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Family Involvement - Influence on Change Management, Value and Performance of Small and Medium Scale Businesses - A Research Proposal

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Abstract

The aim of this research proposal is to analyze the impact of family involvement over change and performance of small and medium size family businesses. Three family business theories mostly used by previous researchers namely: entrepreneurial, stakeholder and stewardship theories will be used to explore relationships between ownership, change management and the performance objectives of family firms. This study will examine the relationship between Familiness (that is, family ownership) and firm performance by considering the influence of family management, family control, and firm size using the family influence scale (the familiness-power, experience, and culture scale [F-PEC]) presented by Klein, Astrachan, and Smyrnios (2005). A set of questionnaires will be sent to family firms across the United States of America, Western European countries (e.g. United Kingdom, Spain, Italy, etc.) Taiwan, Romania and the data obtained from these firms, together with range of performance measures and objectives will be examined to assess this relationship, and to ascertain if family ownership is positively or negatively associated with firm performance. Information from other studies has been used for the development of this study to understand various variables that can be used to identify what constitutes a family firm. The findings from this study will be used to establish whether potential family-ownership effects are more likely to be realized when family ownership is combined with active family management and control in small- and medium-sized enterprises (SMEs).

Keywords: family firms, firm performance, family ownership, family involvement, change management, SMEs.

Introduction

Family-owned and/or family-controlled firms consist of the largest proportion of businesses throughout the world (Bjuggren Johannson & Sjogren, 2011; La Porta et al., 1999; Shanker and Astrachan, 1996), and dominate the small- to medium-sized business landscape (Howorth et al., 2010; Patel et al., 2012). Family-owned and family-controlled firms account for approximately 90% of incorporated business in the United States (Poza, 2007). Founding families are present in one-third of the S&P 500 corporations (Anderson & Reeb, 2003) and the Fortune 500 companies (Shleifer & Vishny, 1986). In East Asian countries, over two-thirds of the firms are controlled by founding families or individuals (Claessens, Djankov, Fan, & Lang, 2002). In Western Europe, about 44% of the firms are family controlled (Faccio & Lang, 2002). Despite the widespread of family ownership, the debate whether family ownership is beneficial or detrimental to firm performance remains inconclusive. Several empirical researches have attempted to determine how family involvement influences change and firm performance (e.g. Barontini & Caprio, 2006; Chrisman, Chua, & Litz, 2004; Dyer, 2006; Jacquemin & De Ghellinck, 1980; Miller, Le Breton-Miller, Lester & Cannella, 2007). However, the evidence has been inconclusive.

Exploring the entrepreneurial theory, stewardship theory and stakeholder theory together to better understand the effects of family involvement, this study will test theoretical explanation about how family involvement interact to influence the adoption of change into small and medium family firms. Entrepreneurial theory is selected because of its general accepted relevance to managerial studies (Argote, 2007) and because it points out those stakeholders in a company have a diverse set of objectives. To argue that the set of objectives adopted will be influenced by family involvement on change processes, Freeman, (1984); Mitchell, Agle and

Wood, (1997) support stakeholder theory because it provides perspectives into which stakeholders are likely to affect a company selection of objectives. Stewardship theory because it has been used by researchers to explore associations between ownership and management profiles and the performance and objectives of family firms.

Furthermore, this rationale will be tested using a sample of small and medium firms with 5 to 500 employees. The focus on small and medium firms because they constitute the vast majority of businesses in the economy and because the relationship between family involvement, change adoptions, and performance is likely to be more pronounced and more important in influencing behaviors in these firms than in larger firms where large cadres of professional managers, wider ownership dispersion, and independent boards of directors may dilute the relationships of interest. The results should suggest that family influence partially mediates the relationship between family involvement and adoption of change. “By identifying factors that determine the manner in which the family influences firm behavior, we contribute an explanation for the heterogeneity of family firms” (Chrisman, Chua, Pearson & Barnett, 2012). This research is important as it enumerates how direct family involvement influences small and medium firms’ results, performance and behaviors.

Problem Statement

Family business researchers have attempted to examine the relationship between family involvement, willingness to adopt changes and their influence on firm value and performance. Family ownership showed associations with revenue, capital structure, growth, decision makings, change adoption and perceived performance; however, the relationships were both positive and negative.

Purpose of Study

This study aim at addressing how family involvement influences the implementation of change in a small and medium family business and investigate the relationship between founding-family ownership and firm performance by asserting that the relationship is influenced by other characteristics such as; family management, family control, and firm size. A family business is a business where a family exerts power over the organization and its strategic direction through ownership, top management, or board positions (Pieper, Klein, & Jaskiewicz, 2008). Therefore, it is important to examine the possible influence of family management and control to understand whether family ownership creates or destroys firm value; improve or worsen firm performance.

Research Questions

For this study, the following questions will be addressed:

1. Does family involvement and control influences change processes in family firms?
2. Does family-ownership and management structure affect firm value and performance of small and medium firms?
3. Are there any other factors that may influence change objectives and firm performance that should be considered?

Hypotheses

H1: Family ownership is positively associated with firm performance. If family shareholders can create value for firms, they should be able to influence the decision-making and managerial systems of the firms. In other words, the active involvement of family members in management and control is important.

H2: Founding family directly impact the change management process of the firms. If the controlling family is involved in the change management of the firm, then they could influence the firm behavior.

Literature Review

The effect of family direct involvement and control of small and medium firms is a growing field of interest in the business, finance and management literature. "Since family control can have both positive and negative properties, empirical evidence is of paramount importance for judging its final effect and for orienting regulation. Many papers highlight that founder-CEOs have a positive effect on corporate performance" (Barontini & Caprio, 2006). There are diverse opinions about the control and management of businesses by founding family. On one hand, it is respected because many of these firms have prospered under the founding family for a long time, thereby sanctioning that families are long-term investors who are committed to the success of the firm they invest in. On the other hand, the different priorities that families may have relating to outside shareholders are seen as a potential for conflicts of interest which may hinder value creation and the growth of the firm. Founding families are clearly aligned to maintaining control of their companies and often consider executive positions in the firm as a channel for providing highly remunerated jobs to the offspring, thereby depriving outside shareholders of the value creation potential that the selection of the best managers would provide.

In recent studies the question of how the family contributes to the performance of the firm were addressed using: the demographic approach and the essence approach. The demographic approach is based on the belief that family involvement is sufficient to capture the family effect on firm performance. It considers the physical presence of the family in the firm, using proxy variables of behavior such as ownership, governance or management as the main explanations of the family effect on firm performance. “This approach states that family involvement variables are proxies for what happens inside the firm” (Basco, 2014). According to Cyert and March (1963) the essence approach comes from a behavioral perspective and focuses on specific resources and behaviors resulting from the family–business interaction. According to Dyer (2006) and Huybrechts et al (2011), the rationale is that the family affects the way that an organization is governed and managed and creates and brings distinctive resources.

Sirmon and Hitt, (2003) stated that the family is expected to participate in the firm by providing assets such as economic, human and social capital. Basco and Pérez Rodríguez, (2011) went further that how these assets are assessed and used is based on competitiveness. Under the business logic, resources are paid based on the efficiency and the function that people have in the firm (stakeholders, board of directors, employees, and managers).

In this present study, three theories: entrepreneurial theory, stakeholder theory, and stewardship theory which are mostly used in family firm research will be applied to expound the effects of family involvement in family firms’ adoption of change and performance. The Entrepreneurial theory indicates that the involvement of family in the ownership and management of a company will strengthen it to influence the company’s objectives, behaviors and performance “family involvement in the ownership and management of the business provides the ability to engage in particular behaviors that would either be impossible or more difficult in other types of businesses” (Ceptureanu, 2016). The stakeholder theory suggests that family businesses are likely to emphasize change objectives because they create powerful interest group within the company which comprises of the owner and other members of the family. This interest group can influence business processes, decisions and forecasts. “Since the family comprises a very important coalition in the family firm, stakeholder theory suggests that the association of a family with the ownership, management, and governance of a business will give it the power and legitimacy to influence firm goals" (Chrisman, Chua, Pearson & Barnett, 2012). Involvement of family in the ownership, management, and governance of the firm provides the ability to engage in a particular way that would either be impossible or more difficult in nonfamily firms. According to stakeholder theory, the salience of a stakeholder in influencing the goals, decisions, and actions of a firm largely depends upon that stakeholder's legitimacy and power (Mitchell et al., 1997). "Stewardship theory suggests that closely held family firms with little outside influence or representation may exhibit an organization-serving culture and a focus on nonfinancial objectives. To ensure family control of the firm, owners may make it difficult for nonfamily members to gain ownership and control stakes" (Westhead & Howorth, 2006). Based on these theories, it is safe to emphasize that family involvement on change gives the controlling family the ability to influence company behavior but does not stipulate whether and how it will be used.

To further expatiate on the relationship between family involvement and firm value and performance, the Familiness-Power, Experience, and Culture (F-PEC) scale developed by Klein, Astrachan and Smyrnios (2005) is assessed. "The F-PEC Scale possesses the rare capability to measure degrees of "familiness" in a given firm, rather than using a dichotomous categorization that has been criticized by family business researchers" (Rutherford, Kuratko, & Holt, 2008). The scales measured (1) Power, the influence the family has on governance and management of the firm; (2) experience, the information knowledge, judgment, and intuition that comes through successive generations; and (3) culture, the alignment of the family's goals with the firm's goals.

Most recent studies report that firms controlled by founding families are more valuable and perform better than nonfamily firms. Anderson and Reeb (2003) found that family-controlled firms in the S&P 500 outperformed nonfamily-controlled firms by 6.65% in returns on assets and return on equity and created an additional 10% in market value. McConaughy, Walker, Henderson, and Mishra (1998) found that firms with family ownership have higher market-to-equity ratio and stock market returns than non-family-controlled firms of similar size, industry, and percentage of managerial ownership.

Empirical evidence from Asia and Europe indicates positive relationship between family ownership and firm performance. Previous study on 240 public firms in Thailand shows that family ownership is positively associated with firms' return of assets and net income-to-sales. Data collected from 435 large companies in 12 European nations also shows that family ownership concentration is positively associated with the profitability and market value of companies.

Separating the family and business systems will allow the firm focus on business objectives. Where family is prioritized, for example, people may be promoted based on seniority and trust, without considering their actual contribution to the firm's competitive position. However, where the business comes first, experience and past results in connection with the needs of the firm will be used as the criteria for promotion. Prioritizing the business system does not mean a complete separation of family and business systems, and there will be exchanges of resources at diverse levels. Singell and Thornton, (1997) found that concentrated ownership and management by members of the kinship group owning the majority of shares in the business may limit the pool of experience and retard family firm performance. A focus on family objectives

(Birley, Ng, & Godfrey, 1999) and a reluctance to plan for firm growth (Ward, 1997; Upton, Teal, & Felan, 2001) may also restrict firm performance.

One of the setbacks of family ownership and control of an organization is that; founding families can work to their own benefit at the expense of other shareholders. For example, family members can draw scarce resources away from profitable projects to satisfy their nonpecuniary compensation (Demsetz, 1983); family shareholders tend to treat the company as a family employment service or a private bank (Shleifer & Vishny, 1997), and they may limit top management positions to family members instead of recruiting qualified and capable professional managers (Carney, 1998). “Therefore, firms with large, undiversified owners such as founding families are likely to underperform those firms with a dispersed ownership structure” (Chu, 2011).

Design and Methodology

Participants for this study will be selected using the following criteria: (1) Ownership concentration, to be considered a family business, a firm need to have at least one of these two characteristics: (a) family members on the board or in management positions; and/or (b) capital divided among family members (at least 51% of the ownership by members of the same family); (2) Firm size, businesses with 5 to 500 full time equivalent employees will be chosen (this is in line with what other studies consider as similar ranges of small and medium-sized firm, such as Barbero et al., 2011; Leitner & Güldenberg, 2010, Ceptureanu, 2016.) “A company with fewer than 500 full-time employees are recognized as an SME (Small, Medium Enterprise)” (Chu, 2011); (3) Power over strategic decisions of the firm; (4) Involvement of multiple generations; (5) Active management participations in operations by family member.

Questionnaires will be sent out specifically to firms that met the criteria above across the countries selected. Consistent with the findings of Ceptureanu, 2016 and other studies reviewed here, it is expected that the responses received will justify the hypotheses.

Based on the purpose of this study, four control variables: Firm age, firm size, firm industry/sectorial measures and performance satisfaction will be employed. Firm age will be measured as the number of years since the inception of the firm. It is assumed that age should be positively related to change objectives and family should become more attached to the firm over time. Firm size will be measured by the number of employees and total assets. Firm total assets in industrial literature reflect the existence of economies and diseconomies of scale and may form barriers to entry (Bain, 1968). The more a business expands, the desirability of change objectives is likely to increase. Firm industry/sectorial measures, family businesses are more suited to compete in some industries than in others and this could affect their ability and desire to pursue change objectives. Firm industry will be measured by classifying all firms into four industrial categories: (1) retail, (2) service, (3) manufacturing, and (4) other. Performance satisfaction, this will be measured by how the firm's profitability (return on sales) over at least three years of operations has been compare to their expectations. This is included to ensure that the importance of the founding family goals have not been affected by the extent to which the firm's profitability met aspiration levels. These variables are among the most frequently used measures of family involvement.

The F-PEC Scale measurement: Power, will be measured by two items. The participants will be asked to indicate (i) the percentage of family members that share ownership and (ii) the percentage of family members on the firm's board; Experience, will be measured with three items that capture the successive generations involved in ownership and governance. Participants will be required to indicate (i) the generation of the family owning the company; (ii) the generation of the family managing the company; and (iii) the generation active on the governance board. These items will be used to indicate when the greatest experience of family succession was gained between the first to the second generations and when the benefits of experience diminished with each successive generation; Culture, will be measured with seven items that reflect the family's commitment, loyalty, and pride toward the company. For each of these items, participants will express their agreement by choosing one of five response options (1 = strongly disagree to 5 = strongly agree).

Participants

Forty-seven thousand, nine hundred and fifty participants will be selected across United States of America, Western European countries (e.g. United Kingdom, Spain, Italy, etc.) Taiwan, Romania. These participating firms are family firms that meet the criteria above and have at least 51% of the ownership by members of the same family.

The order of the questions constituting the dependent /independent variables to be sent to the different respondents will be mixed to reduce preconceived responses and they will be assured that their responses will be confidential.

Results

Reports on the background information of the sample firms will be obtained to reflect that family firms SMEs characteristics are very different from those of large and nonfamily firms. (For instance, family firms are expected to be smaller in terms of assets, annual sales, and employees). Active family participation in management and control will be prevalent. For example, family firms will have family CEOs, which should be significantly higher than nonfamily firms, at least one family member in the top management teams. Regarding family control, higher percentage of family firms will have family chairpersons, at least one family member serving as director of the board. From the companies selected as samples, the average family ownership stake should be at 95%. There should be an above average of family managers. Excluding the main entrepreneur, an above average number of family generations is expected to have been involved in the company. Thus, the results should appear to consist of acceptable distributions of family involvement and family control.

The findings from the test of the variables should reveal what percentage of family business members agree that the change provides better conditions for survival of the SME in the medium and long term; the results will emphasize that family members involved in the change process occupies strategic and important positions in the organizational structures. The results should suggest responses to the hypotheses.

Discussion

The result of this study will be evaluated in light of the relationship between family involvement, control in change management process, firm value and performance. This study will add to the previous research on founding family influence in making change management process decisions and, more important, identifies and provides evidence that the manner and extent to which family influence and involvement potentially affects firm value and performance.

The findings of this study will be used to demonstrate that the dominant coalition's ability to influence change management and goals adoptions in family firms is affected by its power and legitimacy, through the property rights conferred by ownership as well as the number of family managers and generations involved in the firm. This means that the adoption of change does not depends only on exercising the power originating from ownership rights but also on the extent to which family members participate in the firm.

Limitations and Future Research Directions

Some of the limitations to this study are; first, theoretically it is assumed that family stakeholders would dominate the decision-making coalition of the firm. Although this seemed reasonable, small firms may also be susceptible to the influence of powerful competitors or outside stakeholders who might limit the ability or willingness to change objectives and influence performance. Future research might fruitfully investigate how external stakeholders affect change objectives in small and medium family firms, how the interest groups within such firms might respond to pressure from external stakeholders as well as from other powerful internal stakeholders who might possess little to no direct involvement in the family or the firm.

Second, the sample selected composed of businesses that are micro, small and medium size. This is a limitation shared by the vast majority of studies in the family business literature. This is not clearly representative of all companies, families, etc. For example, as stated by Combs, 2008; Miller et al., 2007, the nature of a family's involvement and its influence on firm behavior could be different for larger firms. Family involvement and its effect may vary across countries and there may be important cultural differences between family firms in different countries. It would be interesting to know how decision-making and change management process fit together in diverse cultures. Applying this model to other nations would not only validate its dimensions and relationships, but also help to provide a better understanding of the differences in family firms between countries. Therefore, care should be taken in applying the results to firms that are larger, older, or based outside the convenience sample. Future research could use different samples or expanded samples to confirm the findings. Using different data collection methods, multiple data sources, and longitudinal designs would be valuable.

Future research could consider the individual and combined impact of the components of involvement of family when investigating the behaviors and performance of family firms. Many entrepreneurial, behavioral resource, and results variables need to be compared such as; differences in human capital, survivability capital, patient financial capital, social capital, etc. Considering these might lead to a greater understanding of the determinants of these behaviors as well as clarify some of the inconsistencies in previous studies that have investigated family firm performance (e.g., Rutherford et al., 2008). This could lead to the conclusion that the fit between family-business decision-making, human and social capital and strategic behavior will affect firm performance.

Finally, some experimentation will be needed on how precisely family firms should be defined and measured.

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