

Agency Differences in Professional Family Businesses: The Known and the Unknown

Ken Moores¹ PhD AM

and

Justin B. Craig² PhD

Australian Centre for Family Business (ACFB)
School of Business
Bond University
Gold Coast, Australia

Abstract

We suggest in this paper one of the reasons that researchers concur agency costs in family firms are more complex than originally thought maybe related to the lack of conceptual clarity. This, we propose, is because when frameworks and theories are borrowed and enthusiastically embraced without attention to clearly defining concepts from original sources, conceptual clarity is clouded. Clarity is achieved by specifying the conditions necessary for these concepts to be applicable in generating originally envisaged consequences. We present the conditions necessary for the optimum applicability of original agency theoretical concepts in family firms and tentatively distinguish between what is known and what is still to be known. From this, we distill a series of research questions that will guide the ongoing development of our *Theory of Family Business Distinctiveness*.

Key Words: Agency Theory, Berle and Means, Family Business, Control.

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¹ Foundation Director ACFB, Professor Family Business

² Co-Director ACFB, Associate Professor Entrepreneurship and Family Business

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Executive Summary

This research project enables us to draw a line in the sand in respect to our research agenda at the Australian Centre for Family Business in order to achieve two objectives: (1) to revisit the research progress that has been made (by our team and others) to address agency problems in family firms, and (2) to take a more structured look to the future in order to continue to develop theory and a better understanding of the complex family business genre.

We achieve the first objective by linking our Australian Centre for Family Business research program to the original musings of Berle and Means. We have over the past 15 years embarked on research projects that acknowledge that there are agency problems in family firms. A common thread that runs between these research projects is that agency problems can be addressed through more professional corporate governance initiatives, management and measurement of strategy, and understanding that control mechanisms need to be paralleled with the changing needs of the firm. In other words, we have not only examined agency problems through multiple lenses but also have worked diligently to develop solutions to these problems. For example, our work with clan controls over the life cycle of a family firm has enabled us to work with families to better understand how they must continue to learn business, learn family business, learn to lead, and learn to let go. Another example is the ongoing action research program we have in place to adapt the Balanced Scorecard to a family business audience.

We achieve our second objective to take a more structured approach to future research by distilling a series of questions that will continue to guide the development of our *Theory of Family Business Distinctiveness*. The nexus of this developing

hybrid theory is that family business can be distinguished by (1) the evidence of business governance and family governance structures that facilitate transparency, inclusivity, and reduce opportunistic behavior (Agency Theory), (2) the identifiable bundle of resources epicentered around their unique familiness (RBV) and, (3) a demonstrated commitment to trans-generational learning (Learning Theory).

In the paper, therefore, we briefly revisit and clarify the *concepts* of agency theory as presented in seminal works of Berle and Means (1932), Jensen and Meckling (1976), and others. We then in more detail specify the *circumstances* unique to family business that have engendered new concepts such as entrenchment, altruism, and personalism. From this conceptual clarity and the family firm-related circumstances necessary for their applicability we introduce proven *consequences* of adherence to originally presented concepts. These we link directly to our ACFB research agenda.

This project contributes to the family business research community specifically by demonstrating that seminal frameworks such as the Berle-Means theses play an ongoing role in guiding a research program. Researchers may see benefit in regularly seeking conceptual clarity to ensure consistency with the original theoretical drivers, as we have learnt that in the case of Agency Theory, increasing scholarly popularity can cloud rigorous interpretation.

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Introduction

Family businesses are fundamentally different from other businesses. The goal structure within a family business is inherently conflicted. The need to balance between a family's personal goals (e.g., the accumulation of personal and family wealth), the well-being of family participants, and to satisfy multiple commercial stakeholder objectives (e.g., profits and sales growth) means that family businesses are unique (Steier, Chrisman & Chua, 2004; Randøy & Goel, 2003).

In family firms, espoused traits such as trust, altruism, and paternalism encourage long-term commitment (Ouchi, 1980), and as such can potentially lead to higher long-term performance (James, 1999). The upside of this blending of family and business goals can result in competencies that are developed and contribute to a distinct competitive advantage (Habbershon & Pistrui, 2002). While balancing family and business goals is considered difficult in privately-held family firms, it can potentially be even more complicated when the shares of the family firm are publicly-traded (Anderson & Reeb, 2004).

Agency theory is most often employed to explain divergent motivations in organizations. Rooted in the economic model of man, according to the assumptions of agency theory, the interests of shareholders/principals and agents diverge as each wishes to maximize their own personal wealth and utility. The assumptions of agency theory suggest agents will exploit their access to superior information for personal gain. The information asymmetry and contradictory incentives between owners and agents demands the need to introduce governance initiatives to ensure clarity, accountability and transparency for stakeholders (Berle & Means 1932; Demsetz 1988; Eisenhardt 1989; Fama & Jensen 1983; Jensen & Meckling 1976). Put another

way, agency theory tries to account for the inability of owners to control their agents effectively (Fox & Hamilton, 1994). Agency theory, therefore, has driven the development of systems of external control with two complementary over-arching purposes: to control agents and reduce agency costs (Dicke & Ott, 2002). Recently, scholars have found settings where the assumptions of agency theory do not hold. The behaviour of family members in family-owned firms is one such setting (Schulze et al. 2001).

The purpose of this paper is multi-faceted but easily distilled under the headings of *Concepts*, *Circumstances* and *Consequences*. First, we briefly revisit and clarify the *concepts* of agency theory as presented in seminal works of Berle and Means (1932), Jensen and Meckling (1976), and others. We then specify the *circumstances* unique to family business that have engendered new concepts such as entrenchment, altruism, and personalism. From this conceptual clarity and the family firm-related circumstances necessary for their applicability we introduce proven *consequences* of adherence to originally presented concepts. Specifically, we canvas the typical manifestation of agency costs in the conditions prevailing in family firms by discussing Australian Centre for Family Business (ACFB) work in the areas of corporate governance, strategic planning, and management control systems. We finally tentatively distinguish between what is known and what is still to be known and distill a series of research questions that will guide the ongoing development of our *Theory of Family Business Distinctiveness*.

Seminal *Concepts* of Agency Theory

Berle and Means (1932) originally proposed that the separation of ownership and control produces the core agency problem, i.e., how can less informed “outside”

owners monitor better informed “inside” managers? The thesis of their argument rested on three propositions developed from observations at the time. Specifically, as observed by Means, that “large corporations were owned by so many stockholders that no one or even no score of them typically owned a significant fraction of the outstanding stock” (p. iv); “corporate officers in general owned a very small fraction of the stock of their corporations (p. iv); and finally, later supported by Berle’s investigation into changing statute and case law with respect to the rights and duties of stockholders and corporate directors and officers, that “the interests of management and stockholders diverge widely” (p. iv).

Importantly, according to the Berle-Means theses an individual or group is said to be in control without necessarily possessing a majority of voting stock and whether or not they use their position actively. All that is needed is the *potential* to influence the choice of directors (Leech, 1987). In their analysis, Berle and Means classified companies into categories on the basis of shareholding concentration. Specifically, they identified five control types: (1) control through almost complete ownership, (2) majority control, (3) control through a legal device, (4) minority control, or (5) management control.

The timing and situation (depression ravaged New York) and the quantitative support (200 largest nonfinancial corporations) for their arguments meant that the Berle-Means theses “were accepted by many, ignored by some, and denied by none” (Stigler & Friedland, 1983, p. 243). So significant were their arguments that they were able to have some influence in the revision of the Securities Act of 1934 and the Securities Exchange Act of 1934. Though subsequently critiqued for lack of rigor, Berle and Means challenged “the applicability of the traditional theory of business behavior to the most prominent form of business organization in the modern age”

(Stigler & Friedland, 1983, p. 246). They drew attention to their arguments through their claim that self-perpetuating managers controlled their own economic destinies and treated stockholders, at best, like complaisant creditors. The problem behavior of these corporate managers is now called the agency problem and was central to the establishment of more robust and transparent corporate governance initiatives designed to address opportunistic activity through, for example, access to superior information i.e., information asymmetry.

Put simply, corporate governance involves the legal, institutional, and cultural mechanisms that enable owners to reduce agency costs (Jensen & Meckling, 1976). The implementation of the appropriate corporate governance mechanisms should benefit owners financially, whether in closely-held or widely-held firms, by enabling them to exercise more control over corporate insiders and management (Eisenhardt, 1989; Fama & Jensen, 1983; Jensen & Meckling, 1976). Two essential elements of corporate governance monitoring have been proposed: (1) incentive alignment by having managers as co-owners (Shleifer & Vishny, 1986) and, (2) long-term ties and commitment between managers and other stakeholders such as employees, suppliers etc. (James, 1999).

Jensen and Meckling (1976) further state that the cost of reducing information asymmetries and their accompanying agency threats is lowest when owners directly participate in the management of the firm. These authors assume that separation of ownership from control is the principal source of agency costs, and therefore related costs are eliminated when the firm is managed by a single owner.

But, agency theory assumes a rational model of wealth maximization. However, behavior economic assumptions note that individuals are not perfectly rational, and have idiosyncratic tastes and preferences. These preferences may be

economic or non-economic in character. It is therefore difficult to simultaneously attain goal alignment and maximization of a myriad of preferences (Lubatkin, Schulze, Ling & Dino 2005). In other words, owners of widely-held firms prefer growth-oriented risk-taking with the ultimate goal of maximizing firm returns.

In contrast, owner-managers define their value in terms of utility, hence, would be more amenable to taking risks commensurate with the preferences for certain outcomes, economic or otherwise (Schulze, Lubatkin & Dino, 2003). Managerial ownership, therefore, hampers the ability of stakeholders to agree on actions that affect the business (Lee, 2004). Moreover, Kelly, Athanassiou and Crittenden (2000) posit that owner-managers include their personal goals along with the strategic context in establishing the family firm's business strategy. The authors also suggest that goals related to family roles may tend to take equal or greater importance than maximizing profits. This may then result in a negative effect on the firm's performance despite a positive effect on the performance of the family's objectives.

Daily and Dollinger (1992) argue that organizations are potentially most efficient when decision-making and ownership functions are shared, since the potential for conflicting optimization paths is minimized (James, 1999). This implies that owner-manager led firms are less prone to the detrimental effects of managerial discretion than other firms. Lee (2004) suggests that the concentration of ownership and control in family firms provides an advantageous position of monitoring the firm. And Le-Breton Miller and Miller (2006) hypothesize that firms controlled and managed by family owners will generate more resources due to lower agency costs, and therefore, for example, will have more assets available to fund long-term investments.

Circumstances Unique to Family Firms

The introduction of stakeholder groups beyond the founder gives rise to disparate demands, dividing management's focus of attention and forcing them to attend to diverse sets of goals simultaneously (Connolly, Conlon, & Deutsch, 1980). Boards of directors are in place in the publicly-traded firm model to ensure proper corporate governance, that individual influence is neither excessive nor inadequate, and that the needs of multiple stakeholders are addressed (Hambrick & Finkelstein, 1987). But, founders have been known to be reluctant to give up too much control to boards and this is particularly significant in family businesses where there is usually concentration of ownership by a single family member or members of a family (Sharma, et al., 1996).

In family firms that are not publicly traded, boards are often made up of members of the family and loyal insiders (executives, consultants, advisors, etc.) who work for, or have a close relationship (usually with the founder) of the firm (Gersick et al., 1997). In this situation, there is a continuance of the informality and flexible decision making that characterized the company prior to board formation (Daily & Dollinger, 1992). The absence of board influence increases the discretion of the founder/CEO (Fiegener, Brown, Dreux, & Dennis, 2000). The alternative situation is a board that is proliferated by outsiders. In this instance, the distinct familiness-based (Habbershon & Pistrui, 2002) virtues of the firm can be undermined. The family business literature suggests that family boards generally have disproportionately fewer outside directors than do non-family boards (leading to more family control), are less willing to pursue new opportunities, and are more conservative in their resource

allocations (because of more concentrated ownership within the family) than non-family boards (Gomez-Mejia et al., 2001; Ward & Handy, 1988).

In family firms that are publicly traded, there is evidence that founding-family ownership benefits outweigh the cost, i.e., they outperform firms without founding firm owners (Anderson & Reeb, 2003a, 2003b). Ideally, the board is structured to ensure that the family directors' interests are balanced by the independent directors' objectivity (Anderson & Reeb, 2004). Founding family influence often transcends generations as family shareholders tend to have their wealth invested, and serve as executives, in the firm (Mackie, 2001). Conflicts arise when the power wielded by the influencing family enables them to pursue the family's interest to the detriment of the firm or other shareholders (Demsetz & Lehn, 1985). In these situations, the literature suggests that founding families are in an exceptional position to pursue their interests through, for example, control of cash within the firm (Ditmar, Mahrt-Smith, & Servaes, 2003), distribution of profits (Anderson & Reeb, 2003a), workplace inefficiencies due to family nepotism (Burkhart, Gromb, & Panunzi, 1997; Burkhart, Panunzi, & Shleifer, 2003), and decisions regarding resource allocation (Demsetz & Lehn, 1985).

It has been argued that a paradox occurs because of two agency problems within family businesses: entrenched ownership and asymmetric altruism. Entrenchment refers to the relational contract between owners and managers that enable both to occupy key positions in the firm for a significant duration. Asymmetric altruism is an agency problem that is specific to family businesses, hence, provides a distinguishing characteristic against non-family firms. It is a self-discipline problem within the family firm that ultimately translates into agency costs (Chrisman, Chua and Sharma, 2005).

Although there are conflicts in the extant literature, principal-agent dynamics in family businesses are fundamentally different from non-family firms. For this reason, governance structures such as oversight boards, monitoring mechanisms, incentives and strategic planning systems of family firms may need to differ from those of non-family firms (Lubatkin, Schulze, Ling & Dino 2005; Mishra, Randoy & Jenssen, 2001).

An inherent problem in extant agency theory research is that principal-agent conflict tends to be causally and sequentially entwined in a manner that makes their effects difficult to tease apart (Schulze, Lubatkin, Dino & Buchholtz, 2001). Fama and Jensen (1983) suggest that family firms have insignificant agency costs because of the natural alignment between owners' and managers' roles in family businesses. Therefore, the convergence of ownership and management ensure that information asymmetry regarding the firm's resources, risk orientation and growth prospects are reduced. Subsequently, the firm's resources are not misallocated and monitoring and transaction costs are minimized (Schulze, Lubatkin, Dino, Buchholtz, 2001).

Lesser information asymmetry means that owners are less susceptible to the detrimental effects of managerial discretion (Fama & Jensen, 1983). Also, there is evidence that managers are willing to give up real economic benefits in order to satisfy the implicit expectations of owners, these opportunity costs are reduced in family firms. Thus, the cost-savings from the convergence of information asymmetry between owners and managers arise from the reduction of the potential unfavorable results in managerial discretion.

When information asymmetry is reduced, detrimental effects of managerial discretion are also reduced such that monitoring costs can be made redundant. For instance, it has been observed that family ties between the principal and agent

influence the magnitude and composition of executive pay package. There is an inverse relationship between the concentration of ownership in the hands of family members and the compensation of family executives (Gomez-Mejia, Larraza-Kintana & Makri, 2003). Family CEOs earn less and receive less incentive pay than non-family CEOs after controlling for size and tenure (McConaughy, Matthews & Fialko 2001). Gomez-Mejia, Larraza-Kintana and Makri (2003) show that firms which invest heavily in R&D pay their executives more since “self-monitoring” rather than external monitoring becomes important under these conditions. This is because information asymmetries between managers and shareholders increase in tandem with R&D investments. However, the positive influence of R&D intensity on CEO’s total compensation is lower for family firms vis-à-vis non-family firms because family ties counteract the information asymmetries associated with the greater R&D expenditure.

The manner in which agency costs arise can be viewed from a behavioral economics perspective. Behavioral economics suggest that individuals (or in the case of family firms, the dominant family coalition) are motivated by an idiosyncratic set of preferences. These preferences may be economic or non-economic in character; moreover, they may be egoistic or altruistic. It follows that the dominant family coalition is driven to maximize the utility gain from each preference. Conflicts of interest arise because resource constraints prevent the dominant family coalition from maximizing its different type of preferences simultaneously, thus resulting in opportunity costs (Schulze, Lubatkin & Dino, 2003; O’Donaghue & Rabin, 2000). In other words, the presence of non-economic objectives results in the difficulty of aligning various non-economic objectives of owners, and thus cannot guarantee the alignment of owners’ attitudes and risk-tolerance towards growth opportunities (Schulze, Lubatkin, Dino & Buchholtz, 2001). Paradoxically, this situation is

compounded by the informal relationships and governance described earlier, which reduces the formal safeguards that mitigate potential agency costs (Gomez-Mejia, Nunez-Nickel & Gutierrez, 2001).

Moreover, the effects of these agency costs are more severe on minority, especially non-family, shareholders. The dominant family coalition has the power and incentive to act in its own interests at the expense of outside shareholders. This occurs from the family stakeholders' inability to separate their own needs from the profit maximization goals of the outside shareholders and stakeholders outside the coalition. (e.g., Morck & Yeung, 2003)

Further, Carney (2005) suggests that personalism in family firms leads to executive entrenchment and its subsequent agency problems. Schulze, Lubatkin and Dino (2003) suggest that entrenchment arises from the disproportionate power awarded to the family management stemming from personalistic familial sources. Although executive entrenchment is a phenomenon that is not exclusive to family businesses it is nevertheless more prevalent in family firms. Entrenchment issues that arise from family relational contracting are likely to increase agency costs because of the tendency of family firms to decouple the family agent's employment from performance and employment risk. This is because a relational contract between the family and family agent involves a set of mutual expectations that are more likely to be based on the family's non-economic goals and their residual effects (for instance, emotions and sentiments) than non-family contracting. Thus, family bonds engender agency contracts that are prone to depart from economic rationality (Gomez-Mejia, Nunez-Nickel and Gutierrez, 2001).

Executive entrenchment, importantly, is a phenomenon that is not exclusive to family businesses. Nevertheless, entrenchment is more prevalent in family firms

because the presence of a dominant family group can allow emotions and relationships to color the perception of competence of executives. Morck & Yeung (2003) find agency problems resulting from entrenched management is common among family firms that use pyramid cross-holdings to separate ownership from control. Examples of ways executives legitimize their entrenchment include: (1) hiding or obscuring negative performance, (2) hiring consultants to legitimize decisions, (3) manipulating biased information, and (4) embarking on business strategies that capitalize on their idiosyncratic skills and abilities, thus making them irreplaceable (Gomez-Mejia, Nunez-Nickel & Gutierrez, 2001).

Entrenchment may lead to significant agency costs in the form of hold-up problems. Hold-up occurs when family management, who acquire a disproportionate amount of power which emanate from their family status instead of their skills, impose their self-interest onto the firm by keeping the owners hostage (Gomez-Mejia, Nunez-Nickel & Gutierrez, 2001). Thus, entrenched family executives in the firm can make both inside and possibly outside directors beholden to them. This situation threatens the autonomy of the board and undermines the effectiveness of its oversight role. Eventually, agency costs arise when family CEOs remain in the office long after they have ceased to be effective, thus harming firm performance (Schulze, Lubatkin, Dino & Buchholtz, 2001). Further, strengthening the rights, influence and power of family management reinforces a vicious cycle towards further entrenchment, thereby having a negative impact on overall shareholders' welfare. (Schulze, Lubatkin, Dino & Buchholtz, 2001; Gomez-Mejia, Nunez-Nickel & Gutierrez, 2001; Schulze, Lubatkin & Dino, 2003; Gomez-Mejia, Larraza-Kintana and Makri, 2003)

Entrenchment can exacerbate adverse selection problems in family firms because of the limited career opportunities within the executive positions available to

outsiders. Family firms are likely to maintain top management positions for family members rather than hiring more qualified or competent outsiders. Further, entrenched family members are capable of redistributing benefits to themselves through excessive compensation or special dividends that may adversely affect employee morale and productivity (Lee, 2004). Likewise, Morck and Yeung (2003) argue that entrenchment inhibits opportunities for more skilled non-family managers to undertake key roles within the business, and in turn allow less-skilled family-member managers to extract private benefits from ownership. Thus, adverse selection results from a smaller pool of labor market of uncertain quality (Gomez-Mejia, Nunez-Nickel & Gutierrez, 2001; Schulze, Lubatkin, Dino & Buchholtz, 2001). The adverse selection problem is most severe in high R&D industries. Entrenched family firms might have difficulty accepting professional managers who are capable of responding to new technology and increased competition but rather prefer home-grown family executives. However, family management may face greater cognitive constraints in these industries resulting from a narrower market exposure, more parochial work experience, and firm-specific knowledge base (Mishra, Randoy, Jenssen, 2001). This could possibly explain why family firms tend to survive less in high technology industries (Carney, 2005).

Agency problems associated with moral hazard are aggravated by personalism-based entrenchment because family firm ownership and control may free family management from discipline and monitoring, which subsequently fosters self-control problems (Schulze, Lubatkin, Dino & Buchholtz, 2001). Examples of moral hazard problems that arise from entrenchment include (1) management's attention to short-term profit more so than long-term goals, (2) reluctance to be innovative, (3) pursuing pet projects than enhance the executive's image, (4) focus on sales

maximization at the expense of profits (empire building), and (5) consumption of executive perquisites and hubris, among others (Gomez-Mejia, Nunez-Nickel & Gutierrez, 2001; Lee, 2004).

When owner-managers (agents) advance the family's interest at the expense of stakeholders outside of the dominant family coalition (principals), the negative effects of personalism exacerbate agency cost problems (Schulze, Lubatkin, Dino & Buchholtz, 2001). This implies that owner-manager led family firms have more under-versifiable personal risks in the business than other family firms. Further, managerial ownership reduces the effectiveness of external control mechanisms and exposes the firm to a self-control problem created by incentives that allow owner-managers unchallenged discretion over the use of the firm's assets, potentially resulting in greater agency problems (Lubatkin, Schulze, Ling & Dino 2005; Mishra, Randoy & Jenssen, 2001).

Consequences of Adherence: Corporate Governance

The growing body of family business literature has begun to explain how family businesses may extend the underlying assumptions of traditional governance and management theories (Mustakallio, Autio, & Zahra, 2002). Combining the inevitable exit of the founding entrepreneur from the business, the inclusion of other family members into strategic roles, and the growth in size of both the family and the business, expectations of less centralized management structures and associated increases in the use of formalized processes is raised. As a result of the founder's departure, ambiguity related to legitimate authority (which is not formalized) becomes more ambiguous. That is, its strength is reduced, and firm leadership has to rely on more formal mechanisms (Davis & Harveston, 1999).

There is potential for power ambiguity within the family system when multiple generations are involved, particularly during leadership transition. At this time, it can be confusing who has legitimate authority. Is it the incumbent? The successor? When it is not clear or obvious with whom authority rests, structures need to be in place to ensure stakeholders are clear. Specific issues that can occur that make it unclear where authority rests include when family members are elevated to management positions for which they are not qualified; family members who, though not in operating or ownership positions, attempt to influence business decisions; and philosophical divergence between generations over the strategic direction of the business (Kets de Vries, 1996).

In the current business environment, accountability, transparency and individual honesty are increasingly under the spotlight and many public company leaders are striving to somehow ensure ethical values are at the foundation of their operations. Paradoxically, as many family businesses strive to be more professional in their operations and mimic the public company model, they are realizing the need to achieve this professionalism without sacrificing their family influence and values (Moore & Barrett, 2003).

The degree of family influence, both observed and tacit, is one of the factors that make family businesses different to their public company equivalents and can be a point of difference that contributes to competitive advantage. Conversely it can have a stifling effect and inhibit growth (Craig & Lindsay, 2002). In the family business context, the family influence often falls into the intangible category and although attempts have been made to define its contribution (or otherwise) to the business, like many intangibles it is difficult to define let alone measure. As such, family businesses

often function in confusing and clandestine ways that are not evident in non-family businesses (Litz, 1997).

To address complex governance issues in family business, our ACFB research supports the use of outside experts. There is evidence in the broader management literature that engaging outside-the-firm experts is beneficial (Robinson, 1982; Sartain, 1998). Expert outsiders have been viewed as an externalized form of management and knowledge intermediaries (Fincham & Clark, 2002). As such, firms engaging expert outsiders are “a buyer of a knowledge service” (Werr & Styhre, 2002, p. 47). Expert outsiders create value in organizations by generating objective information (Schein, 1988). Because their relationships are independent from day-to-day operational issues, outsiders are able to view organizational problems objectively and remain separate from internal power struggles, hidden agendas, and such like (Kubr, 1996; Kyro, 1995). Expert outsiders “offer the potential advantage of being experienced observers and analysts without the related disadvantage of being locked into defending previously established positions or ways of thinking” (Gattiker & Larwood, 1985, p. 120). However, leaderships’ position is not undermined as the expert outsider is viewed as an advisor, leaving the leadership with the responsibility for critical examination of recommendations and the use of advice (Kubr, 1996).

Family businesses create challenges for expert outsiders (Koiranen, 2003). There is a necessity to address the delicate relationship that exists between the functioning of the family and the operation of the business. It is further recognized that external advice must be within the context of the family with its unique and emotional relationship systems. Additionally: “a family’s emotional process is stronger than any connection that a family member will have to a consultant” (Brown, 1998, p. 203). When input does occur, Baker and Wiseman (1998) argue for the

understanding of this emotional process being an important aspect of consulting to the family business. This could be one explanation for Leach's (1991) observation that family businesses are less likely to have external advisers on the board of directors compared to non-family businesses (also see, Corbetta & Salvato, 2004; Ward, 1998).

The economic literature suggests that competition is also a very powerful force for ensuring good corporate governance. Previous agency theory-based research indicates that product market competition may reduce the potential for managerial expropriation (Shleifer & Vishny, 1997). Variations in industry structures (i.e., monopolistic versus more competitive product markets) may provide different needs and rewards for family firms, hence moderating the relationship between family leadership and performance (Schulze et al., 2003).

Family leadership in publicly-held firms are in the position to provide superior corporate governance in less competitive markets because they are able to propagate organizational memory and contribute to the long-term accumulation of other intangible assets (brand name, family-based culture, family-based values, employee and supplier loyalty, etc.) (Anderson & Reeb, 2003a, 2003b; 2004; Klein Astrachan, & Smyrnios, 2005). The major firm-specific resources and capabilities that facilitate monopolistic competition - and therefore market power - are non-imitable product features, valuable brand names, unique technology, or unique access to non-tradable resources and networks (e.g., Barney, 1991). The corporate governance of firms in less competitive (monopolistic) industries needs to reinforce the build-up of knowledge and other intangible assets to maintain barriers to entry. This is potentially one of the most challenging principal-agency problems for firms residing in less competitive product markets.

In highly profitable markets, the family firm provides an important corporate governance monitoring mechanism; specifically through social bonding and networking with important stakeholder groups. For instance, with lax external monitoring then “hired” (non-family) managers may be able to undertake actions that are not in the interest of their owners (Fama & Jensen, 1976). On the other hand, firms operating in highly competitive industries (i.e., low industry profit margins) are not as able to benefit from family influence as they are already closely monitored by the market place. In these firms, family leadership might even become a liability, as closely-held firms controlled by families tend to be less growth-oriented, less risk-taking, and potentially more vulnerable to decision-making inertia (e.g., Chandler, 1990; Meyer & Zucker, 1989). As such, the open disclosure and discipline of public ownership may enhance the ability of family leadership to resolve inherent conflicts between family goals and institutional objectives, which may especially be true as a firm is confronted by a highly competitive market. As a consequence, in less competitive industries, we family leadership has a positive effect on firm value and profitability (Randoy, Dibrell, & Craig, 2007).

Studies that have investigated the corporate governance role of external factors (e.g., takeovers, mergers) suggest that family influence might be a source of negative loci. For example, the very points that made founder influenced firms successful in the first place – can also lead to cognitive rigidity and an inability to adapt to a changing environment when needed. Following this logic, a competitive product market keeps a business “closely monitored” (i.e., highly competitive), and as such there is less need of family governance – or other means of “strong” corporate governance. Furthermore, corporate strategy in a highly competitive market should focus more on short-term goals and pursue market flexibility. There is evidence that

family leaders often have a difficult time deviating from the dominant logic that first made the firm successful. In highly competitive markets, where consumer preferences and business paradigms are quickly evolving, the ability to be adaptable to change is vital to a firm's success. Therefore, family leadership has a negative or constraining effect when a firm competes in a highly competitive industry.

Family leadership enhances firm value and profitability in less competitive product markets due to the ongoing family influence and the family's vested motivation to align firm management with the goals of the family. Family leadership in less competitive markets are more capable of achieving greater financial performance than non-family managed public firms, as family leaders exercise a greater tacit understanding and knowledge of the core business practices and processes in these product markets. Family leaders manage with a higher degree of interpersonal trust and long-term top management commitment.

In highly competitive product markets, the original business model of the founding entrepreneur must be continually adapted and altered in order to meet the changing demands of the marketplace. Our ACFB research indicates that professional managers may be better agents for shareholders in highly competitive markets that are rapidly changing than members of the family (see, Moores & Mula, 2000). This notion is also consistent with the observation that the competitive edge of founding family firms tends to decrease as a new generation takes control (e.g., Anderson & Reeb, 2003a).

Consequences of Adherence: Strategic Planning

Many studies have supported the notion that strategic planning processes and the resulting strategies of family businesses significantly differ conceptually from the

processes and strategies of nonfamily firms (see for example, Ward, 1988; Harris, Martinez & Ward, 1994; Gudmunson et al., 1999).

Strategic planning is critical for family businesses as a way of reducing agency influences, for providing a framework for reconciling family and business issues and for promoting open and shared decision making (Ward, 1988). The empirical research examining the strategies pursued by or the strategic orientations of family-owned and managed firms is limited and has provided conflicting results (Gudmunson et al., 1999). Family business CEOs have been found to rate strategic planning less significant in successor preparation than non-family business CEOs. Harris, Martinez, and Ward (1994) reviewed the strategy literature pertaining to family business and came up with a list of characteristics that may influence strategy including “inward” orientation (Cohen & Lindberg, 1974), slower growth and less participation in global markets (Gallo, 1993), long-term commitment (Danco, 1975), less capital intensive (Moore & Mula, 2000), importance of family harmony, employee care and loyalty (Ward, 1988), lower costs (McConaughy, Walker, & Henderson, 1993), generations of leadership (Ward, 1988) and, board influence on implementation (Ward & Handy, 1988).

From a strategic management perspective, therefore, families are both a resource and a constraint. Sharma et al. (1997) considered family business research in the areas of (1) goals and objectives; (2) strategy formulation and content; (3) strategy implementation, and (4) strategy evaluation and control. They subsequently concluded that “(1) family business is more likely to have multiple, complex, and changing goals rather than a singular, simple, and constant goal; (2) although more attention has been paid to the process of strategy formulation and the content of strategy in family businesses, relatively little is still known; (3) while the family-

business literature describes the influences of family on strategy implementation, unfortunately, however, it stops short of showing how a particular family influence helps or hinders the firm's achievement of its goals and objectives; and (4) the literature tells us very little about whether strategic decisions and performance are evaluated and controlled differently in the family firm, or if such differences are justified" (p. 17).

At the ACFB, Moores and Mula (2000) found that family firms use a mixture of strategies to cope with business uncertainties. Their goals however emanate from product differentiation type strategies more so than cost leadership ones. Product and service quality is the dominant form of differentiation. But relatively few family business CEOs use formal strategic planning processes. Less than fifty percent of CEOs in a 1991 study reported heavy to extensive use of long term planning while 16% indicated no use of long term planning (Moores & Mula, 2000). This observation was subsequently found to be consistent across time (Craig, Cassar & Moores, 2006).

Some (e.g., Post, 1993) have suggested that for family businesses to remain successful, they must generate a new strategy for every generation that joins the business. Strategies recommended include starting a new venture or division of the business (Barach, 1984), internationalising the business (Gallo & Sveen, 1991), and helping successors acquire skills that other family members do not possess (Wong, 1993). As a firm morphs into a *family* firm, strategies must be put in place and these strategies need to be communicated to an increasingly diverse group. Then as the *family* firm evolves, the strategy and the priorities change and a framework is needed to deal with this evolution. The Balanced Scorecard (BSC), a widely accepted strategic management and measurement tool (Kaplan & Norton, 1992) can be employed as a way to address the constantly evolving generational family business.

The BSC provides a framework to address the strategic complexities in family business highlighted in the literature by Sharma et al. (1997) and others.

Our ACFB research has deployed the BSC in both additive and integrative forms to address the potential agency costs introduced in original Berle and Means discussions. In our first action research study (Craig & Moores, 2002) we added *familiness* to each of the four BSC perspectives. In a subsequent and ongoing innovation action research project (see, Moores & Craig, 2006) we are integrating the family business unique challenges into the BSC being used by a third-generation family business (Moores & Craig, 2006). This process has proven particularly beneficial in addressing the earlier introduced family business challenges such as asymmetry and personalism.

Consequences of Adherence: *Management Control*

In an early ACFB research project, Moores and Mula (2000) determined that there are salient controls for each stage of the development life cycle. Specifically, clan controls are used twice in the life cycle but are most prominent in mature firms. This suggests that, consistent with Berle-Means theses, monitoring costs are minimized when ownership and management are separated, as is the case in mature family firms.

It makes intuitive sense that clan control would be particularly relevant to family firms. In clans, as opposed to bureaucracies and market-based systems, there is a fraternal relationship in which there is a tendency for members to believe that they will be dealt with equitably. Clans tolerate short-term equities and trust those to whom they have entrusted legitimate authority to deliver in a cooperative, often unspecified, relationship. Long and stable membership, absence of institutional alternatives

(Ouchi, 1980), emphasis on the development of shared organizational understanding and commitment through participative, not centralized, communication processes (Quinn & Rohrbaugh, 1983), and interaction among members (Wilkins & Ouchi, 1983) are all characteristics of organizational groups that have been identified to be clan-like.

Further, clan-like behavior is characterized by the addition of common values and beliefs that provide the harmony of interests that reduce the possibility of opportunistic behavior (Ouchi, 1980). Clans reflect a situation where information is diffused but the lack of codification requires personal, nonhierarchical relationships in transactions (Biggart & Delbridge, 2004) and in which there is high trust, low conflict and low resistance to change (Zammuto & Krakower, 1991). This is consistent with literature that indicates that families involved in business activities are renowned for their informality that, in some instances, extends accepted governance practices (Mustakallio, Autio, & Zahra, 2002) but, at the same time, provide competitive advantages, leads us to conjecture that the clan framework lends itself to a discussion of behavioral differences within family businesses and between family- and non-family businesses.

The normative requirements of clan controls are reciprocity, legitimate authority, and common values and beliefs (Ouchi, 1980). A norm of reciprocity is universal and one of only two social agreements that have been found to be universal among societies across time and cultures (the other is the incest taboo) (Gouldner, 1961).

In organizational settings, legitimate authority permits the assignment of superiors who can specify and audit the work assignments of subordinates. In bureaucratic organizational cultures, legitimate authority will commonly take a

rational/legal form that is characterized by hierarchical surveillance, evaluation, and direction. In this environment, there is an explicit understanding that good performance will be rewarded and poor performance will be punished. Once established, legitimate authority that leads to clan controls can create an atmosphere of trust between employees as they assume a certain commonality of purpose and goal congruence, which minimizes conflict and the problem of opportunism (Bendix, 1956; Landsberger, 1958).

The key implications from the empirical analyses of a 10-year two wave ACFB study supplied rare insights into the use of (clan-related) control systems in family business. Firstly, at a basic level established family firms appear to place substantial importance upon innovation practices and strategy. This potentially is at odds with perceptions of the role of innovation in these firms. Secondly, there are strong observed interactions between innovative strategy and environmental uncertainty associated with technological change, and the scope and timeliness of information acquisition and use. This shows that family firms appear to manage and adjust to innovative strategy. While such notions are more associated with high-tech firms, it appears that family firms exhibit similar relationships and behaviours. Thirdly, the longitudinal analysis generally confirms the static relationships found, thus providing greater validity for the study's findings. In addition, this suggests that family firms not only select postures based upon environment and innovative strategy, but that they adapt such postures over time. Fourthly, we find evidence consistent with life stage influencing both the level of innovation and its relationship with information acquisition within family firms. Again, such life-stage effects have been observed in high-tech firms, it is interesting that even in established family firms, these types of differences are observed. All the findings discussed above suggest that

linkages between established family firms and innovation may be substantially stronger than currently assumed by many.

Summary and Future Direction

The purpose of this paper was to effectively draw a line in the sand in order to achieve two objectives: (1) to revisit the research progress that has been made, and (2) to more formally look to the future. We were able to achieve the first objective by linking, albeit at times loosely, our research program to the original musings of Messrs Berle and Means. We have over the past 15 years embarked on research projects that acknowledge that there are agency problems in family firms. A common thread that runs between these projects is that these agency problems can be addressed through more professional corporate governance initiatives, management and measurement of strategy, and understanding that control mechanisms need to be paralleled with the changing needs of the firm. We are able to demonstrate that we have also achieved our second objective to more formally look to the future by distilling a series of research questions (Table 1) that will continue to guide the development of our *Theory of Family Business Distinctiveness*. The nexus of this developing hybrid theory is that family business can be distinguished by (1) the evidence of business governance and family governance structures that facilitate transparency, inclusivity, and reduce opportunistic behavior (Agency Theory), (2) the identifiable bundle of resources epicentered around their unique familiness (RBV) and, (3) a demonstrated commitment to trans-generational learning (Learning Theory).

Table 1: Developing Future Research Pathways

KNOWN: Seminal Discussions	KNOWN: Examples from ACFB-Related Research	UNKNOWN: Future Research Question Examples
<p>Berle and Means classified companies into five control types: (1) control through almost complete ownership, (2) majority control, (3) control through a legal device, (4) minority control, or (5) management control.</p> <p>Product market competition may reduce the potential for managerial expropriation (Shleifer & Vishny, 1997). A competitive product market keeps a business “closely monitored” (i.e., highly competitive), and as such there is less need of family governance – or other means of “strong” corporate governance.</p>	<p>ACFB research indicates that professional managers may be better agents for shareholders in highly competitive markets that are rapidly changing than members of the family.</p>	<ul style="list-style-type: none"> • Is there benefit in using Berle-Means control categories to help better understand agency costs in (different types of) family firms? • By what process do family firms move from one Berle and Means control type to another? • Is Berle-Means process evolution of control (whereby firms slowly process from type 1 to type 5) distinctly different in family firms?
<p>Asymmetric altruism is an agency problem that is specific to family businesses, hence, provides a distinguishing characteristic against non-family firms. It is a self-discipline problem within the family firm that ultimately translates into agency costs (Chrisman, Chua and Sharma, 2005).</p>	<p>There is a point in the life cycle of a firm where clan controls are more efficient than market or bureaucratic control initiatives (Moores and Mula, 2000). The empirical analyses of a 10-year two wave ACFB study reported positive effects of the use of (clan-related) control systems in family business (Craig, Cassar & Moores, 2006).</p>	<ul style="list-style-type: none"> • Will global entities, unprecedented technological advancement and an increasingly multi-cultural workforce affect agency theory as a dominant family firm governance framework? • How can clan controls be intentionally established earlier in the life cycle in family firms? • Can individual differences based on accepted personality or behavioral types be used to identify altruistic behaviors in family firms?
<p>Lesser information asymmetry means that owners are less susceptible to the detrimental effects of managerial discretion (Fama & Jensen, 1983).</p>	<p>ACFB research has deployed the BSC in both additive and integrative forms to address the potential agency costs introduced in original Berle and Means discussions. In our first action research study (Craig & Moores, 2002) we added <i>familiness</i> to each of the four BSC perspectives. In a subsequent and ongoing innovation action research project (Moores & Craig, 2006) we are integrating the family business unique challenges into the BSC being used by a third-generation family business. This process has proven particularly beneficial in addressing the earlier introduced family business challenges such as asymmetry and personalism.</p>	<ul style="list-style-type: none"> • To what extent will the changing nature of the family in the postmodern era and the universal acceptance that family life is changing dramatically across virtually all western societies influence family firms? • Will the fact that humans are living longer mean that in the future entrenchment challenges will be different in family firms?
<p>Entrenchment may lead to significant agency costs in the form of hold-up problems. Hold-up occurs when family management, who acquire a disproportionate amount of power which emanate from their family status instead of their skills, impose their self-interest onto the firm by keeping the owners hostage (Gomez-Mejia, Nunez-Nickel & Gutierrez, 2001).</p>	<p>At the ACFB, Moores and Mula (2000) found relatively few family business CEOs use formal strategic planning processes. Less than fifty percent of CEOs in a 1991 study reported heavy to extensive use of long term planning while 16% indicated no use of long term planning (Moores & Mula, 2000). This observation was subsequently found to be consistent across time (Craig, Cassar & Moores, 2006).</p>	<ul style="list-style-type: none"> • What influence will changing ownership structures (e.g., introduction of equity funding partners to finance growth or founder exit) have on agency theory explanations in family firms?

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