownership group is usually involved in big company decisions
- Non-family managers lead the business; there may be family employees
- Business Size and Complexity: the business is usually at least moderate sized and often is large and complex
- Purpose: usually a Multi-Generational Economic Activity; family may recruit and develop one or more family successors to return to Type 5; continued family commitment depends on trust, pride and money factors
- Business Family: generally only a few family members are very involved or informed about the business; family commitment depends on trust, pride and money factors; family members are typically active in a variety of careers, businesses, investments, philanthropic activities, etc.

Type 7 Public-family controlled business

- Family Operator, Supervisor or Investor Type
- Control: ownership control by actives or passives; there may be significant public ownership; one or more family members generally control board but family ownership group is buffered from big company decisions
- Family and/or non-family managers lead the business; there may be family employees
- Business Size and Complexity: the business is usually at least moderate sized and usually large and complex
- Purpose: usually a Multi-Generational Economic Activity; family may recruit and develop one or more family successors
- Business Family: family involvement in and commitment to the business are typically low and depend on trust, pride and money factors; generally only a few family members are very involved or knowledgeable about the business; family commitment depends on trust, pride and money factors; family members are typically active in a variety of careers, businesses, investments, philanthropic activities, etc.

Type 8 Family business groups

- Family Operator, Supervisor or Investor Type
- Control: ownership control by actives or passives; there may be significant public ownership; one or more family members generally

control board but family ownership group is buffered from big company decisions

- Family and/or non-family managers lead the business; there may be family employees
- Business Size and Complexity: the business is usually large, complex and widely diversified
- Purpose: usually a Multi-Generational Economic Activity; family may recruit and develop one or more family successors
- Business Family: Family involvement in and commitment to the business depends on trust, pride and money factors; generally only a few family members are very involved or knowledgeable about the business; family commitment depends on trust, pride and money factors; family members are typically active in a variety of careers, businesses, investments, philanthropic activities, etc.

These eight types emphasize the diversity of family businesses and family business systems. The character of the system varies significantly from one type to the next. Most family business systems stay in one type their entire life; other family business systems will change types.

Conclusions

The field of family business has developed rapidly in the last two decades but much still needs to be done to build a foundation of commonly held frameworks, classifications, and terminology in the field. Hopefully, the ways proposed here for categorizing family business systems will lead to further refinements in our typologies, greater standardization in the language of the field, and advances in our understanding of how these complex systems adapt and evolve over time.

Note

1. Just because a family business involves a holding company with operating businesses does not make it a Family Investor firm. Even when a holding company is used, the owning family could still be quite involved in the operating businesses.

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7

Embeddedness of Owner-Managers: The Moderating Role of Values

Sabine B. Klein

Introduction

Owner-managers have a central role within the family business system. They are at the center of the four subsystems which constitute a family business, namely the family, the business, the ownership system and the leadership system (Pieper and Klein, 2007). While family business research has traditionally not distinguished between sole entrepreneurs and family business owner-managers with multiple ties from business to family and vice versa, Miller and colleagues (2007) show that whether or not the owner-manager is embedded in a family that actively contributes to a business makes an important difference.

Following this line of argumentation, this chapter investigates the role of the owner-manager's values and its influence onto how s/he is embedded in her/his environment. The underlying hypotheses are that owner-managers with strong non-economic, long-term goals are more deeply embedded in the local society as well as in their own family and social networks. Opposite to this, sole entrepreneurs are rather financially and short-term oriented and tend to more easily shed ties to their local society.

The study makes several contributions to theory and practice. By questioning the homogeneity of the owner-managers group, this study adds to our understanding about the diversity of family businesses. At the same time, I help researchers to clearly focus their work on only one type at a time, and by doing so, avoiding flaws in their studies, such as Miller and colleagues (2007) show for several studies on performance. Bringing the values of the owner-managers into play, I add to several streams of literature which build on different models of man, such as principal-agency theory or stewardship theory. I also add to practice in

clarifying the underlying rationales of different types of owner-managers. In knowing what kind of owner-manager one is dealing with, the consequences of different choices will become clearer. An owner-manager who is rather a sole entrepreneur and not embedded will, for example, be more approachable in terms of selling her/his business than a deeply embedded owner-manager (Klein and Blondel, 2004). On the other hand, an embedded owner-manager will more likely accept personal disadvantages in order to stay in the business, than his sole entrepreneurial counterpart (Astrachan and Jaskiewicz, forthcoming).

The remainder of this chapter is organized as follows. First, I define the concepts used, such as family business, owner-managers, embeddedness and values. Second, a model is developed to connect the value profile and the level of embeddedness of the owner-manager of a family business. In the central section, hypotheses are derived highlighting the relationship and its potential consequences for family businesses and their environment. The chapter closes with conclusions, implications for theory and practice, as well as limitations and future research projects.

Family business, owner-manager, embeddedness and value: definitions and distinctions

Family business has been defined over and over again. Still, there is no single accepted definition yet. Two streams of definitions have been distinguished: the component-of-involvement approach and the essence approach (Chrisman, Chua and Sharma, 2003), which from the point of view of Chrisman and colleagues (2003) are integrated, at least to a certain extent, in the F-PEC (Astrachan, Klein and Smyrnios, 2002; Klein, Astrachan and Smyrnios, 2005), a scale to grasp different levels of family influence. For this paper, a *family business* is defined as a business onto which a family has substantial influence directly or indirectly determining the business' long-term strategy. A family hereby is seen as a group of people related by blood and/or marriage and/or adoption.

A central role in a specific group of family businesses is linked to the *owner-manager*. While there are family businesses solely led by non-family members in management roles, in different studies around the world most of the companies classified as family businesses are led by members of the owning family or – in the case of first-generation businesses – by their founder (see, e.g., Klein, 2000). These owner-managers can exert a higher level of power than non-family managers, since they have three

simultaneous roles with respective duties and rights coming with them: (1) a family member; (2) an owner; and (3) a manager (often CEO).

These owner-managers are more or less embedded in their respective families, companies and environment. Marsden (1981) states that exchange within groups has a pattern which constrains the set of actions available to actors, which is what embeddedness refers to. Following Mitchell and colleagues (2001), embeddedness has three dimensions: (1) the extent of links with other people or activities; (2) the extent to which their jobs and communities fit other aspects in their "life spaces"; and (3) the cost of leaving their present settings. All three dimensions are regarded with respect to the company and to the community. In this chapter, I define *embeddedness* as the level to which an individual either cannot, or does not want to, leave the business, and if so, what costs are associated with leaving.

Lastly, the concept of *values* has to be defined. Following Sørensen, there are two modern concepts of value, "an economic one trying to explain value in terms of utility, interest or preferences, and an ideal one considering values as ends in themselves" (2002: 116). In this chapter, I follow the view of Kant who stated that any good can only have a price, but not an intrinsic value (Kant, cited after Sørensen, 2002). In this respect, Rokeach (1973) distinguishes two types, namely instrumental and terminal values. Values here are viewed as constructs on a high level of abstraction at the intersection of the individual and society. They are rooted in upbringing and education; help the individual with orientation, and influence perception and behavior. Contrary to *attitudes*, values are relatively stable over time and situations, and implicate a high level of emotionality (Klein, 1991: 25). To distinguish values from attitudes, the stability over time and cross-situations are the most relevant criteria (Rokeach, 1973).

Model development linking values and embeddedness of owner-managers

In order to understand values and their influence on individual behavior, we had best look at the development of a set of individual values over time. A firstborn child learns from consequences of behavior which then form a set of attitudes. These attitudes are bonded to specific situations, such as "I am hungry." The child learned that crying when hungry leads to being fed. By abstracting from being hungry, an attitude of "I want attention, crying helps" might evolve. By either sanctioning or supporting this behavior, the parents strengthen or weaken this respective

attitude. Let's assume the parents strengthen this attitude, and over time it might result (with support of other value-oriented interventions of the environment) in a terminal value of "attention for me."

Parallel to this development, a child has several role models who follow their own set of values. This becomes most obvious when we look at families with a clear religious set of values. Here, the set of instrumental and terminal values is additionally rooted in an idea of sense of life. Derived from this sense of life, clear criteria are stated such as "Thou shalt not lie" or "Thou shalt love the other above yourself." We can conclude that values are rooted in both personal development and experience over time, and influence stemming from parents and peers (and their respective set of values). Following Klein's (1991) model, values rooted in a sense of life, firstly, influence attitudes which then, in a special situation, lead to behavior from which experience results. Figure 7.1 sums up the intersections of sense of life, values (both instrumental and terminal), attitude, situation and behavior.

Klein (1991) showed that not only the content of values and if they are viewed as instrumental or terminal values differs, but also the differentiation and awareness of the individual concerning her/his values.

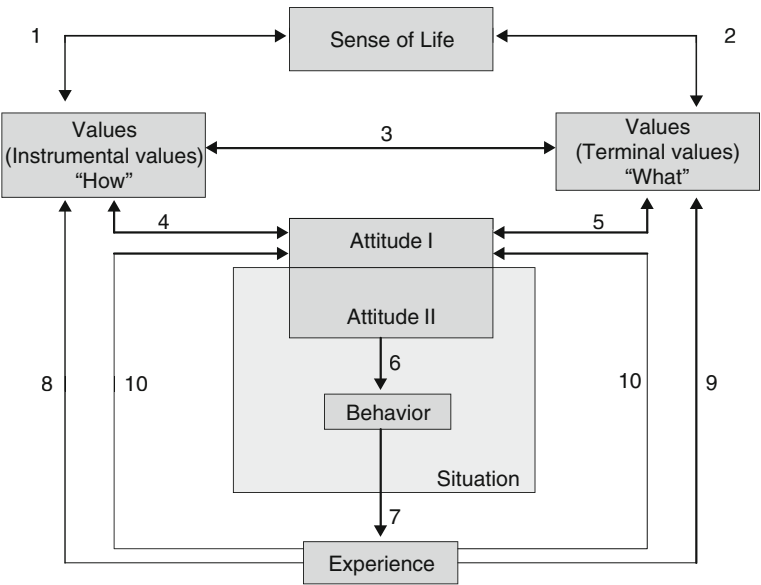


Figure 7.1 Value-attitude-interaction-model (Klein, 1991: 44)

When discussing the influence of values on the embeddedness of owner-managers, I will therefore distinguish between the content and the level of awareness and distinction of the respective value profile. Concerning the content of value profiles, one has to be aware that value profiles vary to a great extent, and the analysis of value profiles requires a great effort.

Now, under what conditions an owner-manager either does not want to or cannot leave the family business is the remaining question. While embeddedness is relating the individual to (a) the company, and (b) the community, *commitment* is describing an attitude of the individual (Sharma and Irving, 2005). They distinguish four bases of commitment, namely affective, normative, calculative and imperative, which have different influences on a successor's overall commitment towards the family business. Commitment here can be seen as an attitude of the individual towards the company and the community. This attitude translates into embeddedness, and breeds behavior in a specific situation (see Figure 7.2).

Following the line of argumentation of Sharma and Irving (2005), the different types of commitment – stemming from different values – will

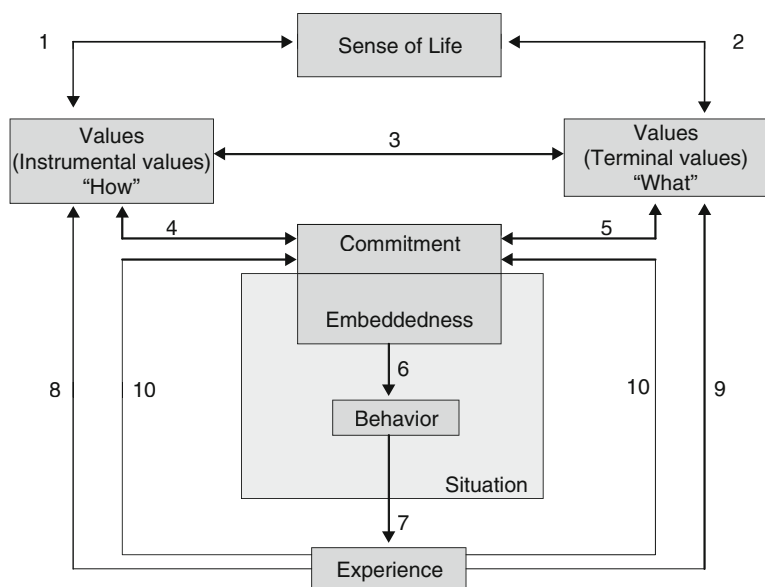


Figure 7.2 Value-commitment-embeddedness-interaction-model

result in different types of embeddedness. There is affective, normative, calculative and imperative embeddedness which results in different behavior in a given situation. While affective embeddedness is found when the owner-manager loves his company and the community, normative embeddedness is found when s/he feels obliged to be with and stay in the company. Calculative embeddedness can be described as building links to the company and the community in order to (better) reach one's goals, and/or to avoid costs of leaving. Lastly, imperative embeddedness has its roots in feelings of anxiety, which are linked to feelings of self-doubt and uncertainty in terms of one's capability to pursue a career outside the family's business.

To give an example, when an outgoing owner requires her/his successor to move with the family to the little village where the company is located, the embeddedness resulting from this situation will be normative. If the successor accepts the request because s/he believes it makes sense to get better connected, it becomes calculative embeddedness. As all forefathers have moved into the little village when taking over the lead, and s/he does not dare to contradict because of a lack of self-esteem, this might also be imperative embeddedness. Only later, when the link to the company and village is rooted in the successor's own feeling, does it become affective embeddedness.

The main hypothesis of this chapter is that the level and kind of embeddedness of an owner-manager is rooted in her/his values. In the following section, hypotheses are developed about these relationships.

Embeddedness of owner-managers – the moderating role of values

The value sets of different individuals differ to a great extent. They differ in content, awareness and level of differentiation. The level of differentiation here is defined as the level of abstraction, distinction, integration, intensity and clarity (Klein, 1991: 153ff.). Klein (1991) could show that only when the level of differentiation and awareness was high, there was a correlation found between the content of the value profile of owner-managers and the values of the organizational culture of the respective family firm (see Figure 7.3). I therefore hypothesize as follows:

Hypothesis 1a: The higher the level of differentiation of the respective value profile of the owner-manager, the higher the influence onto the overall level of embeddedness.

Hypothesis 1b: The higher the level of awareness of the respective value profile of the owner-manager, the higher the influence onto the overall level of embeddedness.

Looking at the content of value profiles, the question is whether or not those values are rooted in special principles. Van Marrewijk and Werre (2002) differentiate between compliance-driven, profit-driven, care-driven and systemic-driven principles. While compliance-driven principles concentrate on order, profit-driven focusses on success, care-driven on community and systemic-driven on synergy. They combine these principles not only with values, but also with, for example, decision structure, leadership style, communication, people and management style. One can assume that the different values rooted in different principles lead to (a) different types of commitment, and (b) different overall levels of commitment (see Figure 7.4).

Hypothesis 2a: Compliance-driven values such as duty, obedience or discipline lead to normative embeddedness.

Hypothesis 2b: Compliance-driven values such as duty, obedience or discipline lead to imperative embeddedness.

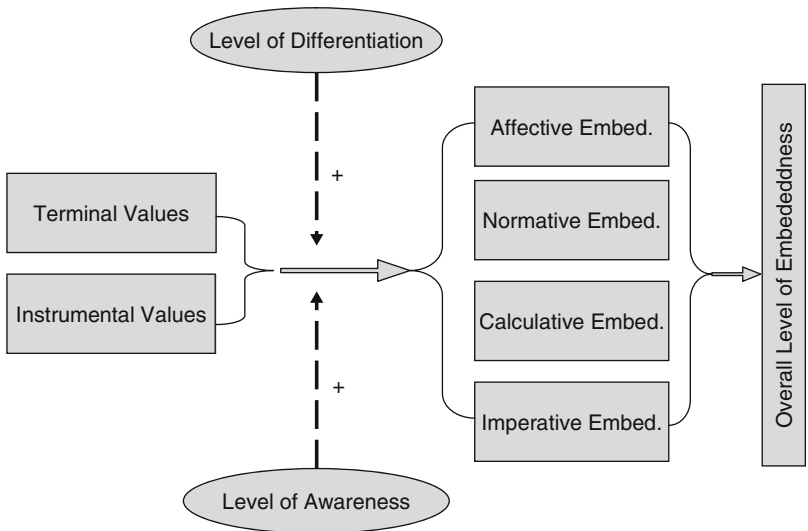


Figure 7.3 The influence of values on embeddedness: moderating variables

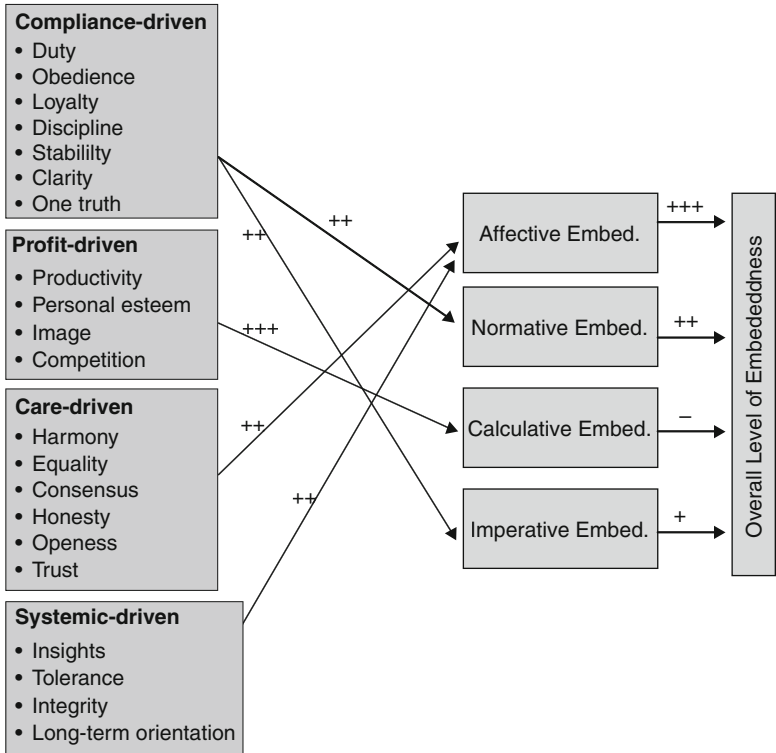


Figure 7.4 Values driven by different principles and their effect on embeddedness

Hypothesis 3: Profit-driven values such as productivity, personal esteem, image and competition lead to calculative embeddedness.

Hypothesis 4: Care-driven values such as harmony, equality, consensus, honesty, openness and trust lead to affective embeddedness.

Hypothesis 5: Systemic-driven values such as insights, tolerance, integrity and long-term orientation lead to affective embeddedness.

Affective embeddedness stemming from trust and long-term orientation – among others – will lead to the strongest influence on the overall level of embeddedness. Embeddedness, as the level of whether an individual cannot or does not want to leave, stems here from the desire to stay rather than from the need to stay. Imperative embeddedness in turn stems from the feeling of not being able to leave; *ergo* opposite to

affective embeddedness, it is a compulsive form of embeddedness. It therefore will not influence the overall level of embeddedness as positively as affective embeddedness. Normative embeddedness is mostly rooted in compliance-driven values, and will only support the overall embeddedness. It is rather extrinsic than intrinsic in nature, and therefore is not as powerful as affective embeddedness.

While all three discussed forms of embeddedness have a positive influence on the overall level of embeddedness, I assume the influence of calculative embeddedness to be rather negative. Calculative embeddedness is extrinsic and is short-term by nature. If the calculative embedded owner-manager (whose values are profit-driven) sees better opportunities elsewhere, there is no need or desire to stay any longer.

Conclusion and outlook

This paper connects values, both terminal and instrumental, with the level and type of embeddedness, especially of owner-managers. It was hypothesized that affective and normative embeddedness have the strongest influence on the overall level of embeddedness, whereas calculative embeddedness, because of its short-term character, has a rather negative influence. While affective embeddedness of the owner-manager stems from her/his care- and systemic-driven values such as trust and integrity, profit-driven values lead to calculative embeddedness. Compliance-driven values can lead to both normative and imperative embeddedness. The level of influence of the owner-managers values on embeddedness is moderated by her/his level of awareness and differentiation of the respective value profile.

The chapter makes several contributions to theory and practice. First, it adds to our understanding of the embeddedness concept, which is seen here as a multi-dimensional construct. Instead of differentiation between embeddedness in the company and embeddedness in the community (Lee et al., 2004; Mitchell, Holtom et al., 2001), embeddedness here is differentiated through its respective quality. Especially within the family business and entrepreneurship field, this point of view opens an arena for further relevant research. By distinguishing, for example, the types of embeddedness of owner-managers, we might be able to define different types, and by that, find out how to motivate them to step down and hand over the business to the next generation. Owner-managers usually try to stay as embedded as they were when retiring. Only by knowing the type of embeddedness can the incoming generation satisfy the needs of the elder.

Second, we add to research on values and their influence on the individual and the organization. As different types of values lead to different outcomes, and therefore also to different organizational cultures, an analysis of the dominating values might help to better develop strategies that not only “fit” the respective markets, but which also “fit” the owner-managers and their families. As values are stated to be rather stable over time, it does not make sense to try to influence the values of an adult, but rather to take the values into consideration. It might be time to accept that values are both facilitators and restrictive elements at the same time.

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8

Single Family Offices: The Art of Effective Wealth Management¹

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Single family offices (SFOs), which are professional organizations dedicated to managing family wealth and family matters, represent the leading edge of a broad trend in substantial personal wealth accumulation. The worldwide concentration of wealth in the hands of relatively few is well documented. As the rich grow even richer, and particularly as fortunes filter down through generations, wealth management becomes ever more complex. It is in this context that SFOs – dedicated to the service of one multi-millionaire or billionaire family – have evolved.

The combination of substantial resources and individual decision-making can result in a great deal of creativity. Indeed, large private investors have been at the forefront of the development of new asset classes and investment vehicles such as hedge funds, private equity and venture capital. Given the scale of family offices, even slight improvements in practices can yield substantial benefits, particularly when these incremental enhancements are compounded over long periods of time. Most family offices are designed with a multi-generational perspective and a core purpose of ensuring the smooth transfer of family wealth from one generation to another.

Yet it is not easy for family offices to compare themselves against a standard, as no such aggregated perspective exists on a global scale. There is, however, a clear desire among family offices to understand better how their own organization and practices compare to those of their peers. Family members and professionals in SFOs participated in our study because they recognized that by doing so they would have an opportunity to learn about a wide range of family office structures and practices without sacrificing their anonymity or risking a commercial solicitation.

We therefore developed a research project to find out more about how SFOs are configured and function in countries around the world, aiming to identify major trends or common structures. Our hypothesis was that although SFOs vary according to each family's needs, some general trends would exist. Furthermore, we believed that valuable insights were likely to result from exploring SFO characteristics and practices across a range of cultures and political systems.

Our international pilot study took place in 2006–7 and forms the basis of one of the first comprehensive international academic studies of SFOs, conducted under the auspices of the Wharton Global Family Alliance. We believe that this research will pave the way for more comprehensive studies in the future as well as provide a starting point for families to compare their family office structure and practices – particularly investment strategies – to those of their peers around the world.

We begin this chapter by, first, reviewing the historical evolution of SFOs and the scant literature about them. We go on to explain the parameters of our study, and its methodology – the 42 pilot in-person interviews – and the subsequent development of our survey instrument. Finally, we discuss some of our preliminary findings, and insights that emerge from the data we collected.

1 The evolution of the family office

Single family offices have a long history. In ancient Rome, the *major domus* (head of the house) was in charge of the treasury and servants, a role that was transformed into the major-domo, or chief steward of a great household, by the Middle Ages. In the Frankish kingdoms of the seventh and eighth centuries, the major-domo was often the true power behind the throne. From the fourteenth to eighteenth centuries the term “superintendent” was often used to describe the person who managed the household of a rich family.

Trusts, an important tool of intergenerational wealth transfer, had their origin in the wars and crusades of the twelfth and thirteenth centuries. They largely evolved out of the problems of returning English crusaders, who had entrusted someone to mind the family lands and assets during their absence, but found it hard to reclaim their property upon return. From the mid-eighteenth century, continental European families traditionally handed down their wealth to future generations by way of the *fideicomisum*, which essentially prevented the sale or division of a family's core assets over generations. These same benefits were granted in England and Wales through the use of trusts.

During the Industrial Revolution, bank trust officers took on an increasingly fiduciary role in assisting wealthy families. The family offices of the time were very basic, focussing on serving a single-generation family and protecting its assets. As the Industrial Revolution spawned bigger corporations, with new forms of ownership and sources of wealth, the need to separate the management of wealth from the operating business and the family's personal and financial affairs became evident, spawning the first separate family offices.

According to Gray (2005), the European private banking model was carried to the New World in the eighteenth century by people such as John Pierpont Morgan (J. P. Morgan, 1800s) and Stephen Girard (Bank of Stephen Girard in Philadelphia, 1812, which became part of Mellon Financial Corporation in 1983). Private banks, which grew out of the goldsmith banks, eventually partnered trust companies to provide a wider range of services for the affluent.

Successful entrepreneurs found themselves at the helm of big corporations, running ever-expanding businesses or starting new ones, investing in other companies and diversifying their holdings. Families such as the Rockefellers, Carnegies, Fords, Vanderbilts, Roosevelts and Morgans built up such large fortunes that they faced the dual demand of managing both their businesses and their huge asset pools (Gray, 2005). The responsibility for wealth management was increasingly borne by the family's business staff, not all of whom were family members. In 1838, the Morgan family created the House of Morgan to manage family patrimony issues. The House of Morgan gave rise to one of the first modern family offices, a model then also applied by the Guggenheim, Dupont and Vanderbilt families.

2 Prior SFO research

Literature on the modern family office is scarce, and there is even less on SFOs. Part of the reason is that wealthy families want privacy. Another hurdle is that, depending on how it is defined, "family office" can cover a multitude of office structures, ranging from one family member doing administrative tasks for his or her family alongside other tasks in a family business, to a team of professionals focussed on investment, accounting, legal affairs and concierge services (Avery, 2004; Martiros and Millay, 2006).

Indeed, the various definitions proposed by practitioners include: an organization to support a specific family's financial needs (from strategic asset allocation to record keeping and reporting) (Wolosky, 2002); a

center of influence and stability to help exceptionally wealthy families ensure the preservation and growth of their financial assets and family heritage (Avery, 2004); and a structure created to manage the assets of a wealthy family (Curtis, 2001). Private Banks that offer Family Office services also handle the management of the assorted financial and operating affairs of a family fortune, including providing financial expertise, privacy and the integration of the family's wealth and operations, serving as a clearinghouse for investment and accounting services, assisting with philanthropic endeavors, and offering additional educational and advisory programs.

Based on its comprehensiveness and simplicity, we adopted the following definition of an SFO: "a professional center dedicated to serving the financial and personal needs of an affluent family" (Amit, 2006). An SFO could also take the form of a trust or any other legal structure.

As mentioned earlier, a common scenario is when a family business is so successful that it presents a dual challenge: the continuing management of the business itself and that of the fortune that the family has amassed. Many such families resort to specialized help in managing their assets, typically in accounting and record-keeping (Wolosky, 2002). This need for outside assistance is usually accentuated by the sale of the family business and the sudden liquidation of an immense amount of wealth (Avery, 2004). Second and subsequent generations, who inherit large fortunes or acquire them suddenly through the sale of a family business, often lack the time and expertise to manage their vast wealth wisely.

It's easy to see why such families need help, but why turn to a family office rather than another wealth optimization service? Curtis (2001) quotes a family office manager in addressing this: "The most fundamental reason has to do with the challenge of stewardship: no one will take your issues as seriously as you will take them yourself." Indeed, previous studies suggest that individualized service, confidentiality, control and flexibility are among the key benefits cited by families who have family offices (Avery, 2004).

Family offices are reckoned to provide more customized solutions, confidentiality, and greater involvement and commitment than other alternatives. They are also more trusted to handle issues that the family wants kept away from the public eye. The family office is typically treated almost as part of the family (Avery, 2004; Newton, 2002) and seen as the best means of preserving trans-generational wealth (Avery, 2004). Other key factors are privacy, the absence of conflicting interests

(such as those due to primary vs. secondary clients' issues), flexible structure, exclusivity and discretion (Allen, 2007).

The literature also reveals some interesting differences in priorities. For example, increased control is one of the top reasons cited by families for using an SFO or multi-family office (MFO) – a commercial enterprise serving several families. Yet ask the manager of a commercial family office what his or her top priority is, and control is not even on the radar – profit generation is the most commonly cited prime pursuit. In contrast, profit generation was not even mentioned when SFO managers were surveyed on their key objectives (Shaw Grove and Prince, 2004). In a similar vein, increasing the happiness and enhancing the lifestyle of family members, and providing family leadership by preparing the next generation for their responsibilities, are valid and important, though non-commercial, criteria for success in an SFO context (Gray, 2004).

These different priorities and motivations are worth bearing in mind as they also affect decisions about services provided, recruitment criteria (both for in-house and outsourced personnel), governance mechanisms, performance measurement and future vision for the family office market.

Finally, amid the increasing number of family offices and hybrid forms, there is also more demand for elite wealth management professionals to work in SFOs. Family offices often appeal to such professionals for lifestyle reasons, not just remuneration and career advancement (Avery, 2004). Several articles cover the qualities needed to work in an SFO, including a liking for detail and dealing with family dynamics, and more than one area of expertise (Wolosky, 2002). These qualities should be combined with the ability to handle multi-generational complexities, numerous entities, the unique goals of each family member, and the inevitable emotional issues (Bowen, 2004).

The literature reflects this diversity. Most articles cover various alternatives for the management of great wealth, among them different types of family office service providers, rather than focussing on one specific type (Avery, 2004; Gray, 2004, 2005; Newton, 2002; Shaw Grove and Prince, 2004; Wolosky, 2002). It is also worth mentioning here that in recent years, small companies that specialize in one service have been acquired by bigger companies that want to provide a full range of services to families. One example of this is concierge services, which often make the client feel they are receiving more personal attention (Avery, 2004).

Other articles address issues of most relevance to practitioners employed or looking for work within the family office niche (Bowen, 2004; Curtis, 2001; Newton, 2002; Prince and File, 1998).

What is evident from the literature is why the very affluent are increasingly using SFOs – they value factors such as privacy, control, flexibility and individualized service. What is lacking in the literature, however, is guidance on how to gauge how well SFOs are delivering on these and other key performance criteria. The very confidentiality they afford impedes assessment of their competence. In fact, preliminary research (Martiros and Millay, 2006) suggests that SFOs are looking for knowledge forums that would provide standardization of practice and more market transparency, in order to ensure more consistent and effective experience. Another key knowledge gap, when it comes to setting benchmarks, is that not much is known about the main differentiators among the plethora of SFOs operating today.

3 The pilot interviews

The study presented here is part of a joint project by four leading business schools – Wharton, IESE Business School, SDA Bocconi and Singapore Management University – under the auspices of the Wharton Global Family Alliance (GFA). Specifically, it is part of an ongoing Family Office Research Project, a cross-continental study that has the aim of researching and sharing best practices of globally influential family enterprises, and establishing a framework for understanding the evolution of family offices.

The popular perception is that each SFO is idiosyncratic, reflecting the objectives, priorities and history of a unique family. Although there is some truth in this, we hypothesized that there were some trends and common configurations that could be discerned.

The first exploratory stage of our research involved an in-depth clinical analysis of individual cases as part of a pilot study of SFOs.² To expand our understanding of SFOs, as well as to find out what families and SFO heads saw as priorities, we followed the example of Glaser and Strauss (1967) and Strauss (1987) who stress that practicing empirical research is the best way to uncover tacit knowledge.

To collect the necessary data it was important to use a method that allowed us to spend sufficient time with informants, the flexibility to change question sequencing where necessary, the handling of very complex issues, and avoidance of non-response issues (Dilman, 1978). Flexibility was also important for detecting any new variables that might appear as the research progressed (Eisenhardt, 1989).

Personal interviews are the most effective way of gathering essential information and meeting these criteria. They reveal categories, variables,

concepts and potential measures, in turn helping to formulate a preliminary hypothesis for later follow-up study (Eisenhardt, 1989). It was not the objective of this project to generalize the findings to the wider SFO population (statistical generalization, Yin, 1994): that goal was reserved for the next step in the research project.

Potential disadvantages such as accuracy of response, problems of social desirability bias, omissions (under-reporting of frequency of events), telescoping (over-reporting) (Bradburn, 1979; Sudman and Bradburn, 1974) and the like were addressed by triangulating information where possible.

Our study was unique in that we decided to target only non-commercial SFOs managing more than \$100m (approximately €83m) in investable assets. While some banks define assets under management (AuM) more narrowly, we agreed to a more inclusive concept of investable assets, encompassing real estate, private equity, and hedge funds.

To select subjects for our 42 pilot interviews we applied the following criteria to the SFOs we had identified. First, we sought SFOs of close proximity to the interviewee (to increase information depth and relevance), and second, we looked for variation in terms of geographical location, SFO age and family wealth level (although in keeping with our definition, all had to have a minimum of \$100m in investable assets).

The pilot interviews – 22 in Europe, 16 in the USA and four in the rest of the world (RoW) – took place from September to December 2006. About 75 per cent took place with the head of the SFO or main investment professional (usually the Chief Investment Officer) and the rest with a family member who was well-informed about the SFO.

As various people were to conduct the interviews, we developed an interview protocol designed to facilitate internal congruency and strengthen the internal validity of the data (Yin, 1994). We used wording that would be understood and interpreted equally in all countries. The questions were designed to identify key aspects of SFO structure, and to gather information such as the SFO's primary role, its rationale, use of outsourcing, reporting processes and perceived performance.

The pilot interviews involved recorded, one-to-one questioning, in person for all but five of the 42, which were conducted by telephone. Each interview lasted at least 90 minutes. In some cases the interviewer was not allowed to make notes until after the interview. While we tried to avoid any recalled bias, some may have been introduced.

Care was taken to protect interviewee anonymity and it was made clear that only non-identifying summaries of the interviews would be passed on to the rest of the research team by the interviewer. The research

team met several times during the interview stage in order to review techniques and consider ways to provoke more profound interviewee responses.

The following cases provide non-identifying details of three of the 42 SFOs covered in the pilot interviews. We include them to illustrate SFO variety and the kind of data obtained through the interviews. The first two deal with billion-dollar asset pools and the third with a smaller fortune; they are all distinct in terms of SFO model, age and asset allocation.

Case 1

Created less than a decade ago, this was one of the most professional SFOs we encountered. The family strategically located their SFO – which they refer to as a private investment company – not in a tax haven, but in a financial center where they are constantly networking with top investment experts. Their main objective is the aggressive growth of the family fortune. Secondarily, they seek to give the family members, spanning just one generation and a handful of beneficiaries, more time to devote to their own businesses. Each month, the beneficiaries receive a comprehensive 40-page report. For every matter requiring a decision, there is a one-page summary of key data. Information flow and SFO supervision are enhanced through three committees that deal separately with investment, management issues and audit. The SFO focusses on private equity and hedge fund investment, and almost all other matters are outsourced. The SFO head has an investment banking background and his team includes nine professional investors (among them analysts and traders), ten accountants, one lawyer (other legal services are outsourced) and about 12 support staff. Co-investment possibilities, performance bonuses and broad investment experience helped lure these high performers from the wider commercial world.

Case 2

Set up nearly 30 years ago and located in a tax haven, this SFO team comprises 15 professional investors and various lawyers, accountants, economists and support staff. All investment management is outsourced to experts, while the SFO head devotes himself to dealing with a widely dispersed multi-billionaire family. A lawyer by profession, he estimates he spends half his time supervising investments and a substantial part of the remainder in uniting and even counseling the family. Spread over three generations, about 35 beneficiaries and various continents, the family encompasses widely varying preferences. The SFO's forte is

its ability to tailor asset allocations to each individual. The SFO head said capacity for investment flexibility and the ability to focus on trans-generational wealth management were essential, due to the very different needs and objectives of family members. Some sought aggressive growth, some wanted fund of funds and others hand-holding of the next generation. While its primary investment objective is balanced growth of family wealth, tax optimization has also been set as a priority. The family's \$2b portfolio (approximately one-fifth of their total wealth) is currently invested mainly in equities, fixed income and real estate. The rest is tied up in a majority-owned family business in which two generations are closely involved. The SFO has a management committee and a client relationship committee. It reports quarterly to family members on their investments, providing detailed information.

Case 3

Spanning several generations, several countries and about 15 beneficiaries, this SFO has been tasked with promoting family unity and orderly, intelligent wealth succession. Created about 20 years ago, it also helps the family with administrative duties such as banking, tax and reporting, as well as providing some concierge-type services and estate planning. The family behind this SFO states that they are happy with "plain vanilla" asset allocation. A separate family business brings in plenty of cash so the SFO is required only to pursue an unsophisticated, low-risk approach that helps minimize family disagreement. Most of the \$200m investment pool is devoted to real estate and equity, arranged through outsourced investors. The family has approximately five times more wealth backing a minority-controlled family business that absorbs the time and energy of many family members. The SFO head is a family member, and her strength is in knowing and understanding the family while handling outside financial experts astutely. The ten-employee-strong office benefits from the fact that the family has a clear constitution, leaving no doubt on important matters such as who has what powers and under what conditions, and how much each gets paid and when. There are regular family meetings and the beneficiaries receive a reasonably detailed quarterly investment report, although, according to the SFO head, most have a low level of financial knowledge.

* * *

These three very different propositions are largely a reflection of differing family priorities. The first family spans only one generation, is directly

involved and is looking for aggressive growth. The second, spread over three generations, is more *laissez-faire* and worried about family unity. Meanwhile the third SFO has a smaller investment pool and a family largely happy with “standard” asset allocation.

4 The surveys

Based on the findings of the pilot interviews, we created a survey instrument and distributed it to our pilot interview participants and to additional SFOs that met our criteria.

The survey instrument was made up of five sections that enabled us to obtain information about the SFO and the family that owns it. The first section of the survey explored family background, the size of the family’s business, and the family’s wealth category. The second section gave us background information about the SFO, its characteristics and the challenges it faced. The purpose of the third section was to evaluate the in-house team of professionals working at the SFO. The fourth section gave information about the SFO’s governance structure, and the final section focused on investment management practices and other services provided by the SFO, and their importance to the family.

The survey instrument was sent directly or via our support networks and could be completed online as well as on paper. It was available in English, Spanish, Italian and Chinese.

The questionnaire reached approximately 900 family offices in Europe, the US and RoW. We obtained 138 useable completed surveys from single family offices with over \$100m in assets, a response rate of 15 percent.

(a) General background on respondent SFOs

Respondents represent SFOs around the world, as depicted in Figure 8.1 below. Fifty-one percent of the SFOs have their headquarters in Europe, 42 percent in the Americas and 7 percent are located around the world. Only one percent of the respondents did not identify the SFO headquarters.

Total family wealth of survey respondents varies by region. In Europe, 53 percent of the families declared wealth over \$1 billion, while 26 percent of American families and 33 percent of Rest of the World (RoW) families fell into that category. Indeed, a remarkable number of billionaire families are represented in the responses (see Figure 8.2). The distribution of respondents for fortunes between \$500 million and \$1 billion is 11 percent in Europe, 17 percent in the Americas and 33 percent in RoW. Finally, 30 percent of European, 52 percent of American and 34 percent of RoW

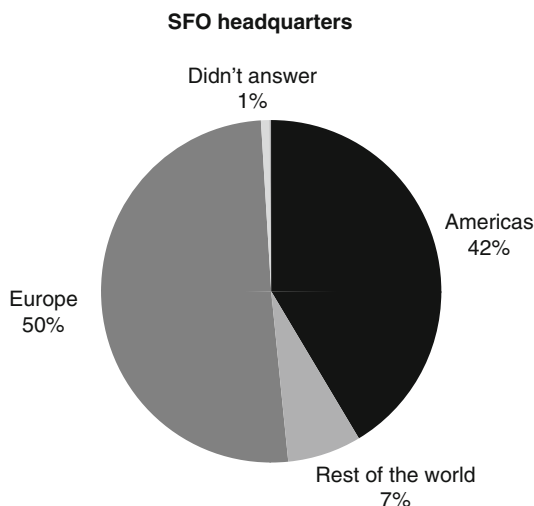


Figure 8.1 Location of SFO headquarters

Source: SFO research project database 2007.

respondents declared family fortunes in the \$100–\$500 million range. Therefore, our sample has a bias towards larger family fortunes in Europe.

The SFOs surveyed served a wide range of generations. In Europe 17 percent of SFOs serve one generation exclusively, while this percentage is 9 percent in the Americas and zero in RoW. Figures for SFOs serving two generations is 45 percent in Europe, 33 percent in the Americas and 67 percent in RoW. The distribution of SFOs serving three generations is 31 percent in Europe, 47 percent in the Americas and 33 percent in RoW. Finally, there is a smaller percentage serving four generations: 7 percent in Europe, 9 percent in the Americas and none in respondents from RoW (see Figure 8.3).

In our sample, SFOs serve on average four households. We note that only 40 percent of families in the Americas who own an SFO operate businesses while 70 percent of European families and 89 percent of RoW families are involved in an operating business (see Table 8.1). The sample reveals an interesting mix: 41 percent of our sample are dollar billionaire families; the families are largely entrepreneurial – half are involved in operating and controlling a business; and the SFOs serve on average two to three generations and four households.

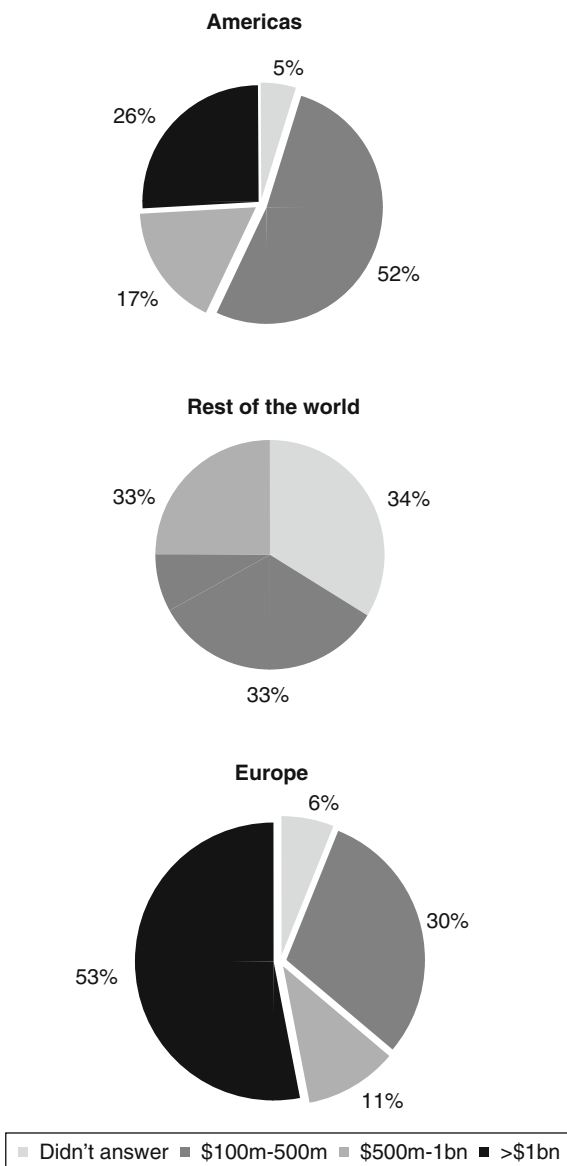


Figure 8.2 Family wealth distribution

Source: SFO research project database 2007.

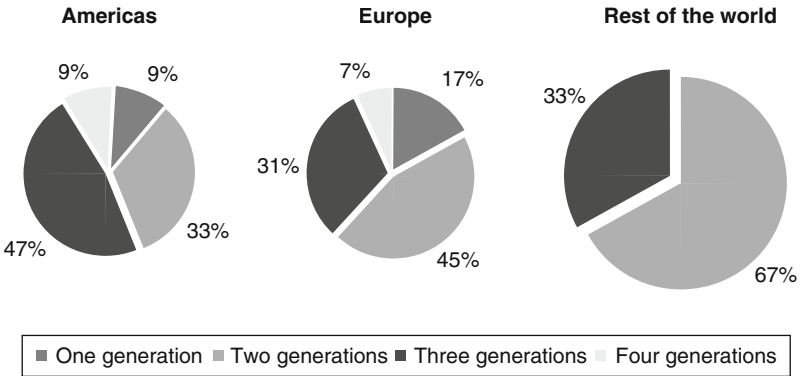


Figure 8.3 Number of generations served by the SFO

Source: SFO research project database 2007.

Table 8.1 Number of households served by SFOs

	Americas	Europe	Rest of the World
Family involved in operating business (%)	40	70	89
Number of households (average)	7	20	5
Number of households (median)	4	4	4

Source: SFO research project database 2007

(b) Objectives and benefits

There is a common shared intent in creating an SFO across all sizes, generations and geographies. Our survey shows that the most important objective the family has for the SFO, selected by 57 percent of respondents, is trans-generational wealth management. The second key objective, selected by 39 percent of respondents, is the consolidation function of accounting, tax and estate planning services (see Figure 8.4). In brief, Figure 8.4 shows that SFOs are really about managing family wealth; education, concierge services and philanthropy are considered significantly less important. The SFO functions primarily as a private investment office. In addition, 43 percent of respondents indicated that the most important key *benefit* of an SFO is consolidated management of family wealth and control.

From the personal interviews, we found some other common if unexpected reasons for having an SFO: freedom of career choice for family members; cost-effective money management; stable controlled scalable asset management; development of trust/loyalty of employees; and cheaper document administration. Although these factors emerge from only anecdotal data, they reflect an interesting diversity behind the general trends summarized in Figure 8.4.

This is consistent with perceived benefits. When the head of the SFO was asked “What are the key benefits for the family of having an SFO?” Key perceived benefits again related to money issues (Figure 8.5).

Common assumption notwithstanding, we found no clear indication that geography influences configuration. There is a popular view that SFOs in the US are generally more sophisticated than their European counterparts, and that those in the UK are more advanced than SFOs elsewhere in Europe. However, we found no evidence for this belief: in fact, in our analysis several aspects pointed to an industry where the upper segment is very global.

Family objectives for the SFO and perceived key benefits of having an SFO are very similar across continents and across different wealth levels. The same results – that the family’s most important objective for the SFO is trans-generational wealth management – hold.

(c) SFO functions

Our survey defined a series of activities that emerged during the pilot interviews as common services performed for families by SFOs. Broadly

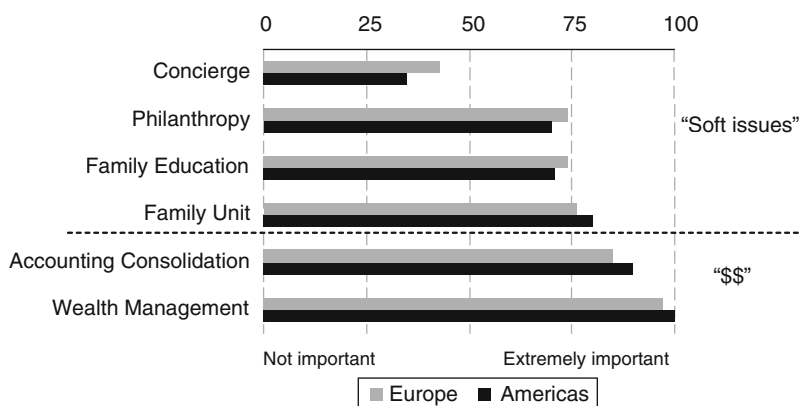


Figure 8.4 Key SFO objectives

Source: SFO research project database 2007.

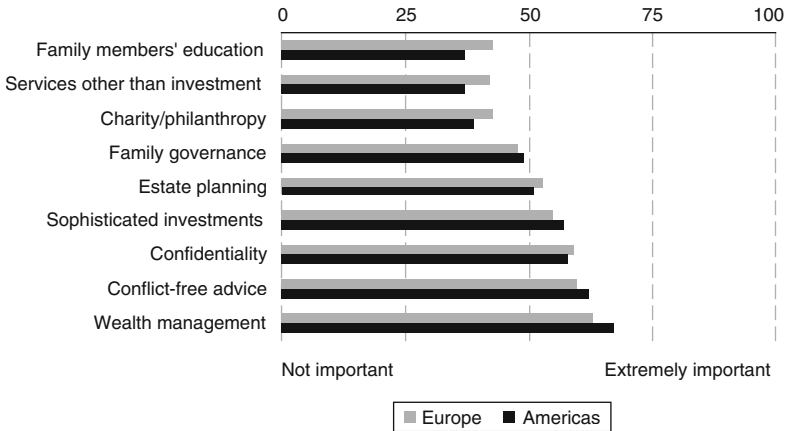


Figure 8.5 SFO benefits

Source: SFO research project database 2007.

speaking, functions fall into three main categories: wealth management-related activities (e.g., asset allocation, manager selection and monitoring, risk management, and estate planning), administrative functions (financial administration and reporting, legal and tax services, etc.), and family-related activities (family education, counseling services, relationship management and so on).

Consistent with the results presented in previous sections, the most important functions are those related to wealth management. The sample does not show significant differences between SFOs in the different regions, with the exception of one area – estate planning – where there is a statistically significant difference (53 percent in the Americas and 31 percent in Europe) between SFOs that consider this function quite important.

However, when we analyze the importance given to the different functions performed by SFOs serving different generations, we find a clear trend that accords higher importance to family-related functions, although functions concerned with wealth remain paramount.

Table 8.2 presents the perceived importance that each specific activity has for a family and the percentage of respondents that selected that prioritization.

The data collected allowed us to understand how SFOs organize their services. Table 8.3 shows whether these activities are both handled in-house and outsourced, only handled in-house, only outsourced, or not applicable (N/A) to the SFO, because they do not manage this activity.

Table 8.2 SFO functions – perceived importance

Activities/Scope	Americas		Europe	
	Importance**	% of Respondents	Importance	% of Respondents
Asset allocation	1	52	1	57
Manager selection & monitoring	1	43	1	40
Education of family members	2	29	3	23
Personal/psychological counseling	3	12	3	13
Philanthropy	2	36	3	29
Risk management/insurance	3	34	2	33
Concierge services & security	3	19	4	20
Estate planning	2	53	2	31
Banking (e.g. loans, deposits)	2	34	2	44
Financial administration (e.g., bill paying, wire transfers)	2	40	2	40
Information aggregating & reporting	1	34	2	41
Legal services	2	47	2	50
Tax services	2	45	2	36
Relationship management (maintaining relationships with groups of family members)	2	21	3	24

** Most important = 1, less important = 5

Source: SFO research project database 2007.

Table 8.3 SFO functions – service organization

Activities/ Scope	Americas				Europe			
	Both	In	N/A	Out	Both	In	N/A	Out
Asset allocation	24%	47%	0%	14%	21%	63%	1%	6%
Manager selection & monitoring	31%	38%	2%	14%	20%	56%	4%	10%
Education of family members	29%	34%	17%	2%	21%	31%	30%	3%
Personal/psychological counseling	9%	7%	55%	14%	9%	17%	53%	6%
Philanthropy	22%	47%	10%	2%	14%	50%	19%	3%
Risk management/insurance	19%	29%	3%	33%	16%	49%	11%	11%
Concierge services & security	19%	24%	24%	16%	11%	37%	31%	4%
Estate planning	33%	7%	3%	40%	36%	31%	1%	17%
Banking (e.g., loans, deposits)	19%	17%	2%	47%	11%	46%	6%	24%
Financial administration (e.g., bill paying, wire transfers)	22%	41%	5%	14%	4%	70%	7%	9%
Information aggregating & reporting	29%	41%	0%	10%	20%	56%	4%	7%
Legal services	17%	2%	3%	60%	23%	16%	3%	46%
Tax services	19%	12%	3%	48%	36%	14%	3%	36%
Relationship management (maintaining relationships with groups of family members)	7%	41%	29%	0%	9%	47%	27%	1%

Source: SFO research project database 2007.

On average we found that Europeans are inclined to outsource fewer activities related to wealth management, especially investment-related activities. For example, 63 percent of Europeans perform asset allocation in-house as against 47 percent in the Americas. Similarly, 49 percent of European SFOs in the sample have in-house risk management services compared to only 29 percent in the Americas; 70 percent of financial administration is done in-house in European SFOs, while 41 percent is done in-house in the Americas. However, there are not many statistical significant differences across geographies in other activities such as services related to the education of family members, counseling or philanthropy.

(d) Team and governance

How to attract and retain the best professionals appears to be one of the common concerns of SFO heads. Many expressed interest in how others were doing this. Our personal interviews showed that the top attractions of working in an SFO were high job security, working in an environment of shared values (e.g., a preference for ethical investment), earning the market rate plus a performance incentive/bonus, flexibility, improved lifestyle, less pressure, no fundraising, co-investment opportunities, informality and greater opportunities for learning due to the need to perform a broad range of activities.

One question many insiders in the family office industry have is whether the head of the SFO should be a family member. First-generation SFOs are more likely to involve a family member in the office; in our survey 46 percent of first-generation SFOs and 37 percent of later generation SFOs indicated that the head of the SFO is a family member. The larger and more diffuse a family becomes, the more likely the family will be disengaged from its family office. The more households the family office has to serve, the less family involvement there will be.

When the family office serves only one household, in 50 percent of the SFOs surveyed the head of the family office is also a family member; when the family office serves two to ten households, the head of the family office is also a family member in 43 percent of SFOs; and when the family office serves 11 or more households, the head of the family office is also a family member in 35 percent of SFOs. These family offices are particularly associated with more formal governance structures. Families need to take care formulating the initial structure of the family office, knowing that this dynamic is likely to unfold over time.

Although no correlation was found between total wealth level and the number of committees, which may suggest that wealth level does

not affect governance structure, the results show a big geographical difference with regard to governance; European SFOs have more governance than SFOs in the Americas (Figure 8.6).

Among our respondents there was no correlation between wealth level and the total number of committees. However, there is a difference in the type of committees that wealthier families manage (Figure 8.7). Sixty-four percent of the billionaire SFOs have an investment committee while only 53 percent of millionaire SFOs have one. Similarly, a higher percentage of billionaire SFOs have a board (54 percent vs. 25 percent) and an audit committee (29 percent vs. 11 percent). The percentage differences observed between family offices that have an education

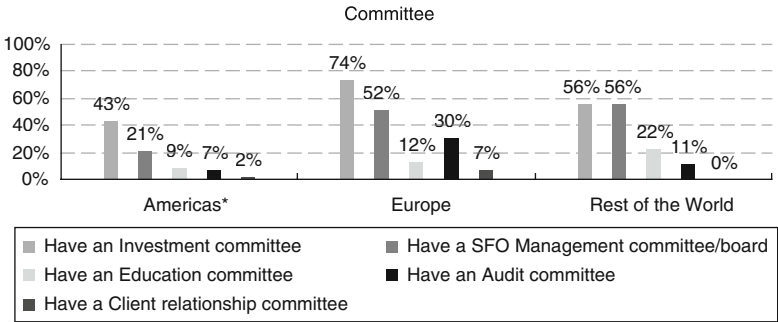


Figure 8.6 SFO governance – types of committee

Source: SFO research project database 2007.

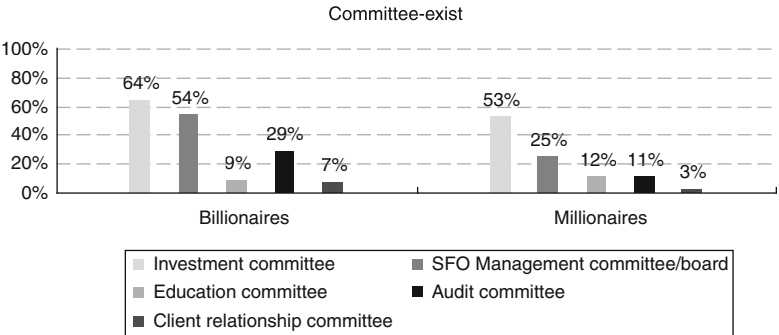


Figure 8.7 Use of governance committees

Source: SFO research project database 2007.

committee and client-relationship committee are insignificant. Our results show, somewhat unexpectedly, that wealth level has no impact on governance structures.

(e) Asset allocation

There are significant geographical differences in the way assets are allocated (Figure 8.8): SFOs in the Americas allocate 44 percent of their wealth to equities while European SFOs allocate only 28 percent.

As for principle investment in companies, the Americas invest only 4 percent of the wealth while Europe invests 13 percent: these findings may suggest that European SFOs are more aggressive toward investments and more entrepreneurial.

When comparing billionaires and millionaires in the Americas to those in Europe, we find these differences are even greater. American billionaire SFOs invest 20 percent in hedge funds while the European equivalent invest only 12 percent in hedge funds; European billionaire SFOs invest on average 11 percent in real estate, the Americas only 4 percent. Comparing millionaire SFOs on the two continents, we can see differences in equities, fixed income, private equity and real estate (Table 8.4).

It seems that billionaires invest more aggressively than millionaires, on average investing more in hedge funds and private equity, putting principle investment in companies and less in equities.

Table 8.4 Asset allocation

	Billionaires Americas	Billionaires Europe	Millionaires Americas	Millionaires Europe
Average				
Equities	47%	25%	45%	30%
Fixed income	16%	15%	15%	17%
Hedge funds	20%	12%	12%	13%
Private equity	9%	12%	9%	12%
Real estate	4%	11%	10%	18%
Other tangible assets (e.g., oil, gas, timber, and commodities)	3%	4%	4%	3%
Principal investment in companies	0%	20%	5%	6%
Other stores of value (e.g., art collection, wine cellar, etc.)	1%	2%	1%	2%

Source: SFO research project database 2007.

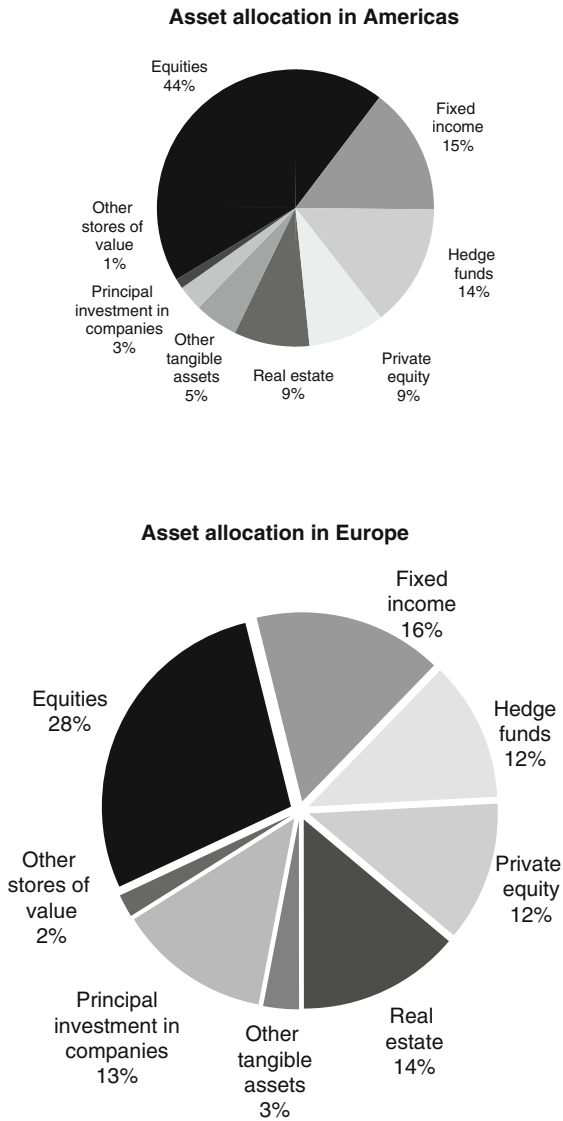


Figure 8.8 Asset allocation (by geography)

Source: SFO research project database 2007.

This is surprising because it contradicts the stated objectives for their respective investment strategies (Figure 8.9). As we would expect, the billionaires have a broader and more balanced approach toward investments, while millionaires are more aggressive. However, this does not conform to the asset allocations described in Table 8.4.

Looking at the impact of the number of generations that are served, we see some substantial differences in ways of allocating assets.

First-generation SFOs spend more time on investment activities; 33 percent of the heads of the first-generation SFOs spend over 80 percent of their time on investment activities, while only 9 percent of heads of later generation SFOs spend over 80 percent of their time similarly. Also, when asked about their objectives with respect to investment, it seems that first-generation SFOs are more aggressive with respect to investments, as shown in Figure 8.10.

Although on average asset allocation is very similar across the two groups, there is a significant difference with regard to principle investment in companies and investing in other stores of value (e.g., art collections, wine cellars, etc.). In our survey, among first-generation SFOs, 10 percent (median) of the wealth is allocated toward private equity, while later generation SFOs allocate only 5 percent (median). First-generation SFOs allocate on average 14 percent of their wealth to

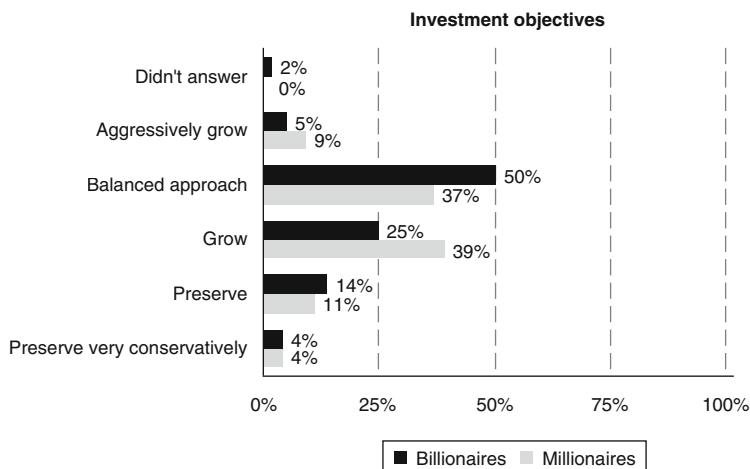


Figure 8.9 Investment objectives – billionaire versus millionaire SFOs

Source: SFO research project database 2007.

principle investment in companies, while later generations allocate only 9 percent. Also, while first-generation SFOs invest only one percent of their wealth in other stores of value, such as art and wine, later generations invest 3 percent of their wealth in these sorts of assets (Table 8.5).

Our research was intended to survey the landscape of family offices. The data we collected are consistent with our initial expectations about the wide variety and arc of development of SFOs we would find. While 138 full responses is a remarkable level of response from this demographic, which is not easy to reach, it is not enough to make detailed

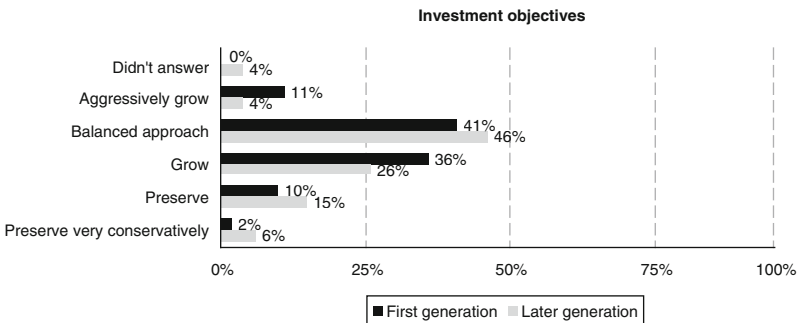


Figure 8.10 Investment objectives – first generation versus later generation SFOs
Source: SFO research project database 2007

Table 8.5 Asset allocation by generations

	First Generation	Later Generations	First Generation	Later Generations
	Average		Median	
Equities	32%	33%	30%	30%
Fixed income	15%	17%	13%	10%
Hedge funds	13%	13%	10%	10%
Private equity	11%	9%	10%	5%
Real estate	11%	12%	10%	10%
Other tangible assets (e.g., oil, gas, timber, and commodities)	3%	4%	0%	1%
Principal investment in companies	14%	9%	3%	0%
Other stores of value (e.g., art collection, wine cellar, etc.)	1%	3%	0%	0%

Source: SFO research project database 2007.

comparisons between the subsets of family offices in our sample. Nor is the information we collected prescriptive – the survey is intended to illuminate what is currently being done, not to evaluate how well a given type of family office performs relative to another, nor to provide data on best practices of SFOs.

5 Implications of our research

Based on our observations of various well-functioning SFOs, we offer some recommendations for sound practice.

1 *Having a purpose enhances performance.* Well-functioning SFOs tend to be linked to families that have a strong sense of purpose for their fortune. This is particularly true where the rich invest not only their assets but also their enthusiasm in the pursuit of something beyond mere wealth preservation. This applies to a broad range of objectives, including involvement in entrepreneurial activities and business, worthy causes, philanthropic pursuits, research foundations, patronage of the arts or taking on public responsibilities.

Families with a long-term vision tend to rally together (with the aid of their SFO) to ride out adverse external factors, such as financial crises, political turmoil and war. Families lacking such consensus and/or ambition are less likely to provide the right leadership under unfavorable outside conditions. They are also more prone to internal strife.

The families with a clear purpose for their wealth, and hence more incentive to stay informed and in control, seem to have SFOs that enhance this, allowing them to concentrate on the big picture while the SFO sorts out the detail. Freed from being bogged down in the paperwork, and with reliable expert advice at their fingertips, family members can better combine the wealth of their intellects, inspiration and experience with that of their fortune, with more chance of adding value both to their wealth and society.

2 *Seek excellence in every activity.* Some families have closely analyzed their strengths – considering their background, experience or asset mix – then cleverly structured their SFO to capitalize on them. They employ an in-house pool of experts to focus on areas of strength and then, as needed, out-source to tap excellence in any other spheres.

This approach seems not only to concentrate expertise, it also helps attract and retain the best personnel. Several of the SFOs that focussed on certain aspects of wealth management were on a par with the top

professional investment firms active in this field. They were also shrewd users of out-sourcing, contracting other experts where necessary and conscious that, as pointed out to us by one SFO head, it's easier to sack a supplier than someone on your staff.

There should be no place for nepotism in an SFO. Yet some families appeared to be compromising the professionalism of their SFOs for reasons of family politics and even penny-pinching. We find that a family member might be good as chairman of the SFO supervisory board, but on average may not be as good as the chief investment officer.

In terms of SFO structure, strict separation of function seems to enhance performance. The highly paid hedge fund expert should not be distracted by dealing with the car fleet, let alone collecting the dry-cleaning.

This is not to say that SFOs cannot handle "softer" services, such as art collection and travel, but they appear to perform optimally when the functions are separated. A model that seems to work well is to have the equivalent of separate companies for the different specialized areas of asset management and concierge services, and a discrete foundation for philanthropic activity.

To attract the right talent, SFOs can offer numerous advantages. There is the potential for profit-sharing and co-investment, the attraction of working in an environment closely aligned with employees' own values, the opportunity to gain broader investment experience, and to enjoy more flexible working conditions.

3 Keep it simple. Many SFOs preside over very complex corporate structures. One SFO in our pilot interviews dealt with 200 non-active (holding) companies and few dealt with fewer than 80. This can create problems for family members wanting to supervise, let alone direct SFO decision-making properly. Many simply do not have the time, interest or expertise needed to find the devil in a huge amount of company detail. As a result, their wealth ends up increasingly under the control of the SFO accountants.

There is a need for various holding companies (e.g., for corporate governance, not just tax factors) and in various places, but within reason. And one reason not to let the corporate structure get too unwieldy is Parkinson's Law – the tendency for bureaucracies to expand to fill the space they are given. Another is to keep family and SFO governance achievable.

Sophisticated families insist on the highest standards of governance, reporting and education not just in the SFO but within the family itself.

Families that themselves have clearly defined internal procedures will create SFOs that are strong on governance. For example, we found that those with concise written guidelines or even constitutions (e.g., on family members' different roles, powers and entitlements) tended to have the equivalent in their SFO (documents clearly stipulating the frequency of reporting, who should report to whom, committee structures, meetings, etc.). Family governance is key to ensuring adherence to the family's value system, its overall purpose and successful trans-generational wealth transfer.

The SFO has a crucial role to play in promoting transparency and accountability, namely by making an art of reporting. This should be punctual, focussed on key issues and, when providing important details for meetings, ideally kept to a maximum of one page per decision. Committees are important for this, but should be few in number and efficiently run.

Many of these lessons can be applied by families with far fewer resources than hundreds of millions of dollars. Indeed, several of the family offices in our survey were responsible for multiple households (presumably with varying levels of individual wealth). As we noted earlier, there was no observable correlation between the amount of wealth a family office oversees and its sophistication in the form of governance committees or the professional background of its staff.

6 Concluding remarks

SFOs are redefining the art of effective wealth management. They are a potent tool, allowing super-affluent families to meld the might of their vast fortunes with the mastery of top professionals in order to pursue closely – and confidentially – whatever matters most to them.

In our encounters with key SFOs around the world, we saw little evidence of a correlation between effectiveness in SFO operation and factors such as geographical location, length of existence, and links to a former or current family business. However, what did seem critical was clarity. Families that had clearly defined goals and priorities in setting up and running their SFOs also seemed to have SFOs that delivered on these objectives.

As has been stated, this is a field ripe for research well beyond the scant existing literature. Indeed, many of our interviewees expressed keen interest in finding some way to benchmark their performance against that of their peers both in other SFOs and wider commercial services. Specifically, many wanted to know more about how other

offices handled asset allocation, recruitment and remuneration of SFO staff.

We believe that our study not only contributes to the literature on family business and wealth management but helps pave the way for best practice guidelines to be established for SFOs. Our project will widen general knowledge and deepen the general understanding of SFOs and form a sound basis for much-needed further research.

Notes

1. We are grateful to Josep Tapies for inviting us to contribute a chapter to this book, which is being published to celebrate the Fiftieth Anniversary of IESE. We would like to thank the team at IESE's Center for Family-Owned Business and Entrepreneurship (CEFIE), particularly Netta Etzion, and the Wharton Global Family Alliance (WGFA) team, particularly Sagit Stern, for their support during the project. Results presented in this chapter are based on an ongoing research project on *Wealth and Family* carried out under the auspices of the Wharton Global Family Alliance. We appreciate the involvement of the other partners in the WGFA, SDA Bocconi, Singapore Management University and CCC Alliance. We would like to thank our collaborators from the following European organizations: Institute for Family Business – IFB (UK), Association Française du Family Office – AFFO (France), Campden (International, with HQ in the UK), Family Office Circle run by Aeris Capital (Germany), Instituto de la Empresa Familiar – IEF (Spain), Le Club B (Switzerland), WHU – Otto Beisheim School of Management (Germany). We thank our collaborators Citi and BNY-Mellon for their support of our research.
2. "The case study strategy may be used to explore those situations in which the intervention being evaluated has no clear, single set of outcomes" (Yin, 1994: 15).

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Part IV

The Value of Family Business

9

The Impact of Family Business on Society

Fernando Casado

1 Introduction

Perceptions of family business have changed in recent years. Thanks to the efforts of various organizations, the public image of family enterprise is now closer to reality and more positive than it was in the past. Nowadays, the family business owner is seen as an entrepreneur who promotes his or her company as a creator of wealth and employment for society. We should see to it that this view persists.

All those involved in family business should make it their task to enhance the image of the family business owner and create a more favorable operating environment for family firms, not only in terms of taxation but also as regards firms' internal organization, succession and management. Only then will family enterprise retain its central role as a driver of social development and well-being.

The main difficulty for analysts is how to define family business. Definitions have been proposed from various angles, but I would like to concentrate on those provided by the international organizations that have studied the matter in most depth.

One is the definition given by the European Group of Owner Managed and Family Enterprises (Groupement Européen des Entreprises Familiales, GEEF), an umbrella organization for Europe's leading family business associations. According to GEEF:

A company is a family business if:

1. A majority of (direct or indirect) voting rights are held by the person who founded the company and owns the company's share capital, or by this person's spouse, parents or children, or children's direct heirs.

2. At least one family member or relative is actively involved in managing or running the company.
3. In a public limited company, the person who founded or acquired the company, or this person's family or descendants, hold at least 25 per cent of the voting power of the shares.

This definition has since been ratified by Family Business Network International in its *Family Business Monitor* (published September 2007).

Another definition is the one not explicitly stated, but to be inferred from various articles published by the Boston-based Family Firm Institute, representing the world's top family business advisors, consultants, educators, and researchers. The common thread running through these articles is that family businesses are companies in which a given family has "control", control being the power to appoint the company's CEO.

2 Importance of family enterprises in Spain, Europe and the world

Family businesses play a vital role in the economy. In developed countries they are the most important type of business organization.

According to Michael Worley, Chairman of GEEF,¹

Family firms, whether small, medium or large, account for roughly two-thirds of private sector employment in Europe. They are a major source of innovation within the European economy, natural incubators of an entrepreneurial culture and key to sustaining and expanding employment. Their expansion is often financed from reinvestment of profits and their wellbeing has a direct impact on the localities where they are based.

In Western Europe, the proportion of family firms ranges from 60 per cent to 70 per cent. Their contribution to GDP and employment is around 50 per cent (see Table 9.1).

Estimates suggest that there are more than two and a half million family businesses in Spain. Together, these companies:

- Account for 75 percent of private sector employment, providing more than 9 million jobs.
- Are responsible for 59 percent of Spanish exports.
- Have a combined turnover equal to 70 percent of Spanish GDP.

- Thirty-seven percent of Spanish companies with turnover in excess of one billion euros are family-owned. Seventy percent are listed. In stock market capitalization, they account for 30 percent of the total; in number, 50 percent. In June 1992, family businesses accounted for 6.3 percent of the value of the Ibex 35; by June 2004 this figure had risen 4.5 points, to 10.8 percent.
- Mortality: 21.7 percent of family firms are in their first generation, 16 percent in the second; 8 percent in the third; and one percent in their fourth generation or higher. Compared with non-family firms, the average life span of family firms is shorter: 30 years, as against 40.

Across Europe, the picture is similar. In the EU as a whole, family businesses generate sales of 8000 billion euros. In the UK, 76 percent of the 8000 largest companies are family businesses.

Forty percent of European family firms survive the transition from first to second generation, while 10–15 percent reach the third generation. This means an average life span of more than 75 years, roughly two generations.

In Europe as a whole, close to one-third of family business leaders are aged 50 to 60. One-third of European family firms will face a transfer of ownership and power to the next generation in the next 10 years.

Table 9.1 International comparison of family businesses²

Country	% of Companies	% of GDP	% of Labor Force
United States	95	40	60
Italy	93		79
Finland	80	40–45	40–60
Greece	80		
Cyprus	80		
Sweden	79		
Spain	75	65	
Netherlands	74	54	43
Portugal	70	60	
Belgium	70	55	
United Kingdom	70		>50
Germany	60	55	58
France	>60	>60	45
Australia	75	50	50

The importance of family firms in maintaining a dynamic economy is measured not only in quantitative terms, such as we have seen, but also in qualitative terms. Notably:

- **Innovative potential of family businesses.** If family businesses have survived for so long, it is mainly because they are highly innovative. That is what makes them an engine of growth and innovation for building a thriving economy. In Spain, policies unfavorable to investment in innovation force family-owned businesses to take their investment abroad. Responsible policy-making, in Spain and Europe, should be designed to promote a working environment that encourages family firms to innovate and grow. In particular, a favorable tax climate would help family businesses maintain their capital and give them the confidence to invest in innovation across the generations.
- **Capacity for economic development and job creation.** More than 75 percent of companies in the European Union are family businesses. Family firms are one of the main contributors to GDP in all EU Member States. They are a reliable source of entrepreneurial energy and play a crucial role in driving the national economy.

In the EU as a whole there are approximately 17 million family businesses, employing 45 million people. Twenty-five of the 100 largest companies in Europe are family businesses. The top 1000 European companies (with a combined turnover of more than one trillion euros and over 5 million employees) include no less than 200 family firms. Family-owned enterprises account for 65 percent of GDP and are more profitable than the average European company.

- **An engine of regional economic development.** The long-term investments made by family enterprises give stability and continuity to the regions. Family business owners do not usually move far from home, so their companies also tend to retain their local base. Family enterprises often act as drivers of regional economic development, as they generally have a positive attitude to growth and grow more profitably than other companies.
- **Stimulating the entrepreneurial urge.** Family-owned enterprises foster an entrepreneurial culture and provide a training ground for the entrepreneurs of the future. They have a strong business ethic, a long-term business outlook and a keen awareness of their social and environmental responsibility. They nurture the entrepreneurial instinct at family level, often acting as company incubators. In a dynamic economy, people must be ready to take on risks and responsibilities.

This is precisely one of the main characteristics of family business owners. It is essential to create a business environment that gives family business owners the confidence to pass on their invaluable knowledge and entrepreneurial spirit to future generations.

- **Corporate social responsibility.** Family enterprises foster family values; they display an acute sense of social responsibility and intense concern for the local or regional base. They stand for sustainable and responsible management, and their strategies, management structures and business relationships are naturally oriented to the long term.
- **Family businesses: a long-term investment.** Family businesses typically have a stable capital structure, usually backed by family finances. Their organization, strategy and way of doing things is designed for the long haul. They are big enough to take the long view in their recruitment and investment policies, and are less easily alarmed by short-term fluctuations in share value. Their investment horizon affords scope for anti-cyclical investment.
- **Upholding the welfare state.** By paying taxes such as personal income tax, Social Security contributions and VAT, family businesses contribute to the continued well-being of society.

Worldwide, family-owned enterprises account for two-thirds of all businesses.³ In some countries the proportion is even higher: in Chile 90 percent, in Mexico 80 percent.

Below are some family business statistics for the United States:

- Family-owned businesses comprise 80–90 percent of all business enterprises in North America, accounting for around 50 percent of GDP and 60 percent of total US employment.
- Thirty-seven percent of Fortune 500 companies are family-owned.
- According to a study by the US Pitcairn Foundation comparing the performance of 205 family businesses with that of 1800 non-family businesses during the 1990s, the family firms obtained an average annual return of 22 percent on every dollar invested, compared to 14.5 percent for non-family firms.
- In all the countries in which studies have been carried out, family businesses are perceived as producing higher quality goods and services
- Research conducted by the University of Alabama and Virginia Tech, analyzing the companies in the Standard & Poor's 500 index between 1992 and 1999, shows that family-owned businesses provided higher returns than the rest.

- According to a study by John L. Ward, 35 percent of the 500 largest listed companies in the US are family businesses, and this despite the fact that large listed companies are the population in which family businesses are least well represented. These conclusions have prompted numerous academics to investigate the competitiveness of family businesses. Return on capital employed is 35 percent higher in family-owned enterprises than in non-family companies. Family businesses have higher sales growth and obtain the same productivity with half the investments in assets, although they also tend to operate in industries that do not require very heavy asset investments. Family businesses use their working capital more effectively.
- According to a report published in the *Journal of Finance*, 33 percent of the Standard & Poor's 500 companies are family-owned. On average, the founding family owns 18 percent of the shares and the companies' average age is 78 years.
- In the US, family businesses have a lower cost of debt and their CEOs earn 10 percent less, on average, than their counterparts in non-family firms. Family firms perform better when a family member is CEO than if the post is held by an outsider. In both cases they perform better than non-family firms

3 Institutional involvement

The importance of family-owned businesses and the institutions that have been set up to promote them is very clearly demonstrated by the amount of political attention they receive. Here I shall confine myself to the European Union and the Family Business Institute, to illustrate the impact that institutions of this kind can have on the development of family enterprise.

3.1 The European Union

The importance that the European Union gives to family business is demonstrated by the Commission's initiative on Transfer of Businesses (2006), which highlights some of the main concerns of family businesses and reminds Member States how important it is to create the right conditions for business transfer.

As the Commission points out in its Communication, one-third of EU entrepreneurs, mainly those running family enterprises, will withdraw within the next ten years. This will affect 610,000 enterprises and 2.4 million jobs every year (see Table 9.2). According to a EU study, 1.5 million

Table 9.2 Business transfers by country⁴

	Business Transfers Per Year	EU Total Per Year
Finland	8,900	610,000 – equivalent to 2.4 million jobs
France	43,160	
Germany	71,000	
Italy	66,000	
The Netherlands	20,000	
Spain	150,000	

companies face the threat of closure over the next ten years due to problems of succession (placing more than 6 million jobs at risk).

The Communication from the Commission makes it clear that increasing the number of successful business transfers would have immediate beneficial effects for Europe's economy: a company that is transferred successfully conserves on the average five jobs, whereas on average a start-up generates only two.

The Commission highlights six key issues at national level. The following three deserve special emphasis:

- More political attention needs to be given to business transfers and start-ups
- There must be transparent markets for the transfer of businesses
- Tax systems should be made more conducive to transfers

3.2 Instituto de la Empresa Familiar (Family Business Institute) in Spain

The Institute was created at the end of 1991. Its main purpose, as stated in its by-laws, is to study, analyze and assess the problems specific to family-owned businesses; to promote family enterprise as an engine of the economy; to protect the interests of family businesses in dealings with government at all levels – EU, national, regional and local; to lobby, through the appropriate legal channels, for changes in the law to promote the growth and continuity of family firms; and lastly, to encourage initiatives aimed at studying and solving the specific problems of family-owned companies.

In formulating these objectives, the Institute declared its intention to act as a pressure group to protect the interests of family businesses in a transparent and non-discriminatory way. Sixteen years on, practically all the improvements in which the Family Business Institute has had a

hand (in collaboration with other organizations) have benefited Spanish family firms across the board.

The Institute's activities have been, and continue to be, aimed at developing what might be termed a "productive economy." No doubt this is one of the reasons why the Institute has preserved the good image it has had ever since its early days.

After the very positive media response throughout Spain at the founding of the Institute, a flood of applications poured in, making it difficult to maintain the limit of 100 companies established by the Institute's founders. Not wishing to betray either the letter or the spirit of its by-laws, but determined to find an outlet for the many applications it had received, the Institute decided to encourage the setting up of regional family business organizations. Today, each Autonomous Community has its own family business association, modeled on the Institute and sharing the Institute's goals and activities. The regional associations linked to the Institute serve a total of nearly 1000 family businesses, which together account for 17 percent of Spanish GDP and employ nearly one million people. The Institute's 105 members alone account for 11 percent of GDP. Their average turnover is one billion euros. Fourteen of them are over 100 years old. More than half are in the third generation or later and have survived for more than 68 years – compared to an average of 50 years for Spanish companies as a whole. Seventy percent of the Institute's member companies have more than 1000 employees, and more than 70 percent invest abroad. Overall, they represent the life-blood of the Spanish economy.

3.2.1 The institute's academic activities

To stimulate research and raise awareness in society about the problems of family-owned businesses, the Institute has collaborated actively with Spanish universities to create chairs of family business. The purpose of these initiatives is to awaken universities to the need to open their academic programs to a subject that concerns 90 percent of companies in Spain. These companies depend for their survival on the work done in the education system to train entrepreneurs and managers, and the various other people and institutions involved in family business.

In the academic year 1998–9, a Chair of Family Business was established at the University of Barcelona. This was the first Chair sponsored directly by the Institute. The process continued in the following years until, today, more than 30 Spanish universities have a Chair of Family Business sponsored directly or indirectly by the Institute. To promote university-level training and research, the Family Business Institute

oversees the Chairs' activities, ensuring consistency and quality of content, and also the high caliber of the practicing managers and academics who take part in the teaching programs. Each year some 2000 students receive training from the family business chairs.

Of the students who study at the Chairs of Family Business, 70 percent are preparing for degrees in Business Studies; 20 percent are Law students; and 10 percent are from other degree courses. Around half of them have direct ties with a family business, either through their own family or because they have worked in a family firm, or because they have had dealings with family firms in a professional capacity. The other half would like to work in a family-owned business.

As a university subject, Family Business has been made an elective, which means that students from any specialty can take it. This was done in the belief that the problems of family business should be open to all, both family business members, whatever the nature of their activity, and other sectors of society.

The research output of the family business Chairs and the courses and seminars the Institute has been running almost since it started have helped create a family business culture in Spain, a culture that may prove very important in facilitating the future growth of family enterprise, on which much of the wealth creation and employment in Spain depends. Besides the Institute's direct contribution, there are now numerous independent consultants specializing in family business, and also specialized publications and media, helping to spread the family business culture.

All these academic contributions give family businesses access to tools and a knowledge base to help them address their specific problems, especially those of succession and family-company relations. A particularly important achievement has been the general acceptance that the handover of power in a family business is not something that can be tackled in an afternoon. On the contrary, it requires careful planning, sometimes over a period of years, and timely training of successors. Succession should not be an emotional decision, or subject to family pressure. To be successful, it needs to be professionally managed from start to finish.

Other key academic contributions concern the professional training of family members who enter the business; the structure of governing bodies, aimed at drawing clear lines between family and company; the creation of family councils; the education of family shareholders; the inclusion of independent non-executive directors; and the drafting of family protocols to regulate relations between the family and the

company. Added to these are the many analyses, studies and practical guidelines on how best to implement these initiatives in order to avoid errors that might compromise a company's future.

Many of the Family Business Institute's 105 members have demonstrated that it is perfectly possible to make the transition to the next generation successfully, despite the dangers, provided things are done properly, with sound advice and within the framework of a family business-friendly tax system. More than half of these companies have a family protocol. Twenty-eight percent have completed their first succession and are in the second generation. Thirty-one percent are managed by the third generation, 19 percent by the fourth, 5 percent by the fifth, and 2 percent by the sixth generation. Only one company is in the seventh generation. Sixty percent of the member companies have independent non-executive directors, without being obliged to do so by law. Nor are they obliged to undertake corporate social responsibility activities, and yet 58 percent of them do so.

3.2.2 The institute's geographical reach

As the Family Business Institute became known, growing numbers of companies applied to join. The founders, however, stood by their decision to have no more than 100 members, so as not to betray the original idea. As an alternative, the Institute chose to encourage the creation of parallel local initiatives in the Autonomous Communities of Spain to accommodate family firms throughout the country that identified with the Institute's goals.

It was stipulated that while these regional family business associations would have the Institute's full support, they would be independent and self-governing, and would act exclusively within their territory. The regional associations are linked to the Institute through identical collaboration agreements, in which the parties undertake to exchange documents, studies, position papers and transcripts of activities, without payment of any kind.

The Institute also offers the associations' training programs, with the participation of leading experts, to study issues such as succession, family business governance or family protocols in greater depth.

Although the regional associations are independent, the Institute considers it very important to build strong indirect ties, so that they all send the same message. This makes communication with government more effective. To prevent inconsistent messages and goals from undermining the family business lobby in Spain, the Institute has two mechanisms that strengthen its ties with the regional associations. First,

members of the Institute may also be members of their regional association, either as ordinary members or as officers. Second, the associations' managers meet regularly to combine their efforts and promote collaboration, in their respective areas, to protect and improve the business environment for Spanish family firms.

Essentially, the Institute offers government a direct insight into the everyday reality of family business. The fact that the country's leading business owners, the ones who take the major economic risks, are able to put their real concerns directly to the government has resulted in a better understanding of the problems, and better solutions.

3.2.3 The institute's outreach to civil society

We have seen how important family business is for the economy and what an important job the Family Business Institute and its affiliates (chairs and associations) are doing through their program of activities to improve the management of family firms and create a more favorable environment for these firms' development.

Major achievements include:

- On the legal front, improvements in tax treatment, inheritance law and company law.
- Increased awareness of how family businesses contribute to the well-being of society in general, a fact which has not always been properly recognized.
- Measures to combat the stereotypes surrounding family firms. For example, the traditional image of a family business is of a small "mom and pop" outfit. It should be clear by now that family firms are not defined by size, but by a special way of doing things and understanding business. There are small, medium-sized and large family businesses.
- Close ties have been forged with social partners and universities. Already thousands of students receive education from the network of family business Chairs.
- Efforts have been made to research and disseminate knowledge about the issues that most typically affect family-owned enterprises, such as professionalization, succession, communication and conflict prevention.

As we have shown, family businesses drive wealth and employment creation. There are and always will be family businesses. Some large multinationals are built around a family-owned core. The challenge for

society lies not only in facilitating the creation of new companies, but also in making it easier for existing companies to stay in business. Currently only 15 percent of family businesses reach the third generation. The Family Business Institute's primary goal is to increase the survival rate for the good of the wider economy and the well-being of society.

Throughout its short but very active history, the Family Business Institute has endeavored to make every family business owner's dream come true: to see the next generation grow, develop and take up the baton of the family firm. Its members have given their time, and will continue to give their time, to ensuring that the generational transition is smooth and successful.

Specifically, at the last annual assembly, the members voted to focus the Institute's efforts on the business-owning family and family firm governance.⁵ The results of the vote were as follows.

1. Do you think that the Institute's goals should be focused on?
 - The business-owning family **59 percent**
 - The issues of primary concern to society, provided they have an economic component **22 percent**
 - The factors that determine business competitiveness in general? **12 percent**
 - The public image of family business **7 percent**
2. The Institute regularly organizes training activities in the areas listed below. Which are of most interest to you?
 - Good governance of the family firm **42 percent**
 - Efficient boards of directors **25 percent**
 - Leadership **11 percent**
 - Professionalization and human resource management **8 percent**
 - Innovation **8 percent**
 - Internationalization **6 percent**

4 Perception of family business in society

4.1 The public image of family business⁶

The general conclusion of a study carried out by the PR firm Edelman in collaboration with the Family Business Institute is that family business has a good public image. The prevailing view is that family firms not only have a better image now than they did a few years ago, but also that they have a better image than non-family firms. However, this

image is still rooted in the perception that family businesses are different from large corporations. In other words, this good reputation is partly due to the fact that family business is still associated with small and medium-sized companies. This illustrates how concern for product and service quality, being close to customers, and respect for history and tradition go hand in hand with other attributes, such as small size, lack of professionalism and conservative attitudes. Family-owned businesses are also perceived as being less innovation-oriented.

In many cases, therefore, there is a big gap between the image and the reality (some family firms are industry-leading multinationals).

Evidently, the maturity and organizational complexity of family business is not yet fully appreciated. Often this is because family business is not understood as a type of business in its own right, but is still very much associated with small and medium-sized enterprises.

4.2 Perceived strengths of family businesses

The perceived strengths of family business could be summed up as follows:

- Family firms are generally considered more likely to build relationships of trust with their customers and other stakeholders.
- They are thought to be driven by values that go beyond the mere logic of the markets in which they operate, forming strong ties with their local community.
- They are credited with a long-term outlook and a strong sense of social responsibility toward the environment in which they operate and the people that work in them.
- At the same time, they are thought to play a vital role in creating employment and developing the local economy. This is thought to reflect deeply held values of service to the community.
- Family businesses are seen as having a very thorough knowledge of the industry in which they operate, along with other qualities such as dynamism, competitiveness and an ability to adapt to the market.

4.3 Perceived weaknesses of family businesses

The perceived weaknesses of family business could be summed up as follows:

- The supposed values do not always translate into explicit corporate social responsibility or social marketing actions beyond the company's immediate area of influence.
- There are problems of long-term company survival and growth.

- Family businesses are often thought to have less chance of survival than non-family businesses because of inadequate succession planning, lack of professional management or reluctance to innovate.
- The main factors affecting survival are disagreements and lack of communication among family members and poor succession planning.
- Internal communication among family members to ensure business survival is considered inadequate.
- There is a general perception that family-run organizations fail to adopt effective communication policies to support a strong and differentiated brand image, have poor communication and do not advertise effectively.

5 The reality of family businesses and their engagement with society

In any family business, certain relationships are established between the family and the company on the one hand, and the company's stakeholders and society at large on the other. These relationships are governed by a series of processes which are reflected in the following data on family businesses in Spain:⁷

- 70 percent of family businesses have considered establishing written rules on the transfer of ownership
- 75 percent want the company to remain family-owned and family-run
- 74 percent believe that there is a leader in the next generation
- 65 percent consider it important to hire outside advisers or independent non-executive directors
- 60 percent have no agreement or established method for valuing the company's shares
- 50 percent have no dividend distribution policy
- 55 percent have no rules on wills; and 54 percent have no rules on joint and separate property in marriage
- 74 percent of family members who work for the family firm do so without having met any special requirement. However, in 56 percent of firms, family members' employment and pay are regulated
- 50 percent have no succession plan
- 77 percent believe they have in place a serious professionalization program
- 47 percent believe owners should be managers, as against 31 percent who disagree

In May 2007⁸ a survey of the Institute's members was conducted on the occasion of the twenty-third annual assembly. Members were asked to state their position on the most pressing problems facing family business owners. The results were as follows:

3. How do you plan to transfer the company's shares to your heirs?

- Equally among the heirs, in both economic and voting rights **34 percent**
- Unequally, in both economic and voting rights, depending on each person's involvement in managing the company **32 percent**
- Unequally in voting rights but equally in economic rights, depending on each person's involvement in managing the company **34 percent**

Clearly, opinion as regards the transfer of shares is divided.

4. Do family members who are directors receive any remuneration?

- No **31 percent**
- Yes, less than 6000 euros per year **2 percent**
- Yes, between 6000 and 18,000 euros per year **24 percent**
- Yes, more than 18,000 euros per year **43 percent**

Here we see contrasting positions: 31 percent offer no remuneration, while 43 percent pay more than 18,000 euros per year.

5. Does the company distribute dividends?

- No **28 percent**
- Yes, less than 16 percent of profits **31 percent**
- Yes, between 16 percent and 30 percent of profits. **19 percent**
- Yes, between 30 percent and 50 percent of profits **12 percent**
- Yes, more than 50 percent of profits **10 percent**

Again, the diversity of dividend distribution policies is striking.

6. Are there any regulations in place for family members and relatives (in-laws) who wish to join the company management?

- No, there are no rules; anyone who wants to may join **2 percent**
- No, there are no rules; those the family considers appropriate may join **49 percent**
- Yes, there are rules **49 percent**

The same diversity is apparent in the procedures for admitting family members to management positions.

All this adds up to the fact that the problems of family business need to be addressed individually for each business-owning family. Different firms' cultures and values do not necessarily coincide; they are the product of a tradition that has formed over generations.

Data published by the European Group of Owner Managed and Family Enterprises (GEEF) indicate that this overview of Spanish family business owners can be extrapolated to the rest of Europe, where the problems are similar.

6 The challenges for family businesses

In light of the reality reflected in these data, it is clear that family businesses must tackle certain challenges affecting their efficiency and continuity.

The first risk derives from the rapid pace of change in the markets, driven by globalization. Opportunities abound, as new markets open up and previously neglected populations achieve levels of consumption that would have been inconceivable only a few years ago. At the same time, competition has intensified, as new players come onto the scene, offering lower prices and costs.

To meet this challenge, the key is to adapt as quickly as possible, to become more professional in every respect, and to regulate relations between the company and the family.

I do not propose here to deal at length with the factors that determine the efficiency and competitiveness of family businesses, as they are covered more fully elsewhere in this volume. I shall merely list the most significant ones.

The first is the need to structure relations between the family and the company and establish appropriate channels of communication, taking each company's values and culture into account. According to leading US family business expert John L. Ward, the three most important factors in family enterprise are "*communication, communication and communication.*"

This requires, first, proper professional training for all family members who join the business as managers; and professional succession planning, so as to identify the person best suited to lead the enterprise and maintain the entrepreneurial spirit.

Second, it requires proper governing bodies. Current theory recommends having a family council as well as a board of directors. It is not

easy to get these two bodies working together efficiently, but every business-owning family must assign roles as appropriate, so that both the family council and the board of directors fulfill their task and relations between them are fluid and complementary.

Third, it requires a framework for relations between the family and the company. Situations and positions must be defined in such a way as to avoid, as far as possible, the conflicts that are bound to arise in any family firm as it grows and develops.

And fourth, family businesses need to address the management factors that influence a company's efficiency in a globalized economy, factors such as innovative capacity and international expansion.

Clearly, family businesses still have a long way to go. But the future of the economy in general, and of the Spanish economy in particular, depends on their ability to remain competitive, to innovate, and to expand internationally, as some of them are doing already. The best way to promote national competitiveness is to recognize the role of family businesses, support them and learn to appreciate what the entrepreneurial spirit means for the country's well-being.

In sum, family businesses are called upon to play a leading role in internationalization, professionalization and innovation, and to actively engage in the wider debates taking place in civil society over the course of the twenty-first century.

Notes

1. GEEF European Group of Owner Managed and Family Enterprises (Groupement Européen des Entreprises Familiales).
2. Data provided by IFERA. 2003.
3. Harvard Business School, 2001.
4. Commission: Final Report of the Expert Group on the Transfer of SMEs, May 2002. Projection for the next 5–10 years.
5. Voting machine survey of 78 members carried out during the Institute's annual assembly, May 2007.
6. Study carried out by Edelman in 2006 involving 153 Spanish companies (33 family companies, 31 non-family, 36 consulting firms, 29 business schools and 24 media enterprises)
7. Data from a study published in 2004 by UNILCO
8. Voting machine survey of 78 members carried out during the Institute's annual assembly, May 2007.

10

Fair Process and Emotional Intelligence

Ludo Van der Heyden and Quy Nguyen Huy

Introduction

In an earlier paper (Van der Heyden et al., 2005) we presented the case for the fundamental role that *fair process* – also referred to in the organizational literature as *procedural justice* – plays in creating a perception of fairness inside a family business. Interactions in family businesses tend to be more complex than those in non-family firms because these involve at least three influential groups with different needs and interests: family members, shareholders and employees.

In their simplest form – and this is the usual representation of firms in economic theory – businesses are an alliance between shareholders who provide capital (and assume social responsibility for the business) and employees who provide their labor. Family businesses form a more complex alliance, as they involve a family in support of a business venture, and vice versa.

In any alliance between groups, conflicts unavoidably arise about the appropriate distribution of the advantages gained, and about the principles that govern the resolution of these conflicts. For alliances to be enduring, at least two conditions must be present: mutual advantages must be experienced over a certain time period (but not necessarily at any point in time); and, more subtly, the principles governing alliances are seen by the groups involved as fair. Fairness acts as glue keeping the members together; unfairness breaks alliances apart, even in the presence of mutual advantage.

The transition to an evaluation of fair process as distinct from the evaluation of the advantages gained by the various groups – otherwise known as *distributive justice* – is required by the fact that the principles that guiding the appraisal of distributive justice differ radically across the

three constituencies forming family firms. Family members are likely to perceive fairness when resources are allocated to members that show legitimate *need*. Meanwhile, employees are more likely to perceive fairness when decisions regarding matters such as budgets, promotions, resource allocation are based on *merit*. Finally, shareholders are more likely to perceive fairness when every shareholder is given the same information at the same time, and the same dividend per share. In other words, the principle guiding judgments of fairness by shareholders is *equality*. It is therefore impossible for the three main constituencies of the family business to agree on a common principle that could be used to evaluate distributive justice. One potential means to address this difficulty is for the family to define processes (or procedures) that are perceived as fair so that the outcomes – including the potentially disadvantageous ones – are accepted by all. This is the rationale for fair process.

It is worth underlining that the potential promise of fair process is to move the discussion from an acrimonious, divisive discussion over shares of a fixed-size pie to a structured, constructive exchange over how to generate better and bigger pies, and sometimes smaller ones. Fair process enables constituencies to move their discussion from the quality of outcome to the process that generates the outcome. Fair process not only changes the object of the discussion, but also the very nature of the discussion. The reduced emphasis on tradeoffs (or even negative sums) amongst groups or group members and the increased attention to designing and executing processes of interaction lie at the heart of the promise of the fair process concept. Indeed, the remarkable effectiveness of fair process relies on its ability to improve both the economic performance of the alliance and the psychological satisfaction and commitment of the people involved (see, e.g., Kim and Mauborgne, 1991, 1997, 1998).

Van der Heyden and colleagues (2005) illustrated how difficulties inside family firms emanate from a perceived violation of fair process, and how good practice can be interpreted implicitly as application of fair process. This article, argued that fair process, known to be important to collective decision-making and execution in non-family firms, is particularly useful for family firms, in areas as diverse as conflicts amongst family shareholders, human management processes, leadership succession and the organization of *the business family*.

More importantly, it proposed a new and more operational definition of fair process. The literature on fair process (e.g., Kim & Mauborgne, 1991, 1997, 1998) had shown the consequences of violations of fair process, but had explored relatively little how to avoid these violations. Van der Heyden and colleagues (2005) addressed this question by suggesting

a relatively simple and very operational fair process model. The effectiveness of this model was validated empirically by Limberg (2007), whose results appear summarized in Van der Heyden and Limberg (2007).

Recently, the management literature has begun to explore the role of emotional intelligence. Emotions were explored by early management scholars such as Lewin (1947) and Argyris (1990) who posited that people often resisted change because of their fears of uncertainty and ambiguity. Schein (1992) suggested that organizational change efforts challenge individuals' "non-negotiable" assumptions regarding their belief systems and sense-making abilities; these assumptions are an inherent part of their identity. Salovey and Mayer (1990) introduced the concept of emotional intelligence as the ability of individuals to understand and manage their emotions and those of other people they are interacting with. Goleman (1995) popularized the notion very effectively so that today *emotional rationality* (or the logic of emotions) is viewed as complementing the traditional notion of economic rationality.

Huy (1999) moved emotional intelligence from the individual level to the organizational one. He argued that some organizations develop routines or processes that make them more emotionally intelligent than other organizations, *and this regardless of the innate traits of their members*. In other words, Huy argues that organizations can be emotionally intelligent even when their members are not. As a result of Huy's work, emotional intelligence thus enters the realm of *organizational capabilities* that need to be developed and nurtured. Huy (2005) furthers this argument by identifying 5 emotion-related organizational routines – or emotion-based capabilities – that help an organization manage major strategic change. Each routine involves a dominant emotional state that can be particularly critical to the success of various sub-processes related to organizational change. The emotions that are thus addressed are emotional authenticity, constructive discontent, sympathy/empathy, fun (or passion) and hope. Considerate attention to these emotional states fosters attitudes and behaviors that open up individuals to consider and mobilize for ambitious and difficult change.

As we have alluded to earlier, family businesses are influenced to a significant degree by emotions, as well discussed by Goleman (1995). Positive emotions such as love and pride, as well as negative ones such as anger, fear and envy regularly permeate relations among family members. This also applies to family business managers and shareholders, who equally are human beings experiencing feelings and thoughts.

In this chapter we link fair process with the emotional intelligence literature and thereby gain new insights into the effectiveness of fair

process practice. We will show how this linkage helps us understand why fair process is so effective for family businesses, and thus can be construed as an essential organizational capability for business families. We explain why fair process is likely to be beneficial for families and their businesses, regardless of the levels of emotional intelligence of the individual members. Our chapter seeks to contribute to the organizational literature by articulating the deeper emotion-related mechanisms that underlie the effectiveness of fair process.

1 Emotions in family firms and emotional intelligence

The family as a social institution incorporates several key goals, including nurturing young children and providing mutual support between family members or partners. Its principal driver is not money, but emotion. In modern societies, people often marry more for love than for economic interest (although the two can coexist to a certain extent), and the desire to bear children is intimately related to the love of the parents. This love can have complex facets which scholars such as Freud (1920) have explored, leading to the development of psychology and psychiatry. Emotions are varied, can be elicited by many different causes, are non-verbal and largely tacit. Families are the first context where we experience and express them and where we learn to regulate our emotional states, albeit imperfectly. Goleman (1995) makes this argument very well, speaking about “the family crucible.” A key point throughout the book is how emotional intelligence is developed at home and at an early age. In this Goleman also illustrates and expands upon the fundamental work of Erikson.

Erikson (1950) expanded Freud’s development theory into what he referred to as “eight ages of man,” each age bringing a challenge to be mastered. The infant age (from 0 to 1 year), for example, is where children experience or fail to experience safety, leading them to become trusting or mistrusting. The next stage (from 1 to 3 years) is where toddlers start acting more autonomously and where they also learn about limits. Healthy determination to explore one’s limits and learning to fail without shame are good outcomes of this stage. Unresolved development at this stage generates control issues, as well as excessive tendency to doubt or to feel shame. Erikson raises several points that are important to our arguments. First, the *sequential and cumulative dynamic* of the stages is key; each stage builds upon the previous one, and hence failure at any stage leads to difficulties at subsequent stages. Second, the developmental influence is not unidirectional: children

equally contribute to the development of their parents – described by Erickson as *mutuality*. The early years represent “natural” time periods for the developmental challenges to be addressed, but these challenges can also be addressed later in life when not addressed successfully during their natural time period. Such “recovery” or “late development” can be favored by the “context” such as a meaningful spouse or parent–child relationship.

A family business context generates a distinctive context for human development. Opportunities for learning are more diverse than those that pertain to a non-business family, but so are tensions and constraints. One does not easily escape one’s family; escaping one’s boss is easier when the boss is not your father. Being bypassed for a promotion or for an ownership transfer by one’s sibling makes the loss even more painful. Professional management is challenging in itself, but the challenge is amplified by family factors. These factors permeate the family business in various ways. First, our behaviors are determined largely by the quality of our learning during our early family development stages. When family members are involved in the same business entity, this macro organization-level factor adds a significant overlay onto our individual “micro-factors” that already influence each of us. It is this macro-factor that shapes the centrality of emotion in the family business. This phenomenon has been described by researchers such as Kets de Vries and colleagues (2007), who show how emotions can be very positive or very destructive. Thus, there is no need to eliminate or deny emotions in family businesses – even if feasible, this would trigger bottled up frustration and unhealthy denial. However, more than in a family unrelated to a business, it is critical for business family members to learn to manage them so that energies are channeled positively, and not destructively.

Emotional intelligence scholars such as Mayer, Salovey, and Caruso (2004) have argued that in order to regulate emotions, people must display abilities in recognizing and distinguishing various emotional states, both in themselves and in other persons. This is where the work of Huy (1999, 2001) is particularly noteworthy.

Huy (1999) proposed that emotion management is not only a concern for any given individual, but should also receive organization-level attention. Previous scholars such as Kets de Vries and Miller (1984) had already described the collective nature of emotions in organizations and its dys-functionalities, coining the term *neurotic organizations*. Huy (1999, 2005) went further by identifying certain emotion-related organizational routines that can foster beneficial outcomes for organizations, including receptivity to change and organizational learning (see Figure 10.1). This

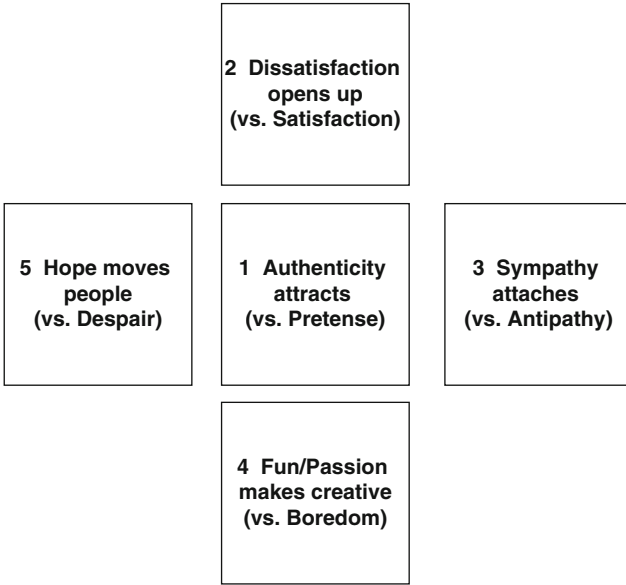


Figure 10.1 Emotional levers for organizational change according to Huy (1999, 2001)

is very important for it connotes, amongst others, that organizations, or their routines, can be unintelligent emotionally, even when involving emotionally intelligent individuals; and, conversely, that certain routines render organizations more emotionally intelligent, even when composed of individuals that can be described as only moderately emotionally intelligent.

The first emotion-related organizational routine involves *authenticity*. Authenticity refers to the honest expression of one's internal feeling. Authenticity strongly influences the well-being of people at the personal level (the true self) and generates a virtual cycle of reflection inside the individual finding authenticity in others (Argyris, 1993). Hence, authenticity fosters emotional intelligence in those encountering it. On the contrary, perception of emotional manipulation inside an organization leads people to reject instinctively other people's words and behaviors and rapidly closes off both their hearts and their minds. At best, this results in a reduction of attention. At worst, defensive, opposing routines are activated.

The second emotion – *dissatisfaction* – helps to motivate the questioning of the *status quo*. Given that people are naturally averse to the

risk that change represents, a necessary step is for them to experience uncomfortable, agitated feelings regarding the continuation of the *status quo*. Dissatisfaction that one has not yet fully achieved one's aspiration level in regard to a specific goal is more sustainable than experiencing continual fear. Although the latter emotion can energize survival reactive behaviors and therefore lead to remarkable results, people experiencing prolonged fear become de-energized. Managers who continually employ fear as a managerial lever risk eroding loyalty or commitment amongst their followers. As a result, fear as a lever for change seems sub-optimal as a regular routine in organizations. Rather, dissatisfaction that is framed *constructively* as an invitation to improve typically inspires individuals with renewed energies and commitments.

The third emotion relates to the expression of *sympathy*. Sympathy represents a less demanding emotional process than empathy, since it refers to our ability to feel for the general suffering of another person, with no direct sharing of that person's experience. Expressing sympathy in a stressful period involves behaviors that show respect for another person's identity and demonstrates care about their welfare.

The fourth emotion, *hope*, represents an emotional state that is elicited by appraisal of future positive prospects for self (Ortony et al., 1988). Hope buffers people against apathy and depression and strengthens their capacity to persist under adversity; it bolsters people's beliefs that they have both the will and the means to accomplish goals (Snyder et al., 1991).

Finally, *fun* (or *passion* or *joy*) as an emotional state results from the motivated search for pleasant experiences and aesthetic appreciation and is a key attribute of emotional intelligence (Salovey and Mayer, 1990). Fun fuels intrinsic motivation, which represents one of the necessary preconditions for creativity (Amabile, 1988). From a neuropsychological perspective, fun permits the rapid generation of multiple images so that the associative process is richer. A happy person engages more often in exploratory behavior, which is necessary for creative discovery. By contrast, neurologists have found that sadness slows image evocation, thus narrowing the associative process and reduces creativity (Damasio, 1994).

Summing up the argument of Huy (1999) is triple: (i) organizations can foster emotional intelligence amongst its members – even if the latter are not necessarily emotionally intelligent to begin with; (ii) a specific number of emotions (authenticity, constructive dissatisfaction, sympathy, fun, hope) are key to organizational change; (iii) for organizations

to benefit from these positive routines, it is important to properly *sequence* these emotional routines properly so that the individuals can master and manage their emotions, and not become confused due to an excessive emotional input and blockage.

3 Fair process in family firms

Having highlighted the potential importance of emotions for individuals, families, and organizations, we now describe fair process, as discussed by Van der Heyden et al. (2005). We will then show how fair process interacts with emotions to explain its influence on the performance of family firms.

Van der Heyden et al. (2005) construe fair process as a dual construct encompassing both a sequence of specific steps and a set of behaviours demonstrated by the actors implicated at each of step. It is the combination of a well defined process and a set of behaviours espoused by the relevant actors that results in the process being perceived as fair, resulting in a similar perception for the outcome generated by the process. The framework is presented in summary form in Figure 10.2.

The organizational literature on fair process had, since the early work of Leventhal (1980), recognized the importance of fair process, but had

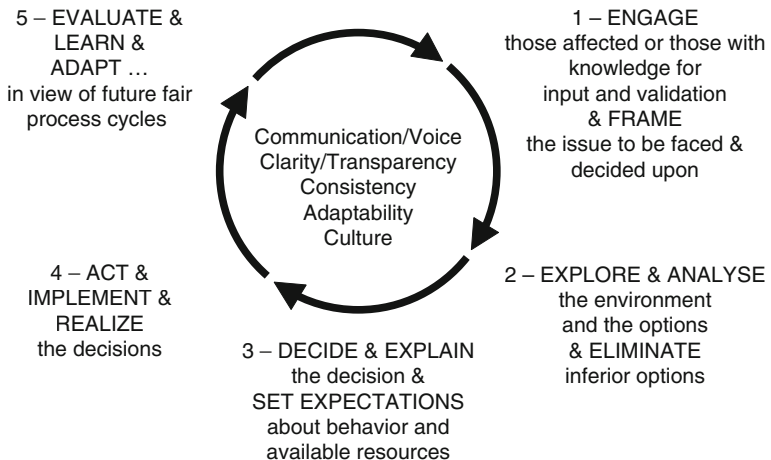


Figure 10.2 Fair process framework due to Van der Heyden et al. (2005) (with a description of the five process steps and required behaviours at each step)

not so far explicitly introduced a process description in this definition. The framework presented in Van der Heyden et al. (2005) was motivated by a standard decision-making frameworks as given in the decision-making literature, such as Russo et al. (2001). These authors describe a decision-making process as consisting of a set of iterative steps defined as: (1) Framing, (2) Gathering Intelligence, (3) Coming to Conclusions, (4) Learning from Experience. The last step typically starts a new decision cycle.

We made three changes to this definition. The first integrates the fair process lessons as emanating from the work of Kim and Mauborgne (1991, 1997, 1998). These authors identify the three fair process failures regularly made in organizational decision-making. These consist in a failure to engage relevant actors, as well as a failure to adequately explain the rationale of the decision reached. The relevant actors are those that are impacted by the decision, those that will be involved in its execution, and, finally, those that may have some useful information on the decision. These authors also stress the importance of clearly stating expectations to those affected or those involved in implementation. By integrating these “negative” aspects of common organizational decision-making into the Russo et al. (2001) framework, the latter is enriched and a positive or normative framework results.

Further thinking led to a second change to Russo and Schoemaker’s framework. It concerns the introduction of a step corresponding to the execution of the decision. This addition changes the flavor from a decision-making framework to a managerial one that is also concerned with the execution of decisions. This link establishes very clearly that quality of decision-making and quality of implementation are intimately linked, and that preparation of execution is best done with those involved in or affected by its execution. This is also the perspective of Black and Gregersen (1997) whose framework is similar to ours, without emphasizing the fair process aspect.

The process framework that results (and that appears in Figure 10.2) makes the point that each of the steps contributes to the quality of the outcome of decision-making and execution. By insisting on a sequential or process-like progress consisting of five steps, confusion and ensuing conflict are typically reduced in a context which is prone to such outcomes. It is our experience that not paying adequate attention to any of the five steps typically results in inferior formulation decision making and execution.

Techniques and tools exist to support each of the five steps, as presented, for example, in Russo et al. (2001). The fair process literature

makes a further observation by enunciating behavioral characteristics that these decision steps ought to evidence to be taken by those concerned as fair. These characteristics are largely the ones mentioned in the literature and go back to Leventhal (1980). We present them now.

The first characteristic that a fair process must display is to give those concerned with the decision *a voice* so that they can have their views heard and represented. This voice provides those affected with the possibility of shaping the decision under consideration. This voice in larger organizational settings is typically a representative or advocate for a particular stakeholder group. The lack of voice of non-family managers or non-managing family members often represents a difficulty in family firms. The topic of engaging all those concerned in communication by giving them a voice is indeed the first step for building fairness in the family firm.

The second characteristic of fairness concerns the *clarity and accuracy of information*. It requires the process to be informed with the best data and information relevant to decision-making. Kim and Mauborgne (1997) make a key contribution by underlining that this informational requirement must include proper explanation of rationale as well as expectations with regards to execution. Lansberg (1988) would suggest that clarification of entitlements should fall under this rubric too, by which we include rewards that will follow successful execution. Some of the recurring difficulties that business-owning families face often result from misunderstandings of individual or family goals, of aspects of the family firm's decision-making processes, or lack of clarity on rewards that will be bestowed upon those concerned. Younger generations increasingly view this lack of clarity quite negatively. In sum, fair process requires clarity and clarity enhances fairness.

The third requirement asks for *consistency across people, over time, and with agreed values and norms*. We also see consistency as supporting Leventhal's ethicality requirement, which can be framed with consistency of prevailing values and norms. Consistency of current decisions with past ones forms the basis for the *rule of precedence* in law. In management the saying "walk the talk" requires actions to be in line with espoused intent. Inconsistencies inside the family take on forms such as "my brother was treated differently than me," while in business they might be expressed as "we are treated differently than non-family members." The requirement can be stated succinctly as requiring that the decisions and the processes yielding or executing them should be consistent across individuals, over time and with family firm principles.

The law is presumed to be fair, including in dealing with new evidence or circumstance. When such evidence is brought forward, the courts typically follow particular procedures about how this new evidence should be taken into account to review past decisions and possibly alter their content. The inability to alter course turns the family and its firm into a prison whose members will be increasingly motivated by the sole desire to escape. This is the basis for the *changeability requirement* of Leventhal (1980). It is important to note that the latter requirement conflicts with the previous one, which emphasized consistency, but that this conflict is only an apparent one. Its resolution lies in combining them: a clear process should always be followed even to alter past decisions, or when considering changes to organizational processes, goals or principles. For fairness to prevail in the context of unavoidable change, this change ought to be executed in a clear and transparent manner. Family businesses must be prepared to address changes to the business as well as family conditions due to natural or economic life cycles. The ability to adapt values, goals, commitments in the light of changes in the surrounding economic, social, political and physical environment is a critical success factor for all organizations. In the case of family businesses, changes in the family – whether in the composition of the family shareholding or more simply of the family's changing needs and aspirations – should lead the family and its business to reassess its plans, policies and agreements. A unique challenge of family business is that family life cycle events (e.g., death, but also birth) can suddenly cause discontinuities for the business.

In our efforts to characterize fair process in the family business context, we largely followed Leventhal (1980) and identified communication, clarity, consistency and changeability as essential features of the decision-making processes. However, we have experienced that a family business can have clear procedures and principles, communicate well, act consistently and allow for changes, and yet still fall short in its fair process practices. This is the case when either family or business members' actions appear to exhibit fair process practices, but do so in a mechanical way, without a deep commitment to fairness. In such cases, the introduction of fair process as a concept and a practice is generally perceived as a utilitarian exercise intended to maintain or even facilitate support for the leadership. Or when the family's leader becomes more established and more powerful, yet follows routine managerial processes in an increasingly abusive manner. Such impressions often signal that the leader's commitment to fair process is gradually being replaced with executive requirements and a dominating managerial

style. This behavioral change, if left unchallenged, ends up affecting the family business system, causing commitment to be replaced with cynicism, resentment and, finally, a desire for revenge. Our conclusion is that a deep commitment to a *culture of fairness* in the family business system is the best and ultimate antidote to such slow pernicious changes in leadership style and behavior at the top.

Our second observation is that people tend initially to view fairness and justice as *absolute requirements*, which can never be achieved in actual practice. This leads them to conclude too hastily that the concept can have no relevance for the business, or for the family, which both require compromise and tradeoffs. As clearly demonstrated by Kim and Mauborgne (1991, 1997, 1998), it is critical to see fair process as a *relative concept*, precisely because its full essence can only be aimed at in practice while never being fully attained. There is no guarantee that its application will be outstanding or perfect in practice; in fact, its application will always be imperfect. But, and this is the key, any increases in fair process *relative to the past* will improve performance and individual satisfaction, with consequent increases in commitment and trust. Such implications cause a fundamental change to the entire system, as well argued by Weick (1984). No relative gain is to be ignored and arguments based on the lack of absolute fairness miss the understanding that the concept has considerable incremental value. It is a deep commitment to fairness that fuels the continuation and even improvement in fairness in the processes governing the family business system, and that also is the best antidote to any mechanical application of fair process or to its abandonment all together.

To conclude this section we would like to refer to the major result of the fair process literature: the relationship between fair process and performance, economic and psychological, is positive and strong. As an example, the relationship evidenced in Van der Heyden and Limberg (2007), where innovation performance is reported in 15 German manufacturing plants, is both positive and linear (which cannot be considered a given). Fair process is measured using the five-stage fair process framework explicated in Van der Heyden et al. (2005), while innovation performance (in Figure 10.3 we show the performance of a critical innovation sub-process, the strategic product planning process) is measured as a weighted average of different perspectives on innovation outcomes.

The result mentioned in the previous paragraph can be summarized very simply as follows: fair process works and is fundamental for high performance. The operational nature of the fair process definition used

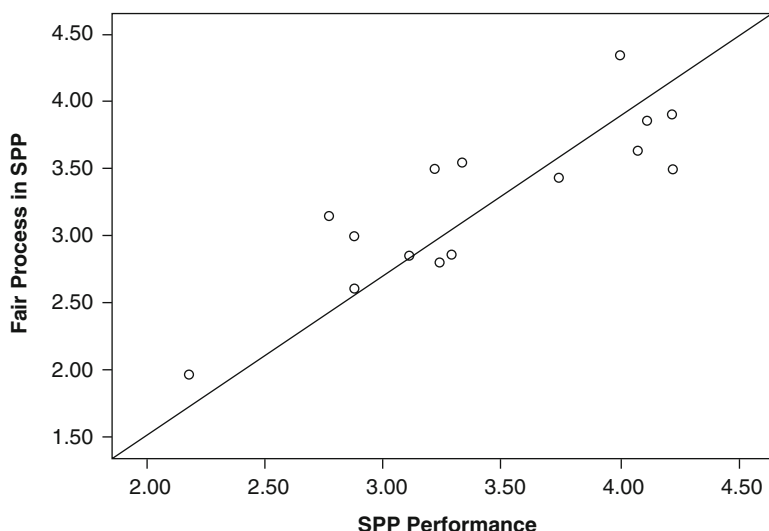


Figure 10.3 The science of fair process: the relationship between fair process and performance in strategic product planning process (SPP) of 15 German manufacturing plants

Source: Limberg (2007).

provides a normative framework that proves most useful to steer management teams in the fairness direction. This raises the final issue or caveat: are there any reasons why fair process, which promises such great benefits, is so often violated in practice? Brockner (2006) presents a number of reasons, including lack of knowledge, risk of appearing weak and indecisive, or losing control of the agenda. Wu et al. (2007) confirm the latter by presenting a model where strong and conflicting private agendas are shown to make fair process less prevalent than it would be in the absence of private agendas. Because of its importance, we detail the model these authors present.

Wu et al. (2007) use a principal-agent framework where both the principal and the agent have private agendas. Their paper shows that the principal will choose for fair process when private agendas do not matter too much. This is the case when either the principal's private agenda is relatively well aligned with the transparent common "public" agenda, or when she realizes that the incentive benefits incurred through a more motivated agent outweigh her private agenda losses due to the empowerment of the agent. On the other hand, when the principal estimates that opting for fair

process would lead to excessive private agenda losses, then she will choose against fair process and follow a more traditional “dictatorial” approach where she simply tells the agent what to do and where she accepts the ensuing motivational losses on the agent’s side. In other words, private agendas, if they are important and cause substantial deviations from a transparent “public” agenda, are not consistent with a fair process approach.

As a rejoinder it is worth noting that if fair process is pursued when private agendas prevail and matter, it is quite likely to reveal their presence. Indeed, our advice here is subtle and apparently “naïve”: engage all, including those possibly motivated by private agendas, but evaluate their inputs only in the light of the commonly and explicitly agreed common objectives. Those with private agendas will either be passive (and not affect the process or its outcomes), (perhaps inadvertently) contribute worthwhile ideas, or alternatively, will reveal that they are motivated by private agendas. One such instance occurs when the principal turns dictatorial and puts a sudden end to a fair process that might generate outcomes that run counter to her private agenda. Such an incident at least has the merit of signaling the existence of such agendas and the inconsistency of the principal’s behavior with a genuine fair process approach. The latter outcome does create a loss of face and credibility for the principal, so that the principal does not escape unharmed.

Any actor identified as pursuing a private agenda can only amend. The person identifying another as violating fair process can then either give the offender a second (and final) chance, or disregard someone so untrustworthy. If given a second chance, suspicion will remain and the only way for the offender to recover lost trust is through impeccable behavior, sustained over time. Only true behavioural change – and not mere words or intentions – will allow the offender to convince others of his real change. Fair process thus has its own logic of focusing on process and letting go of controlling outcomes. In the presence of private agendas, fair process might even reveal them; so, even here, there is a subtle argument for fair process.

The major issue, however, as Brockner (2006) argues, is that the fair process option requires the people in charge to let go of controlling outcomes which they have already mentally committed to. For many people, this choice for certainty of process, but *a priori* ambiguity of outcome is simply too hard to take. The rejoinder is that good leaders will already have a *hypothetical* decision outcome in mind. Fair process will then allow such leaders to *validate* their prior decision by virtue of a fair process cycle with those affected by the decision outcome. The

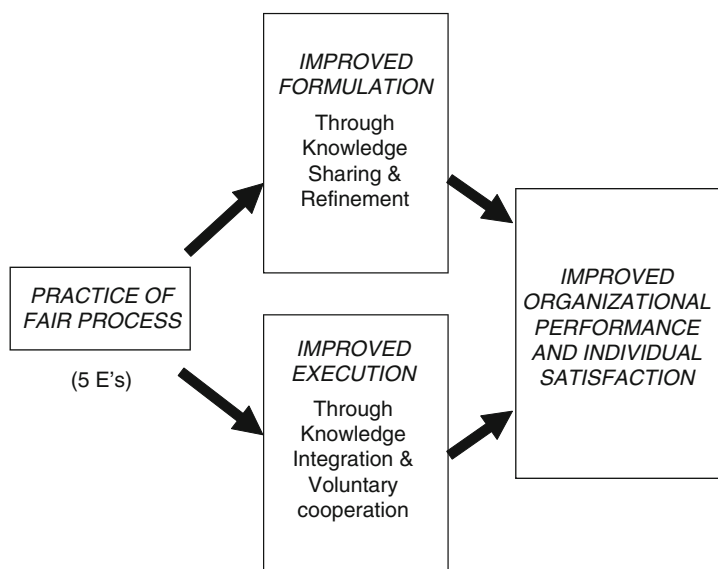


Figure 10.4 How fair process improves organizational performance AND individual satisfaction

psychological and emotional payoffs are considerable, both for the process leader and for those implicated, for both will come out of the cycle with greater insight into and commitment to the decision finally reached; the decisions will be better for the organization, will be more easily implemented, and all concerned will at the end of the process feel much better. This effect is illustrated in Figure 10.4.

4 Fair process analyzed from an emotional intelligence viewpoint

In this section we present a second argument in support of fair process that complements the empirical evidence cited in Van der Heyden et al. (2005) and in Limberg's (2007) dissertation. This argument is that fair process induces an emotionally intelligent approach, as defined organizationally by Huy (1999, 2005). As stated in our introductory section, the latter author identifies five sub-routines that contribute to an organization's emotional intelligence. These are : the practice of authenticity, the generation of constructive dissatisfaction, the demonstration of

empathy, the experience of fun (if not passion), and also the elicitation of hope regarding the future. We review these major emotional requirements in turn, and indicate how fair process indeed incorporates these routines throughout, or at particular instances of the fair process cycle (see Figure 10.5).

The first requirement identified by Huy for organizational emotional intelligence is *authenticity*. In fact, the requirement of a *culture of fairness* – which precisely states that those involved in fair process must be fully genuine about their approach, and not simply “go through the motions” or pretending to be fair when actually being motivated by other objectives – is synonymous to requiring authenticity. Indeed, this implies that the actors will seek and recognize the truth as best they can, however relative the truth is when it takes place in a possibly complex organizational setting, when it concerns a discussion that is largely concerned with the future (as opposed to the past where objectivity is easier to come by), and when the discussion involves many other people, some of whom might not even be known (like family members discussing about employees they do not personally know). Let us note further

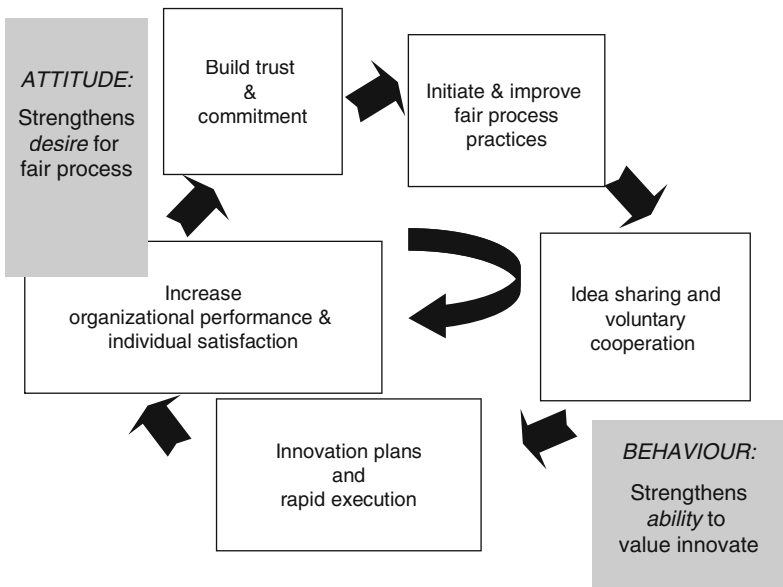


Figure 10.5 The virtuous cycle of fair process : building trust and motivation
Source: Kim and Mauborgne (1997).

that *transparency*, another fair process characteristic, is a catalyst for authenticity.

The second emotional intelligence requirement is *sympathy*. The *voice* characteristic is of course a first requirement, essential for human exchanges. Being endowed with a voice – often through representatives – *engagement* of those implicated or knowledgeable can start. Engagement is a very operational way of evidencing sympathy and generating empathy. Engagement starts with asking people for their ideas and their views on issues and problem-framing them. The most direct way for the fair process leader to engage her people is to ask them: “What do you think I ought to be working on or pay attention to? What would you do if you were in my shoes?” This remarkably simple question has many emotional virtues. First, it recognizes others as individuals, with heads (to think), hearts (to express emotions), and bodies (to get things done and execute properly). Secondly, the above engagement questions connote a real humility as the process leader through engagement is willing to let her brain be filled with a possible answer by the person thus engaged. The emotional payoff of course is consequential, as the *law of reciprocity* states (Cialdini, 2001). This type of engagement is typically reciprocated by an attachment to and trust of the person and/or organization that addresses an individual in this way.

This is a good moment to underline a remarkable contribution made by fair process and that concerns the leader/follower dilemma. The leader, implementing fair process with engagement starts by offering a *leadership opportunity* to the followers by engaging them in the framing of the agenda, and later in its resolution. In short, the fair process leader offers her followers the opportunity to be leaders themselves. This “leadership gamble” has tremendous emotional payoffs, as long as the leader understands that she should lead only if the followers are not capable of exercising the leadership that is offered to them in the first two steps of fair process. In fair process, a leader *de facto* puts her leadership – in terms of framing and planning – on the table for others to actively dispute until resolution becomes obvious, or until the leader calls for an end of the debates and a decision. Of course, this requires her to be sufficiently comfortable and secure. Her leadership rests less on being in front telling others what to do and providing all answers, but instead on *process leadership*. If we can use the analogy of legal proceedings, leaders in fair process move from being the *advocates* of strategies and possible outcomes to become *judges* overseeing adversarial proceedings about goals, means and outcomes.

We close with a final remark on reciprocity: it is precisely because the leader has given the so-called followers plenty of opportunities to propose issues and craft answers that, when it comes to deciding, the followers will reciprocate the leader's behavior and actively listen to what she has decided, why she has done so, and what is expected of the followers to properly execute the decision. This has a further leadership implication: conscious that the followers will look to the leader for an answer should they be unable to generate one themselves, the leader ought to be ready to provide such an answer, should the first two steps not reveal a satisfactory one. In fact, while the followers prepare their answers, she ought to *anticipate* the contingency that the followers do not propose a good plan. Even if not implemented, this anticipatory answer will also make her a better listener as she will gauge proposals in a more active way, being informed and knowledgeable about a situation she already examined earlier in private.

The second human behavioral law that needs to be mentioned in the context of fair process is the *law of self-determination* (Deci and Ryan, 1985). It states that people have innate needs for competence, autonomy and relatedness. Fair process seeks competences out, provides people with an opportunity to "write their own script", and makes people relate to each other. Self-determination, as well as reciprocity, is hard-wired in fair process, and helps us understand and accept its power. We will also refer to reciprocity later when speaking about the third step of fair process, devoted to decision-making.

Creative dissatisfaction is another essential ingredient of Huy's emotional intelligence framework. *Engagement*, especially when followed by *Exploring and Elimination Options*, involves framing issues or searching for improvement opportunities, not by affirming *ex cathedra* what is not working, but by probing people affected by the organization, its products and services. The first two steps of a fair process approach therefore generate, in a creative way, dissatisfaction with the *status quo*. It invites those concerned to express their views. The defensive reaction that can be triggered by telling individuals outright about their failures is replaced with the joy and challenge of creative engagement. Given that individuals are risk averse to change, the fact that they first are asked to examine rationales for change and then ways of changing makes infinitely easier for them.

This then leads us to the fourth element of emotional intelligence, which is that of *fun* and even *passion*. One of the main aims of the fair process approach is to spend enough time examining and preparing a decision, before its execution. By allowing people to voice their opinions

and then inviting them to explore solutions to commonly identified issues, change itself is experienced differently: from being a cause of anxiety, it is turned into an activity – and then an attitude – that is seen as fun and personally rewarding. As people work on change plans, they gradually become more interested, if not outright passionate about them, both in terms of convincing others that their work is superior, but including seeing it into execution (see Black and Gregersen, 2002). Recognizing, as one of my colleagues told me, “that only a baby with wet diapers looks forward to change,” this is a major step forward that the fair process approach aims for.

The second way in which fair process generates fun and even passion is by a disciplined application of the process itself. “The proof is in the eating” might be the saying here. As fair process generates results (see, e.g., Van der Heyden and Limberg, 2007), people having been involved with it will appreciate its outcomes, economic and psychological, and will gain confidence in the approach. What is often an anxious threat is turned into fun, and from there on possibly into a passion for taking on problems and solving them, pretty much the way accomplished consultants go about things when turning around organizational crises.

The final element of emotional intelligence identified by Huy (1999) is *hope*. Again, fair process increases hope for three fundamental reasons. First, those affected or knowledgeable are involved in the pre-decision phase which means that objections and counter arguments will have largely been dealt with and that people will not reject a decision that they have been involved in framing and giving content to. Second, the quality of execution of *deciding, explaining and setting expectations* is key in this regard. The first requirement for a change recipient is not to necessarily agree with the decision, but to at least understand the rationale that motivated the decision. So explanation is key obtaining to commitment. It is hard to put one’s full efforts behind a decision that one does not understand. The *clarity* requirement does not stop there: fair process makes a big point explaining and setting expectations for all actors involved in execution; people will agree to execute a decision that involves others only if they know that others will do their duty as well. Given that we are always more generous with ourselves, having clarity on what is expected of others, knowing that they heard the message and finally seeing them execute it, also assures my commitment. Finally, the fact that those who execute the decision have been addressed, hopefully in a collective way, in the exploration and explanation phase, makes the *execution* phase very different: expectations are clear and shared, so that in the execution phase the entire team goes forward,

informed about and complementing the actions of others. This additionally turns those that execute into controllers – and if needed coaches – of the execution step. In any case, execution is clearer to see, and generates hope as progress is actually observed and meets against expectations.

The third reason why fair process generates hope lies in the final step pertaining to *evaluation and learning*. Life is never perfect; or as another colleague puts it “a plan is what one starts with, but not what one ends up with”. Mistakes are part of life. The last step of fair process stresses that the effective way to deal with mistakes is not to ignore them, but to actively search for them once execution has ended. We may accept that our leaders fail us, but we do not accept that they do not recognize their failure. If they have failed us, we expect apologies, but more than apologies, transparent acknowledgments of the failure and convincing commitment that they have learned and that the failure will not be repeated. Not doing so leads to credibility loss, unavoidably, and fair process reminds us explicitly of this. It is common knowledge that companies are poor at learning the lessons of successful projects, or failed ones for that matter. It is in this capacity to recognize failure and to learn from it that people find new hope for the future. A learning organization, then, is just that: an organization that is able to turn mistakes into learning opportunities, so that similar mistakes are avoided in the future. It may in its pure form be a fiction, but aiming for it remains a laudable goal, and certainly one that generates hope.

5 Conclusion

The main argument of this chapter is that fair process, in its more operational definition due to Van der Heyden et al. (2005), contributes to the emotional intelligence of the actors involved with it. This chapter thereby provides an emotional underpinning as to why fair process is so powerful. Earlier work had already underlined the value of fair process for firms, and for family firms in particular. Here we provide a rationale for this practice rooted in emotional intelligence. The fact that the argument could be made in turn itself supports the operational definition of fair process used here.

Families are institutions that are largely governed by emotions, even if not exclusively so. Love, pride, but also anger, fear and envy often enter and govern the family. Business managers, and even shareholders, are also not without emotions. Hence, it can be stated that family firms are, amongst firms, those where emotions play a larger role.

Establishing that fair process is an emotionally intelligent capability, then, provides the family business with a means for dealing effectively with emotions in the family firm system, even when particular individuals may not be endowed with this capacity. The latter is a critical conclusion, for it makes the family business system more robust to the emotional idiosyncrasies of its members. Furthermore, it makes the case that a family group, even moderately emotionally intelligent at the individual level, becomes emotionally more intelligent when the functioning of the business system is governed by fair process.

More simply, this chapter argues why fair process is often able to effectively deal with quite complex emotional issues.

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Family Firms and the Contingent Value of Board Interlocks: The Spanish Case

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Introduction

In the last three decades, interlocking directorates have become a prominent area of research in the Corporate Governance literature. An interlocking directorate is created when a person affiliated with the board of directors of one organization sits on the board of another organization (Mizruchi, 1996). Over the years, researchers have studied the embeddedness of commercial banks, insurance companies and industrial corporations in the interlocking directorates (e.g., Davis and Mizruchi, 1999; Davis, Yoo and Baker, 2003; Mintz and Schwartz, 1981; Windolf, 1998). Furthermore, scholars have sought to provide direct evidence of the value that interlocking directorates have for corporations. Previous studies showed that interlocking directors affect organizational learning (see, e.g., Haunschild, 1993, 1994), the corporations' power and status (e.g., Davis and Robbins, 2004). Resource dependence theory argues that firms use board ties to manage their resource interdependencies (Pfeffer and Salancik, 1978), for instance, when banks directors sit on the boards of the companies to which they have lent financial resources (Davis and Mizruchi, 1999; Mizruchi, 1996). However, most studies on interlocking directorates have studied primarily US-based public companies and neglected the role of family firms in these networks.

While public firms are diffusing more and more, families still control large chunks of the economy in many countries. Over 60 percent of the 17 million businesses in Europe are family businesses. These firms

employ 80 percent of the total private sector workforce, representing more than 100 million employees. Their contribution to national GNP lies between 40 percent and 65 percent (GEEF, 2005). In Spain, family firms contribute about 60–65 percent to GDP, represent more than 1.5 million firms, and provide more than 80 percent of private employment (Jaskiewicz, Gonzalez et al., 2005).

Even in the United States, family firms are alive and well. Several recent studies show that family firms are at least as common among public corporations as are widely held and other non-family firms (Anderson and Reeb, 2004; Villalonga and Amit, 2006). More than 75 percent of American corporations are family-owned or controlled and one-third of the Fortune 500 companies are family firms. In the US, family businesses account for some 57 percent of employment as well as a similar percentage of the US GDP (Heck and Stafford, 2001).

Whether family firms play a role in the weaving of corporate networks is still an open question, and one that can potentially limit the applicability and relevance of some of the evidence gathered in 20 years of research on corporate interlocks. It seems therefore critical to address this gap by exploring the role of family firms in interlocking directorates. As a first step in this direction, we explore the structure of the interlock networks of the 396 major Spanish firms and focus on the position of family firms in this network.

Even though family firms appear to be quite common in Spain across a broad range of industries and regions, the embeddedness of family firms in the Spanish interlocking directorates is an issue that remains unexplored. Previous research on Spanish Interlocks had mainly focused on the role of industrial corporations, banks, privatized firms and utility companies in the interlocking directorates (Aguilera, 1998; Salvaj and Ferraro, 2005) without considering the role of family firms in the interlocks. Our study provides evidence that family firms are, on average, less central in the Spanish corporate network. Furthermore, the interlocking directorate of family firms is sparse. That is, there are very few directors who sit simultaneously on two or more boards of family firms. Nevertheless, the network of the top 20 family firms by betweenness centrality is more densely connected, thanks to the role of independent directors who sit on the board of both family and non-family firms.

The next section reviews the literature on interlocks. Subsequently, the data, method and results of the present study are presented. Finally, we develop propositions that can explain why we would expect family firms to connect through interlocking directorates.

Embeddedness through interlocking directorates

The concept of embeddedness refers to the actor's relative depth of involvement in the social structure (Granovetter, 1985, 1992). This perspective postulated that the structure of social relations in which a firm is embedded has an impact on its performance because this structure provides both opportunities for and constraints to its action. Researchers have explored the embeddedness of banks and big industrial corporations through the interlocking directorates. An interlocking directorate is created when a person affiliated with the board of directors of one organization sits on the board of another organization (Mizruchi, 1996). Consequently, the embeddedness of one organization in the corporate elite comes from being tied to other boards through shared directors. For instance, based on US data in 1962 and 1966, Mintz and Schwartz (1981) found that at the centre of the US interlocking directorates were major New York commercial banks and insurance companies. Davis and Mizruchi (1999) examined how the position of banks in the intercorporate network has changed as a result of their increasing role as financial intermediaries in the US economy and their reduced reliance on the corporate lending business. An analysis of comprehensive data on the boards of the 50 largest banks, and their connections with several hundred largest non-bank corporations from 1982 to 1994, shows that the centrality of banks has significantly declined over the years. The key driver of this shift, they argue, is financial disintermediation, that is, the fact that corporations were financing themselves primarily on the stock market, and therefore banks were not lending directly to them, and therefore did not need to control the use of these resources by sitting on the boards of the borrowing corporations.

In a study of Spanish corporate networks, based on the analysis of director interlocks among the 100 largest industrial corporations, 50 largest banks and 30 largest insurance companies in 1993, Aguilera (1998) concluded that Spanish domestic banks coupled with utility companies were located at the core of the interlocking directorates; capital intense industrial corporations belong in the inner circle of the network, while foreign-owned and light industry enterprises are isolated in the network. Salvaj and Ferraro (2005) investigated the structure of corporate relationships of the 35 major public Spanish firms in 2002. They found that utilities and privatized companies were now at the core of the interlocking directorates of the IBEX companies. Their results show that banks were not central in the interlocks anymore. Only Banco Santander remained at the core of the interlocking directorate. This finding is

consistent with the trend towards financial disintermediation most European countries experienced in the 1990s, and the associated shift towards retail banking in the banking industry.

The reason why scholars have studied the structure of interlock networks and the position each firm occupies in these networks stems from the evidence that this position affects many critical corporate decisions. Scholars demonstrated that interlock networks affect organizational learning, the imitation of practices among firms and the status and the legitimization of corporate actors. Interlocking directorates are potential sources of learning and diffusion of knowledge (McDonald and Westphal, 2003; Powell, 1990; Uzzi, 1996). Board members are involved in the most critical corporate decisions, so it makes sense that their experience at other firms will be brought to bear on the firm's own decisions. The process through which direct ties among directors might affect the diffusion of corporate practices starts with the monthly meetings of the board of directors. If one or more individuals are board members of more than one company, and both boards meet every month, then a corporate governance reform or a new strategy discussed at a board meeting could in five months make its way via face-to-face contact to almost all the boards of the largest corporations. Monthly meetings and dense local networks provide an ideal situation for the diffusion of practices, strategies and rumors (Davis, Yoo and Baker, 2003). Several studies show that interlocking directorates work as mechanisms for the diffusion of information, knowledge and corporate strategies. For instance, Geletkanycz and Hambrick (1997) found that top managers who held board appointments in different industries were more likely to initiate strategic change in their own firms after learning about new strategies in other industries. Haunschild (1993) showed that executives from the focal firm imitate the acquisition activities of the other firms to which they are tied through interlocking directorates. Westphal, Seidel and Stewart (2001) examined whether interlocking directorates facilitate second-order imitation, in which firms imitate an underlying decision process that can be adapted to multiple policy domains, rather than imitating specific tied-to-firm policies (first-order imitation). They found that firms that have board network ties to firms in other industries that imitate their competitors' business strategy are more likely to imitate their own competitors' business strategy, as well as their competitors' acquisition activity and compensation policy.

Interlock networks not only affect whether corporate decisions are indeed adopted, but also the quality of these decisions. Haunschild

(1994) investigated the effects of inter-organizational relationships on the decision of how much to pay when acquiring another company. Her findings suggest that top executives look at both their interlock partners and professional firms when deciding how much to pay and, in the case of interlocking directorates, this impact is stronger when managers are uncertain about the value of the acquisition target. Beckman and Haunschild (2002) found that firms embedded in interlocks with heterogeneous partner experience pay lower premiums than those in networks with homogeneous partner experience. They found several types of partner heterogeneity to be important: firms pay lower premiums when their interlock partners pay diverse premiums, when they have diverse networks, experience with acquisitions of various sizes, and when the interlock partners are themselves of diverse sizes. These types of diversity provide a wide array of information that helps corporations make better causal inferences. When firms are embedded in interlocking directorates composed of partners with heterogeneous experiences, they are not imitating. Rather, they are improving on partners' experiences and paying lower premiums.

A different approach to interlock networks proposed that social ties are not just relay stations spreading information and knowledge among connected organizations or individuals but also prisms that create differentiation among social actors. In this view, the presence or absence of a tie is an informational cue on which others rely to make inferences about the status and characteristics of one social player (Podolny, 2001). Several studies demonstrate that interlocking directorates affect the status and power of corporate actors (Bigley and Wiersema, 2002; Davis and Robbins, 2004; Finkelstein, 1992; Khurana, 2002; Wade, O'Reilly and Chandratat, 1990). For example, Bigley and Wiersema (2002) found that recently appointed CEOs who are seated on many outside boards are likely to have both more power and a broader cognitive orientation than those who sit on relatively few boards. Knowledge of the CEO's job and its context, provided by their apparent experience, in combination with power and a broadened strategic perspective through outside board membership, may contribute to an increase in strategic change.

CEOs' and executives' board membership on outside boards may increase CEOs' power and self-interested behavior, leading to decisions not necessarily aligned with shareholders interests. According to agency theory, top managers have personal incentives to pursue corporate diversification beyond the level at which shareholder wealth is maximized (Amihud and Lev, 1981; Hill, 1994; Hyland and Diltz, 2002). Agency theorists believe that corporate acquisitions, especially diversifying

acquisitions, and corporate provisions like poison pills and golden parachutes, reflect opportunism by top managers who are insufficiently monitored and controlled (Morck, Shleifer and Vishny, 1990). Palmer and Barber (2001) studied the factors that led large firms to participate in the wave of diversifying acquisitions in the 1960s. They found that firms that pursued diversifying acquisitions were led by well-connected CEOs who were central in elite social networks. In a cross-sectional study, Wade and colleagues (1990) found that CEOs who serve on many corporate boards are more likely to influence a board's decisions and get CEO's beneficial corporate provisions like change-in-control agreements that may go against shareholders' interests.

Most of the studies on the consequences of embeddedness just discussed were conducted on large American corporations. The role of family firms and the behavioral effect of interlocking in family firms were not considered by previous research. There are reasons to believe that family controlled firms might follow different board practices and therefore it seems critical to explore whether and how these firms are connected with the larger corporate network in which they operate. As a first exploratory step in this direction, we will explore the structure of the Spanish interlock network of major business firms and focus on the role of family firms within this network.

Data and methods

Our sample comprises the 396 biggest Spanish firms and 2417 directors. The sample was obtained from the Actualidad Económica ranking for the year 2002. For all these firms we have data on board composition, board size, sales, industry and the region in which the firm's headquarters are located. We compiled our data set from different sources: (1) SABI, Fomento de la Producción, DICODI 50.000 Anuario de Sociedades, Consejeros y Directivos and CNMV (Comisión Nacional del Mercado de Valores) for detailed information about shareholders, board structures and board members; (2) The Maxwell Espinosa Shareholders directory for information on shareholders; and (3) Actualidad Económica 2002 for information on sales, number of employees, industry and the region in which the firm's headquarters are located.

We followed the Spanish *Instituto de Empresa Familiar* (IEF) definition of family firms. According to IEF, family firms are defined as those ventures in which a family group has the power to appoint the CEO or to set the strategy of the company and where the next generation is being educated to continue with the family business (Corona, 2004). Following

IEF definition, 80 firms of our sample can be categorized as family firms. That is 20 percent of the firms included in our sample.

To achieve a better understanding on the role of corporate ties and board practices in family firms, we interviewed 8 owners of large Spanish family firms and 4 directors of family firms. We interviewed both owners of firms that were isolated from the rest of the Spanish interlock network and owners of firms that were highly connected.

The interlock data was analyzed with the social network analysis software UCINET (Borgatti, Everett and Freeman, 2002). We computed standard network statistics on the Spanish interlock networks. There are different measures to capture the centrality of a board: degree, eigenvector and betweenness. Board degree centrality is defined as the number of boards that a given board is connected to. Degree centrality of a node i can be formalized as:

$$d_i = \sum_j a_{ij}$$

Where a is a board connection between firms i and j .

Eigenvector centrality is best understood as a variant of simple degree. Eigenvector has become the standard measure of centrality in interlocking directorate research (Bonacich, 1987; Davis and Mizruchi, 1999; Mintz and Schwartz, 1981). This centrality measure represents power relations within the corporate elite. The idea behind this measure is that it does not just count how many boards one board is connected to, but how many boards are connected to the boards linked to the focal board. Bonacich (1972) defined centrality as the principal eigenvector of the adjacency matrix. An eigenvector of a symmetric square matrix A is any vector e which satisfies the equation:

$$e_i = \lambda^{-1} \sum_j a_{ij} e_j$$

Where λ is a constant (known as the eigenvalue) and e_i gives the centrality of node i . The formula implies (recursively) that the centrality of a node is proportional to the sum of centralities of the nodes it is connected to. Hence, a board that is connected to many boards that are themselves well-connected is assigned a high score by this measure, but a board connected only to near isolates is not assigned a high score, even if it itself has a high degree.

A third measure of centrality is betweenness centrality. A board that lies on communication paths can control communication flow, and is thus important. Betweenness centrality counts the number of geodesic paths between i and k that board j resides on. A geodesic is the shortest path between a pair of boards (Wasserman and Faust, 1994). Betweenness centrality can be written as:

$$b_k = \sum_{ij} g_{ikj} / g_{ij}$$

where g_{ij} is the number of shortest paths from node i to node j , and g_{ikj} is the number of shortest paths from i to j that pass through k . Betweenness indexes the extent to which a board facilitates the flow of information within the corporate elite. If a board with high betweenness centrality is removed from the interlock, the transmission from one board to another is more damaged than if a board low in betweenness is removed. Table 11.1 presents detailed information regarding firms' degree, betweenness and eigenvector measures. We used Netdraw (version 4.14, a network visualization package bundled with UCINET) to visualize interlocks graphs.

Results

Table 11.1 displays the top 30 companies ordered by betweenness centrality. Only two family firms, *Inditex* and *Ferrovial*, are included in the top 30 firms by betweenness centrality. Table 11.2 shows the top 20 family firms in terms of betweenness centrality.

Figure 11.1 shows the interlock network of Spanish firms in 2002. In Figure 11.2 we removed non-family firms from the graph, so this figure only shows the Spanish family firms and the links among them. Figure 11.3 represents the network of the top 20 family firms by betweenness centrality. In these figures, nodes are firms and the value of a tie between any two firms is defined as the number of directors who belong to both. The width of the tie represents the number of directors shared by two firms. Family firms are depicted as square nodes and non-family firms as circles. Black, white and gray indicate the regions in which the firms' headquarters are located. Table 11.3 reports information regarding the colors of each region and the incidence of firms by region. Data show that most firms are located in Madrid (nodes in color white in Figure 11.1). Size of nodes varies with the firms' betweenness centrality. In Figure 11.1 we can see that most central or embedded firms (biggest nodes) are non-family firms. *Inditex* and *Ferrovial*, which as reported in

Table 11.1 Top 30 Firms by betweenness centrality

Firm	Degree	Betweenness	Eigenvector
Grupo Dragados	24	4.401	40.686
NH Hoteles	14	3.218	21.152
Repsol YPF	18	2.4	42.338
Enagás	17	1.77	28.775
Banco de Santander	21	1.767	17.546
Sogecable	18	1.759	12.357
Endesa	15	1.726	23.344
Cepsa	17	1.722	19.761
Inditex	11	1.538	5.753
Caja Madrid	9	1.425	17.778
Uralita	10	1.412	6.045
Iberia	14	1.411	29.602
Asepeyo	8	1.375	3.249
Corporación IBV	13	1.203	19.967
Participaciones Empresariales			
Grupo Ferrovial	14	1.158	4.451
Acerinox	12	1.14	17.482
Telefónica	25	1.019	31.531
Indra	8	0.951	9.183
Areas	7	0.944	4.388
Banco Bilbao Vizcaya	7	0.941	8.065
Holcim España	5	0.93	5.399
ACS	18	0.899	26.798
Telefónica Móviles España	21	0.876	16.259
Unión Fenosa	16	0.866	14.919
Gas Natural	20	0.835	29.472
Aceralia	7	0.802	3.155
Compañía Logística de	12	0.729	7.709
Hidrocarburos CLH			
Logista	10	0.722	15.899
Grupo Sacyr Vallehermoso	9	0.7	13.008
Técnicas Reunidas	8	0.7	10.233

Table 11.2 have a higher betweenness centrality, are notable exceptions among family firms.

Table 11.4 presents descriptive information of our sample of firms. This table provides means and standard deviations for all firms and for connected firms, which are firms that have shared directors.

To investigate if there are differences in the level of embeddedness between family firms and non family firms, Mann-Whitney tests were used (Hollander and Wolfe, 1999). Non-parametric tests were used, because the distribution of the centrality measures was non-normal.

Table 11.2 Top 20 family firms by betweenness centrality

Betweenness Ranking	Firm	Degree	Betweenness	Eigenvector
9	Inditex	11	1.538	5.753
15	Grupo Ferrovial	14	1.158	4.451
36	Vocento	7	0.524	1.862
39	Corporación Agrolimen	7	0.463	1.448
51	TelePizza	8	0.31	6.661
59	Media Planning Group (MPG)	4	0.282	5.782
69	Puig Beauty & Fashion Group	7	0.232	4.141
73	Corporación Gestamp	3	0.201	0.394
75	Centros Comerciales Carrefour	4	0.193	5.662
78	FCC Construcción	7	0.183	12.0
79	Grupo Caprabo	4	0.179	7.282
82	Cortefiel	5	0.149	9.206
83	Ferrovial Agromán	12	0.145	3.11
84	Prosegur	4	0.141	7.943
86	Grupo Campofrío Alimentación	8	0.116	6.965
87	Grupo Villar Mir	9	0.113	0.705
95	Gonvarri Industrial	5	0.07	0.259
98	Acciona	8	0.063	1.38
102	Necso	5	0.05	1.063
105	Henkel Ibérica	3	0.021	3.481

Table 11.3 Incidence of firms by region

Region	Color	Number of firms	Percent
Andalucía	Grey	10	2.53
Aragón	Grey	4	1.01
Asturias	Grey	6	1.52
Baleares	Grey	12	3.03
Cantabria	Grey	3	0.76
Castilla y León	Grey	9	2.27
Cataluña	Black	85	21.46
Comunidad Valenciana	Grey	9	2.27
Galicia	Grey	7	1.77
Madrid	White	219	55.3
Murcia	Grey	2	0.51
Navarra	Grey	6	1.52
Pais Vasco	Grey	24	6.06
		396	100

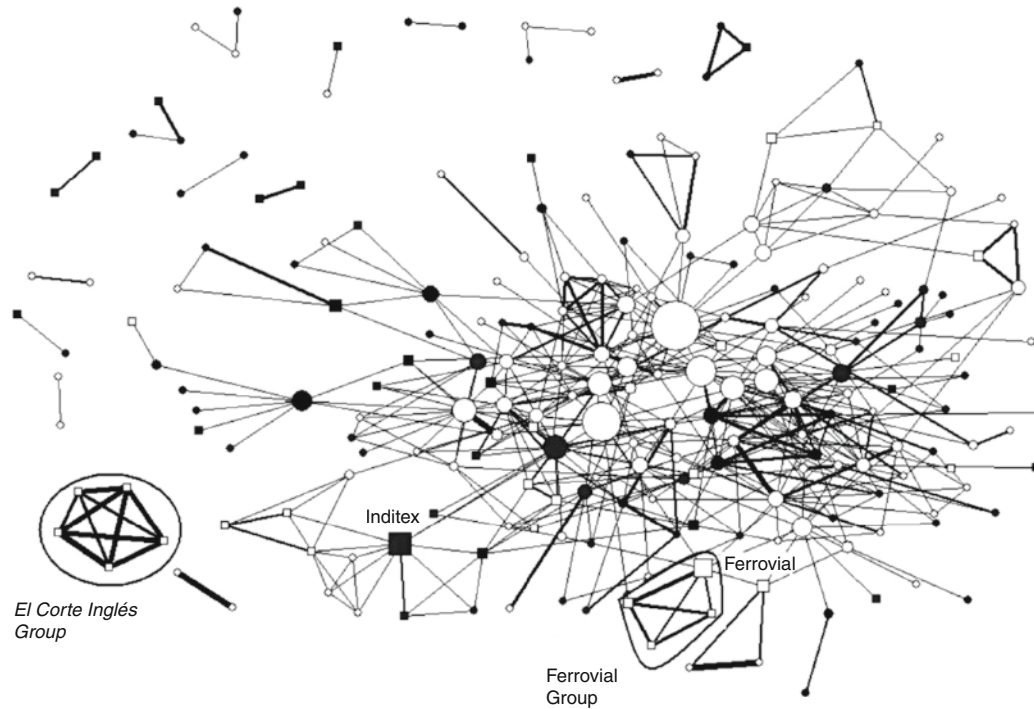


Figure 11.1 Network of Spanish firms

Note: Nodes are firms and the value of a tie between any two firms is defined as the number of directors who belong to both. The width of the tie depends on the number of directors shared by two firms. Square nodes represent family firms and circles are non family firms. Colors represent the region in which the firm's headquarter is located (Table 11.3 includes the names and colors of Spanish regions).

We excluded from our analysis isolated firms, which are firms with zero degree centrality.

The results of the Mann-Whitney test are presented in Table 11.5. We found that betweenness and eigenvector centrality are greater in non-family firms than in family firms. The Mann-Whitney tests reveal significant differences between the betweenness and eigenvector centrality of non-family firms and the centrality measures of family firms. However, family firms are not significantly different from non-family firms in terms of degree centrality or the number of ties to other boards.

Family firms are indeed linked to other firms through shared directors, but most of these ties are with firms of the same economic group, usually wholly owned subsidiaries. In fact, 56 percent of family firms' ties are among firms of the same business group and just 37 percent of family firms' ties are with non-family firms. For instance, one extreme case is *El Corte Inglés*. Firms that belong to *El Corte Inglés* business group, share many directors among them, so, they have a high degree centrality. Nevertheless, they do not have any directors also

Table 11.4 Descriptive statistics

	All firms		Connected firms (Degree>0)	
	Mean	SD	Mean	SD
Sales	1642.9	3345.6	2190.9	4297.2
Board size	7.7	5.1	9.1	5.2
Degree	3.5	5.2	6.2	5.6
Betweenness	0.2	0.4	0.3	0.6
Eigenvector	3.1	6.4	5.7	7.7
Number of observations	396	396	220	220

Table 11.5 Differences in the centrality measures between family firms and non-family firms (connected firms only (degree>0))

Variable	Z-score	Significance
Degree	-0.031	0.9755
Betweenness	2.393	0.0167*
Eigenvector	3.245	0.0012**
Number of observations	220	220

+ significant at 10% level; * significant at 5% level; ** significant at 1% level

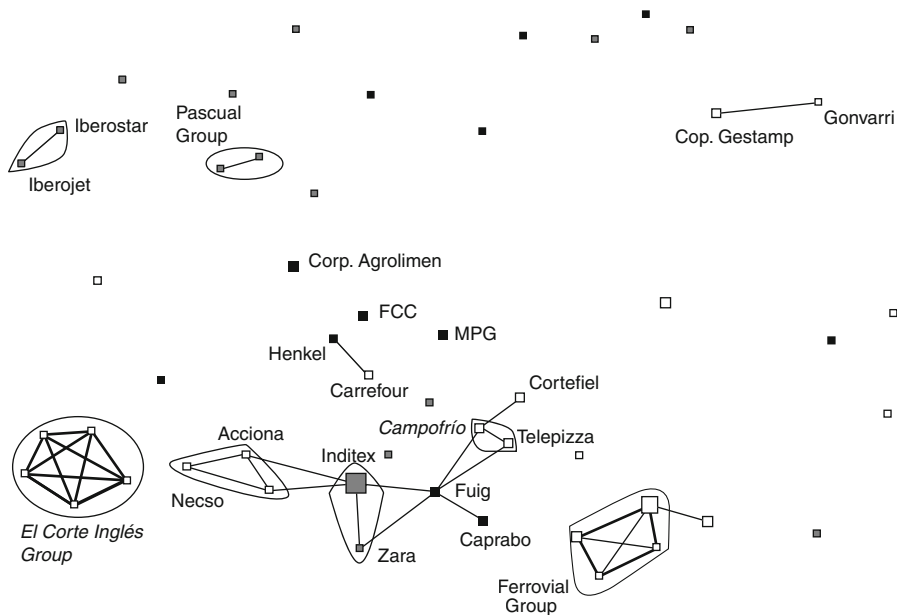


Figure 11.2 Network of Spanish family firms

Note: Nodes are firms and the value of a tie between any two firms is defined as the number of directors who belong to both. The width of the tie depends on the number of directors shared by two firms. Square nodes represent family firms and circles are non family firms. Colors represent the region in which the firm's headquarter is located (Table III includes the names and colors of Spanish regions).

sitting on the board any company not belonging to the *El Corte Inglés* business group. Consequently, these firms have a low betweenness and eigenvector centrality. In Figure 11.1, the boards and relationships of firms belonging to *El Corte Inglés* are represented by a star. As can be seen, *El Corte Inglés* business group is isolated from the main component of the interlocking directorates. Figures 11.2 and 11.3 present other examples of family groups: *Ferrovial* composed of *Ferrovial Inmobiliaria*, *Ferrovial Servicios* and *Ferrovial Agroman*; *Necso* group composed of *Acciona* and *Necso* or *Campofrío* (see the dyad *Campofrío* and *Telepizza*).

Board interlocks in family firms

Family firms can be connected to other firms by either inviting an outside director or by having one of their own directors sit in another firm's board. Most boards of family firms only consist of family members, and there are few outside directors (Ward, 1991). Family owner-managers often resist forming a board with outside directors. This resistance to invite outsiders onto the board of directors may prevent the creation of interlocks. Moreover, the low participation in outside boards of most owners and executives of family firms may also affect the construction of interlocks. Different family values may prevent the embeddedness of family firms. For example, the owner of a family firm explained that his family highly value privacy, discretion and preserving family cohesion, and these values made it harder to invite directors of other firms to the board of his company. In some cases, for instance when there are unusual tensions among shareholders, business owners' resistance to invite outsiders is well founded (Ward, 1991). However, in most cases, resistance to invite outsiders or to participate as an outsider in other boards is rooted in a variety of fears and lack of experience or understanding of the potential benefits of being embedded in the corporate elite. Family firms' owners fear losing their autonomy and giving up control over the company. Previous research on the influence of outside directors on strategic change in public American corporations shows that outside directors, through the selection of a new CEO who has experience at implementing the strategy that board members favor, shape the strategic direction of the corporation (Westphal and Fredrickson, 2001). The owners of family firms learned from the experience of US public companies that external directors and CEOs can take control of the business and force them to change the strategic direction, the culture and values

of the organization (Gersik, Davis et al., 1997; Hiedrick, 1988; Mathile, 1988; Ward, 1991).

Family firms' owners also resist inviting outsiders because they value the company's ability to operate more secretively. Family firms do not like to share information with outsiders regarding salaries, bonus and perks of family members. Moreover, many owners strongly resist sharing financial information and internal problems with outsiders because they are concerned about potential information leaks (Ward, 1991). Because of confidentiality, family firm's owners are especially averse about inviting members of other family firms to participate as outsiders. There are very few directors who sit simultaneously in two or more boards of family firms. Figure 11.2 shows that, with few exceptions, Spanish family firms do not share directors. Only 7 percent of the board ties of family firms are between family firms of different business groups. One example of a shared director by family firms from different groups is given by *Puig* and *Inditex* (see Figure 11.3).

There is also a concern with the identity of the family. The owner of one family firm explained that he does not want to participate on the board of a firm that belongs to a different industry, he said, "we have an identity, we have been in the pharmaceutical industry for generations. We don't want to be associated with the construction industry." This fear prevents intercorporate relationships between family firms from different industries. Other reasons may explain the owners' resistance to invite outside directors. First, business owners may not know how to find and utilize outside directors. Second, firm owners may believe they do not need advice or help. Finally, business owners may feel outsiders are too expensive (Nash, 1988).

Despite the fears and concerns of owners regarding interlocks, many family firms are actually well connected in the Spanish interlock network, but only thanks to the bridge created by a few independent directors who sit on the board of both family and non-family firms. Figure 11.3 shows that the top 20 family firms by betweenness centrality are connected to the corporate elite thanks to the role of outside directors who sit on the board of both, family and non-family firms. For example, *Inditex* is connected with *Cortefiel* through *Banco Santander*. *Ferrovial* and *Inditex* are linked through *NH Hoteles*. *Caprabo* is connected to *Vocento* through *Siemens* and *Inmobiliaria Colonial*. Few independent directors prevent the isolation of family firms and keep the corporate network connected in one component.

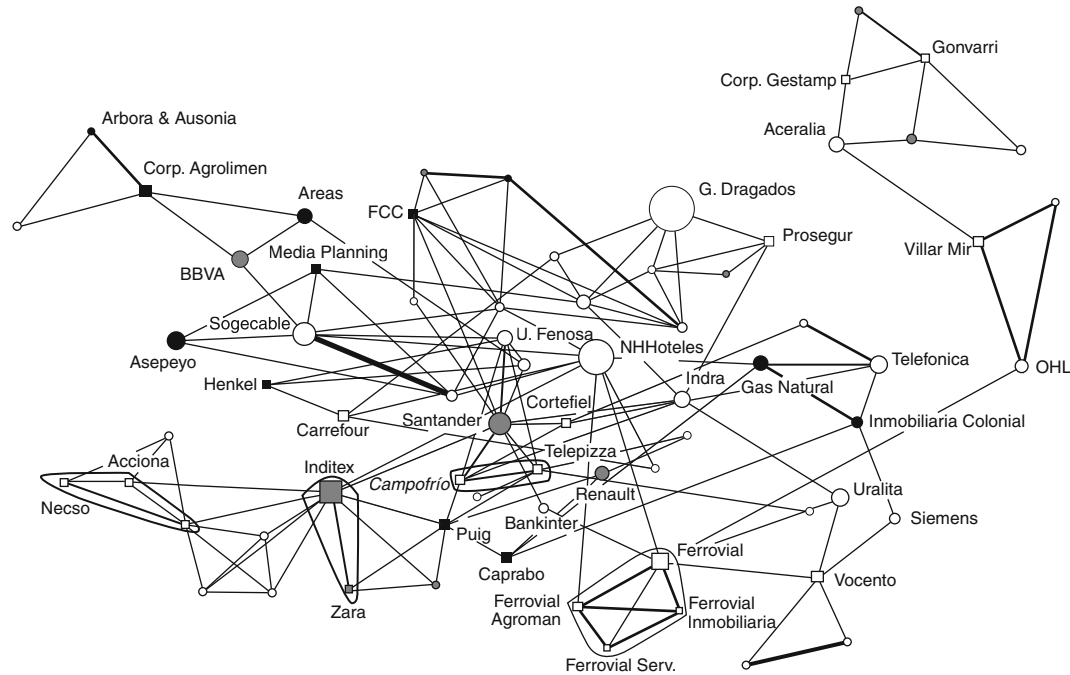


Figure 11.3 Network of top 20 Spanish family firms by betweenness

Note: Nodes are firms and the value of a tie between any two firms is defined as the number of directors who belong to both. The width of the tie depends on the number of directors shared by two firms. Square nodes represent family firms and circles are non family firms. Colors represent the region in which the firm's headquarter is located (Table III includes the names and colors of Spanish regions).

The contingent value of interlocks in family firms

Studies on interlocking directorates showed the effect of board ties on corporate outputs. But the effect of board ties on firm behavior may be contingent upon several factors (Brass, Butterfield and Skaggs, 1998; Adler and Kwon, 2002). For instance, Mizruchi and colleagues (2006) showed that the effect of interlocking directorates on the level of debt of US corporations is historically contingent. The concurrent rise of the CFO and the decline of financial representatives on boards suggested that firm financing decisions were increasingly made by specialists inside the firm, without reliance on board members and the board networks that their presence both created and reflected (Mizruchi, Stearns and Marquis, 2006).

The value of board ties for family firms may also vary across situations. Family firms scholars suggest that outside directors can bring innovative ideas, a long term perspective and new insights to family firms (Gersik, Davis et al., 1997; Martinez Echezarraga, 2006; Ward, 1991). Outside directors can be invaluable in several learning processes. First, outsiders are very important because they provide precious information and insights when family firms are involved in a strategic change process. Directors can suggest strategies that involve acceptable degrees of risk. At other times, outside directors can help the business owner with an affirmation of her instincts or judgments in relation to a strategic perspective. Following this line of argument a reasonable proposition could be:

Proposition 1. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates if it is involved in a strategic change process.

Gersick, Davis, McCollom Hampton and Lansberg (1997) argue that the invitation of outside directors will depend on the developmental stage of the firm, particularly on the business dimension. Boards with outsiders become essential as the company develops in the expansion stage. At this stage of development the outsider's technical expertise regarding organizational design and product development is critical. For instance, outsiders can bring ideas regarding targets for growth and the volume of products and services required to sustain it, new markets, internationalization, diversification, organizational structure, decentralization and integration of a wider circle of senior professional management

(Gersik, Davis et al., 1997). An outsider's incorporation and participation in the board of a family firm and the embeddedness in the interlocking directorates will be more critical when family firms are moving into the expansion stage of business development. So, we suggest that:

Proposition 2. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates if it is at the business expansion stage.

Literature on family business suggests that outside directors may provide critical knowledge in a succession process (Gallo, 2001; Gersik, Davis et al., 1997; Ward, 1991). Outsiders can be invaluable to the succession process in several ways. A board with outsiders can be instrumental in raising the succession issue at the right time. Also, outside directors help the business owner examine his or her options. Finally, outsiders help in preparing the successor and in completing the succession process (Ward, 1991). Consequently, we propose that:

Proposition 3. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates when the owner is thinking in a succession process.

Board ties may also affect the status and the legitimacy of a family firm's board. Determining the quality of a board of directors is problematic, due to several reasons. First, shareholders, financial analysts and the public media have no access to board discussions and decision-making processes because they occur behind closed doors. Second, legal requirements for board composition and structure are minimal. Finally, each board is uniquely organized with regard to how it performs activities. There is thus no guides to evaluate the quality of boards (Davis and Robbins, 2004). In such a context, the collection of board ties the directors create acts in the market as a signal for corporate governance. The number and quality of board ties represent an informational cue on which others rely to make inferences about the underlying quality and characteristics of a board (Davis and Robbins, 2004; Finkelstein, 1992; Podolny, 1993; Podolny, 2001).

Davis and Robbins's (2004) findings indicate that boards of public firms seek to appoint well-connected directors when they are owned by institutional investors and when they have been subject to governance-related shareholder proposals, because connected directors enhance the

firm's reputation and status. Family firms may become more concerned about their reputation when they are considering the option of going public and opening the company to non-family investors. A director of two family firms, explained that "when owners are thinking about going public, the recruitment of well-known directors is a critical issue because high-status directors may help to improve the company image and raise the firm value." Following this line of argument, a reasonable proposition could be:

Proposition 4. A family business will be more likely to incorporate outside directors and, consequently, become more embedded in the interlocking directorates when considering going public.

The issue of opening the ownership of the company arises most frequently in the third generation of a family firm (Gersik, Davis et al., 1997). Moreover, it is at this stage of ownership development when control among family members is extremely diluted. Outsiders become essential as soon as the ownership is dispersed because representation and control issues arises (Gersik, Davis et al., 1997). Outsiders can give minority shareholders a sense of impartial control. So, we argue:

Proposition 5. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates when it is in the third generation.

Resource dependence theory (Pfeffer and Salancik, 1978) strongly influenced academic thinking regarding the value of embeddedness in the interlocking directorates. Resource dependence theory argues that firms use board ties to manage their resource interdependencies and to reduce uncertainty (Pfeffer and Salancik, 1978). Business firms facing uncertainty from technological shifts, deregulation, the globalization of capital and product markets, and political reform, can more efficiently acquire resources by coordinating their efforts from the top of the organization, for instance, the board of directors. For example, organizations belonging to the construction sector face high uncertainty. These organizations could be more connected in the interlocking directorates in order to reduce uncertainty and yet minimize the risks of interdependence. In the Spanish case, 20 percent of the top 30 firms taking betweenness centrality into consideration belong to the construction sector (see in Table 11.1: *Grupo Dragados, Grupo Ferrovial, Holcim España, ACS and Grupo Sacyr Vallehermoso*). Furthermore, 30 percent of the top 20 family firms in

terms of betweenness centrality are construction firms (see in Table 11.2 *Grupo Ferrovial*, *FCC Construcción*, *Ferrovial Agroman*, *Grupo Villar Mir*, *Acciona* and *Necso*). So, from the previous discussion we can advance:

Proposition 6. A family business will be more likely to incorporate outside directors and, consequently, to become more embedded in the interlocking directorates when it faces high uncertainty.

Interlocks exist to coordinate the inter-organizational exchange of resources, such as capital, information and market access, to buffer the effects of environmental uncertainty (Pfeffer and Salancik, 1978). US industrial corporations faced with declining solvency during economic slumps may be more likely to form interlocks with financial institutions to increase their access to financial capital (Mizruchi and Stearns, 1994). Also family firms may form interlocks with financial institutions to increase their access to capital. See in Figure 11.2 that *Inditex*, *Telepizza*, *Campofrío*, *Pescanova*, *FCC Contrucción* and *Cortefiel* have ties with *Banco Santander*. *Tudela Vegin* has two board ties, both are with banks, *Banco Santander* and *Bankinter*. Other examples are *Corporacion Agrolimen* which is connected to *BBVA* and *Prosegur* which has a tie with *Caja de Galicia*. From the previous discussion we suggest that:

Proposition 7. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates when it needs to increase its access to financial capital.

Family firms may adopt the use of outsiders because a board with outsiders may become the institutional definition of the legitimate board form (Tolbert and Zucker, 1983) in the region where the firm and the family members operate. In the United States, geographical factors have been identified as important issues shaping the behavior of firms (Davis and Greve, 1997; Kono, Palmer et al., 1998). Geographical factors may be important to determine family firms' behaviors, specifically the use of outsiders. Family firms may imitate other family firms when they are geographically close, that is, their corporate headquarters are located in the same region, when owners are from the same city or when they are members of the same upper-class clubs (Kono, Palmer et al., 1998). Consequently:

Proposition 8. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in

the interlocking directorates when other geographically close family firms include outsiders in their boards.

Conclusion

This study has explored the role of family firms in the Spanish interlocking directorates and the factors that may explain the construction of board ties. Although this study advances our understanding on the role of family firms in the interlocking directorates, it does have limitations. First, the findings of this study are restricted to the Spanish case and other countries with different corporate governance regimes (and regulations) might differ on a number of dimensions. Second, we only explored the interlocking directorates without considering other critical networks. For instance, owners of family firms are likely to be connected by common memberships in social clubs, trade associations and non-profit boards.

Notwithstanding its limitations, this chapter provides several contributions. Our study provides evidence that family firms are, on average, less central in the Spanish interlocking directorates. Consequently, they are less embedded in the corporate network than non-family firms. Furthermore, the interlocking directorate of family firms is sparse. That is, there are very few directors who sit simultaneously on two or more family firms' boards. Nevertheless, the network of the top 20 family firms by betweenness centrality is more densely connected, thanks to the role of independent directors who sit on the board of both family and non-family firms. Because of confidentiality, family firms' owners resist inviting members of other family firms to participate, as outsiders. However, despite this fear, once they invite independent directors who sit on other non-family firms' boards to their board of directors, they inevitably become indirectly connected to other family firms.

This work contributes to the board interlock literature by developing novel propositions on the effect of interlocks on family business by exploring different factors that may promote the construction of interlocks. Embeddedness in interlocking directorates may be beneficial when family firms are involved in a strategic change process, in the expansion stage of development, in a succession process, when considering going public, facing high uncertainty, needing to increase access to financial capital and when the family is in the third generation. Finally, institutional and geographical factors may also promote the construction of interlocks ties.

These findings have important implications for family firms' experts and practitioners. The phantoms and fears of control should not prevail

when considering the use of independent directors; rather, family firms' owners and experts should reflect and think how family businesses can benefit from this type of connections with the wider corporate network.

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Conclusion

Josep Tàpies

When IESE Business School was founded 50 years ago, many of the participants who attended our first management education programs were family business owners, and that continues to be the case today. So, when IESE decided to mark its fiftieth anniversary in 2007–8, it seemed only natural that we focus attention once again on family business, a subject close to our hearts throughout our history.

The purpose of this book is twofold. First, it presents an academic review of family business research as it has evolved over the past few decades. Second, in inviting a select group of academics to engage with these evolving themes, it aims to foster professional interaction and stimulate further research on this subject. Thus, this compilation by thought leaders in the field of family business seeks to bridge the gap between theory and practice, addressing real issues that family business owners face on a daily basis in a practical, straightforward manner.

Despite the influential role that family businesses play in developed economies, it is striking to realize that they only began to be studied less than three decades ago. As Professor John Ward points out in his introduction, the values and cultures of successful family businesses were long acclaimed, but not examined.

This oversight can be partly attributed to the way family businesses used to be perceived. Not long ago, working for one's own relatives carried negative connotations. Many of those involved in family firms did not wear their status proudly. Nowadays, however, family businesses are warmly regarded as wealth-creating employers, playing a central role in the communities in which they are embedded, and their owners are respected as truly competitive entrepreneurs. No one questions the legitimacy of studying family firms alongside their non-family counterparts anymore.

It is worth noting that the creation of certain organizations and publications, such as the *Family Business Review*, the Family Business Network (FBN), the Family Firm Institute (FFI) and the International Family Enterprise Research Academy (IFERA), have been instrumental in the development and dissemination of knowledge that has lent this field greater credibility over the past 20 years. This book is an acknowledgment of that, featuring articles by prominent researchers who pioneered this field before it was popular and helped to make it what it is today.

Besides the historically negative perception of family businesses, another reason why this field remained overlooked for so long comes down to the typically shy nature of family businesses themselves: the strict privacy policies maintained around family affairs means that there is often a distinct lack of publicly available information. Secrecy and safeguarding information do not readily lend themselves to easy study by outside researchers sticking their noses into what is quite literally someone else's business.

We see this tendency in our studies of Spanish family firms. Many are still reluctant to incorporate outside directors onto their boards, for example. Part of the reason for this has to do with fear over relinquishing some control or changing the family's values. There is also the related fear of "interlock" occurring if the family firm brings in one or more directors who also happen to sit on the boards of other companies.

Yet, as the research shows, without the inclusion of some independent directors, these family firms, by and large, may never connect with other non-family firms. While there are pros and cons involved with interlocking directorates, those family firms that have brought in outside directors have, in many instances, experienced certain benefits, especially when undertaking some major strategic change, such as an expansion or a succession.

As this book demonstrates, family businesses need to face up to major issues like these. Besides opening the door to more outside directors, there are other tricky issues related to governance, social and firm embeddedness, power as service, wealth management, emotional ownership, the transference of values, fairness, values dilemmas and succession – all relevant themes touched on in this book.

Preparing for what's next

Take one of the issues touched on in this book: succession, which poses a major challenge to any family-run business. Contrary to what is

sometimes assumed, succession must be addressed not as an event but as a future-oriented process, which both the senior and junior generations need to plan together. In this sense, succession could be better expressed as "generational transition."

As the research suggests, senior members of the family business need to create opportunities whereby they are able to transfer their most cherished values to the next generation and to key staff. Likewise, the next generation needs to be given the scope to update and reinterpret these traditional values, adapting them to changing circumstances. What's become clear is that succession planning must go beyond mere questions of financial transfer or taking possession; rather, succession must include the passing on of key values such as pride and responsibility. Uniting family members around a shared sense of identity can be a powerful tool, creating a much closer bond between the next generation and the family business. Engendering "emotional ownership," therefore, is equally essential for the future prosperity and longevity of the family business.

Getting the senior and junior generations to work together for the sake of continuity of the business project is also of paramount importance when it comes to communication. While seniors are more inclined to delegate responsibilities gradually, juniors tend to be one step ahead, anticipating strategic challenges on the horizon. Both sides need to share their expectations from their different standpoints.

No study of the handing over of power in family businesses would be complete without also considering the nature of that power itself, and how best to manage it. That's why we have included research exploring two types of power: "auctoritas," the power attained through professional competencies or moral authority, and "potestas," the power obtained through possession or force. In family businesses, political power is usually concentrated in the owners of the capital, in which case, the younger generations with fewer resources in their hands are more likely to resort to "potestas." "Potestas" finds its expression in nepotism, which cannot naturally confer "auctoritas." The best way to gain "auctoritas" is through education and meritocracy. To achieve this kind of power, it is recommended that juniors complete their studies and ideally gain some work experience in other business environments before entering the succession process. This will help them to shape their own career identity apart from the family business, and provide them with wider business perspectives and skills, which will better equip them to manage the company successfully in the long run.

As laudable a goal as meritocracy is, however, when applied to relatives, the question of "merit" is a delicate issue. It is one thing to judge

employees on merit in a non-family company, but doing so in a family business, when not just the employees but the shareholders themselves are related to each other, more often than not raises cries of “not fair!” This requires the issue of fairness to be weighed against the concept of “distributive justice,” a system of allocating resources in proportion to individual need, contribution and responsibility, in pursuit of the common good and fair outcomes. It also points up yet another dilemma characteristic of family businesses: the fundamental clash of values between blood ties and business ones.

The merit of power, the power of merit

Any business – family or otherwise – needs to be managed by competent people. An incompetent manager undoubtedly worsens the company, which is why meritocracy is so essential. It is the primary way of ensuring that the next generation achieves feelings of worth and self-motivation, and it will avoid confusion in the blurred boundaries that exist between business and family. In short, it will earn them “*auctoritas*.” In the training for the exercise of power in a family business, it is essential to ensure that the future owner acquires the necessary “*auctoritas*” to exercise “*potestas*” responsibly. This will endow the company with open-mindedness and a consistent entrepreneurial model, bringing about a process-oriented perspective and a disposition to adapt to new business situations.

The social dimension of family firms and their impact on the community in which they operate are also aspects worth mentioning. A family business has its own internal social responsibilities, such as creating wealth, ensuring its own long-term survival, developing the human qualities of the members of the community, and providing products and services. In addition to that, it also bears external social responsibilities, which consist mainly of helping to prevent damage to the common good.

As several contributors remind us, the family business’s sphere of influence reaches not only its immediate stakeholders, but also the wider community in which it is embedded. Thus, it can be inferred that the overall success of the firm will be a public good. From this stems the need to understand power as a service – a service exercised through “*auctoritas*” – and based on moderation. This is also the reason why the next generation needs to view the company as a valuable asset, which needs to be managed responsibly.

If one of the functions of the family is to transmit “*auctoritas*” to the stakeholders and the community they are embedded in, then this is an

especially important aspect to be taken into account by the owner-manager. In fact, owner-managers who hold strong non-economic, long-term goals are more likely to be embedded in their local community and are, as a result, less likely to sell their business, thereby ensuring that they will produce greater good for society as a whole.

This underscores the very central role that owner-managers of family businesses play: they are at the heart of the family, the firm, the ownership system and the leadership system. Again, this could easily lead to confusion, as family and business roles become blurred, and juggling all these relationships becomes difficult. In fact, this situation becomes more acute in the second or third generations, as more members of the family start getting involved in the business. This adds greater weight to the argument for insisting on proper education for the generations coming through, in order for them to develop the intellectual and human characteristics necessary to handle the intricacies of their position.

Values make the difference

So, after more than 20 years of scholarship on this subject, what can we conclude? Certainly, it is evident that family businesses behave differently from non-family businesses and that their particular values are much more than just a minor aspect of their unique nature. Values, in fact, are the main influence in a family business's strategy and performance, and they determine its long-term goals. Their key role in sustaining both the family and the business cannot be stressed enough. Thus, it can be inferred that different governance mechanisms are required, both to foster enduring values and to match these values with business practice.

Furthermore, it can also be stated that in order to secure a satisfactory succession process and to attain an observance of long-term goals, family firms need to manage their capital resources well. Hence, we have witnessed the global rise of such structures as "single family offices," providing wealth management to affluent family businesses. But quite apart from financial capital, it is vital that family businesses develop their intellectual capital as well as their human capital – their people – in order to maintain their enduring values. This will do as much to help the family business remain competitive and ensure the continuity of the business.

We must always bear in mind that family businesses need to be viewed not only as estate, but as the combination of estate and values. That is, a family business implies legacy and stewardship, since a family business

not only serves financial profit, but it is also a means of transmitting certain values and providing a service to the community in which it is embedded. In short, family businesses are values driven, and these values are precisely what represent the company's culture.

Finally, I would like to thank the academics who have collaborated with us to produce this important book. Their invaluable contributions have created a challenging platform of reference for future researchers. We sincerely hope this fiftieth-anniversary compilation provides all of those involved in the field of family business with inspiration for at least another 50 years.

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