A TYPOLOGY FOR CAPTURING THE HETEROGENEITY OF FAMILY FIRMS[1]

PRAMODITA SHARMA
School of Business & Economics
Wilfrid Laurier University, Canada

MATTIAS NORDQVIST
Jönköping International Business School
Jönköping, Sweden

ABSTRACT

We use family values regarding property rights and the role of business in family, and modes of family involvement in ownership and management to develop a family firm typology. Governance mechanisms likely to be effective in each of the family firm types are discussed leading to propositions for future research.

INTRODUCTION

An awareness of the staggering numbers and large variety in the organizational form generally referred to as 'family firms' has prompted scholars towards finding ways to capture the heterogeneity in these firms (Klein, Astrachan, & Smyrnios, 2005; Sharma, 2003; Westhead & Cowling, 1998). While family involvement in business is understood to be the factor that distinguishes family firms from other organizational forms, researchers grapple with the fundamental question of the aspects of family involvement that differentiate these firms from others (Sharma, 2004). Towards this end, two primary approaches used in the literature have been described as the '*components* of family involvement' and '*essence'* approaches by Chua, Chrisman, & Sharma (1999). The more dominant components approach captures the extent and mode of family involvement in management, ownership, governance, and succession (Klein et al., 2005; Westhead & Cowling, 1998); while the essence approach focuses on the behavioural consequences of family involvement in business (Chua et al., 1999; Klein et al., 2005).

The components approach is descriptive in its orientation as it addresses the '*what'* and the '*when'* questions, that is, what is the extent and mode of family involvement in management and ownership of a firm – at a particular time, and the expected or intended involvement over the longer term (Litz, 1995). The essence approach, on the other hand, is focused on the *'how'* questions or the consequences of family involvement, that is, how does the family involvement in business influence the behaviours and decision making in these firms (Chua, et al., 1999; Klein, et al., 2005). Both the components and the essence approaches are integral for capturing the diversity in family firms. Thus far, however, the question *why* varied levels of family involvement in a business are observed has not been addressed.

Greenwood and Hinings (1993) argued that elements of an organization design such as structures and systems, or the *whats* and *hows* described above, are not neutral instruments but embody the underlying sets of beliefs and values, that is, the *whys*. From this perspective, an understanding of the logic (i.e., the *why*) propelling the extent and mode of family involvement in a business (i.e., the *what*), and effective governance mechanisms (i.e., the *how),* can be gleaned through the guiding values held by the family. This configuration or fit approach

contends that firms with coherence between guiding values, structures, and systems enjoy performance advantages (Greenwood & Hinings, 1993; Miller & Friesen, 1984). Guided by this approach, the overarching propositions of this article are that: (i) different types of family firms can effectively be distinguished based on family values and the extent of family involvement in business, and (ii) family firms with a fit between guiding values – mode and extent of family involvement in business - governance structures, are more likely to achieve performance objectives than firms lacking such coherence.

FROM GUIDING VALUES TO COMPONENTS OF FAMILY INVOLVEMENT

We theorize that family values and norms (*whys*) are likely to determine the extent and mode of family involvement (*what*) in a business. Specifically, we suggest that familial norms with respect to property rights are likely to determine the extent and mode of family participation in ownership, while norms regarding the role of business in family determine the extent and mode of family participation in the management of a family firm.

Property rights and family ownership

The literature on family structures suggests that depending on the combination of authority-liberty and equality-inequality considered as a norm, families can be classified as *authoritarian, egalitarian nuclear, community,* and *absolute nuclear* (Todd, 1985; Ling, 2002; Sharma & Manikutty, 2005). The authoritarian families display the values of inequality between siblings with one anointed heir, who is treated more equal than other siblings. The ownership in firms of families with such beliefs is held by one individual who is the sole proprietor. Although sole proprietorship is a common form of ownership in small and new ventures, many large family firms have been found to retain ownership with one controlling owner (Astrachan & Shanker, 2003; Miller & Le-Breton Miller, 2005).

Egalitarian nuclear families believe in dividing the property equally among the children. Such families are likely to display ownership shared within the nuclear family as parental property including the family firm, is divided equally among the children. Community families, on the other hand, exhibit values of equality where children live with parents in extended families and all next generation members are treated equally in terms of property rights. Families guided by these beliefs of property rights are likely to exhibit firm ownership dispersed within members of an extended family. Last, the absolutely nuclear families have no precise conventions of property inheritance. Property is regarded as belonging to one generation who may do as it wishes with it. Members of next generation are expected to be independent and self-sufficient. Such families are more likely to engage in a mix of family and non-family ownership.

It follows that firms enjoying coherence between familial norms and values regarding property rights and adopted ownership form are likely to display the following four combinations: authoritarian families – sole proprietorship, egalitarian nuclear - nuclear family ownership, community family – extended family ownership, absolute nuclear family – family and non-family ownership.

Role of business in family and management of the firm

Four varied levels of family involvement in business have been observed in the literature: sole-manager, nuclear family management, extended family management, and family and non-family management (Gersick, Davis, Hampton, Lansberg, 1997). Based on whether family or business is held central to decision making, families might be *family- or business-centred* (Singer & Donohu, 1992). In terms of the management of a firm, most new ventures start either as the founder operating as the sole owner-manager of their firm, or helped in the firm operations and management by his/her immediate family members (Aldrich & Cliff, 2003). Thus, most small start-ups are likely to be either owner-managed or managed by the founders' nuclear family. At this stage of a business, survival needs and getting the business off the ground are the primary considerations (Greiner, 1972). While the guiding familial values of family- or business-centrality, may be the prompting reasons for an individual to start his/her independent venture, these are not likely to be exhibited in visible ways in small sole-proprietor firms. Instead, as the firm grows in size and the founder makes decisions on whether to engage members of his/her nuclear or extended family or hire non-family employees, the guiding values emerge through the outcomes of such decisions. Firms guided by centrality of family in business are more likely to employ members of immediate or extended family, whereas those who regard business as central will be more inclined to hire non-family employees.

FROM FAMILY INVOLVEMENT TO GOVERNANCE STRUCTURES

The four modes of family ownership and of family management lead to sixteen possible combinations of family involvement in the ownership and management of family firms. The next question in our theory building effort to link between the *why, what*, and *how* questions shared earlier, is the mode of governance that is likely to be effective for firms in each of these sixteen categories.

Drawing from the literature, four governance mechanisms likely to be useful in family firms are *Family council, Executive council, Shareholder assembly,* and *Board of directors/advisors*. The fundamental reason for setting up these structures is to enable voicing the perspectives of stakeholders with varying levels of current and expected future involvement in the ownership and management of a family business (Gersick et al., 1997, Ward, 1991). Not all of these mechanisms are found helpful in all family firms. In general, the higher the stakeholder variance in ownership and managerial roles, the greater will be the need of different governing mechanisms, so as to ensure the perspectives of all stakeholders are taken into consideration while making strategic decisions in a family firm (cf., Freeman, 1984).

Ownership Dimension

As we move from ownership being held by one individual – within nuclear family – to extended family members – shared between family and non-family members, the need for governance structures to understand owner perspectives increases. While no specific structure is needed with sole owner, partnership agreements can be adequately used to bring clarity to and manage ownership relationships within a nuclear family. However, as members of extended family such as cousins, in-laws, siblings from different marriages, etc., become involved in the ownership of a family firm, a mechanism such as Shareholders' Assembly, to understand and educate different shareholders' is likely to be helpful. As the number of shareholders increases and it becomes cumbersome to hold regular meetings, an active Board of Directors' is likely to

be helpful governance structure. Furthermore, as the number of family members involved in ownership increases, and variance in the ownership levels of these members (from no ownership to minority to controlling ownership) increases, a Family Council is likely to be a useful means to understand and share information with these varied categories of shareholders.

Management Dimension

As we move from management by one individual – within nuclear family – to extended family members – shared between family and non-family members, the need for governance structures to co-ordinate and manage the business increases. No specific structure is needed with an individual manager as informal decision making can be effectively used. As more family members' become involved in the business employment contracts may prove valuable to help define the roles, responsibilities, and performance expectations of family members. Further, as the business gets larger and begins to grow with family and non-family members' holding managerial positions, the heightened need for managerial autonomy and delegation arises (Greiner, 1972). As the number of managers' increases the need for integration and co-ordination escalates as well, leading to the integral role of governance structures such as Executive Council for effective management of a firm.

DISCUSSION

Researchers interested in understanding the governance efficiencies in family firms, question the adequacy of governance mechanisms for all family firms. 'Does one size fit all?' wonder Corbetta & Salvato (2003). An awareness of the large diversity in the organizational form referred to as 'family firms' (Astrachan & Shanker, 2003), leads to an intuitive response of 'of course not'. However, despite this common understanding and some recent efforts to distinguish between various types of family firms based on the extent of family involvement in business (Klein, et al., 2005; Chua, et al., 1999; Westhead & Cowling, 1998), the issue of relative effectiveness of governance structures in different types of family firms has not yet been adequately addressed.

Following the tenets of 'fit' in the writings under the rubric of configuration approach (e.g., Miller, 1981; Miller & Friesen, 1984; Greenwood & Hinings, 1988), we have argued that the guiding values of families determine the extent of family involvement in ownership and management of their firm. In turn, the chosen mode of family involvement determines the governance structures likely to lead to desired performance outcomes. Specifically, four beliefs regarding property rights of family members lead to four varied levels of ownership involvement, while the beliefs of the role of business in family determine the four levels of family involvement in the management of family firms. These combinations of ownership and management involvement, lead to sixteen varied types of family firms and determine the types of governance structures likely to be effective in achieving organizational goals.

The more the complexity and variance in stakeholders, that is minority / majority owners, family / non-family owners and managers, blood relatives / extended family members, the higher the need of varied governance structures to ensure the perspectives of all stakeholders are taken into consideration while making strategic decisions in a family firm. While coherence between family values, the extent of family involvement in management and ownership of business and governance structures adopted enables sustainability and high performance, ill-fitting

components retard firm progress (Miller & Le-Breton Miller, 2005).

The typology developed in this article is versatile as it covers a large spectrum of firms ranging from owned managed sole proprietorships to firms with ownership and management dispersed between family / non-family members. It can aid our understanding of the role that founders' values play on the extent of family involvement in his/her business, and the governance structures that are likely to be effective with varied levels of family involvement in business.

ENDNOTES

1. We appreciate the funding support received from the Social Sciences and Humanities Council of Canada (SSHRC) for this project.

REFERENCES

Aldrich, H.E., & Cliff, J.E. 2003. The pervasive effects of family on entrepreneurship: Toward a family embeddedness perspective. **Journal of Business Venturing,** 18: 573-596.

Astrachan, J.H., & Shanker, M.C. 2003. Family businesses' contribution to the U.S. economy: A closer look. **Family Business Review,** 16(3): 211-219.

Chua, J.H., Chrisman, J.J., & Sharma, P. 1999. Defining the family business by behavior. ***Entrepreneurship Theory and Practice,*** 23(4): 19-39.

Corbetta, G., & Salvato, C.A. 2004. The Board of Directors in Family Firms: One size fits all? **Family Business Review,** 17(2): 119-134.

Freeman, E. 1984. **Strategic Management: A Stakeholder Approach**. Boston: Pitman.

Gersick, K.E., Davis, J.,A., Hampton, M.M., & Lansberg, I. 1997. **Generation to Generation: Life Cycles of the Family Business.** Harvard Business School Press: Boston, MA.

Greenwood, R., & Hinings, C.R. 1988. Organizational design types, tracks and the dynamics of strategic change. **Organiztaion Studies,** 9: 293-316.

Greenwood, R., & Hinings, C.R. 1993. Understanding strategic change: The contribution of archetypes. **Academy of Management Journal,** 36(5): 1052-1081.

Greiner, L.E. 1972. Evolution and revolution as organizations grow. **Harvard Business Review,** July-August.

Klein, S.B., Astrachan, J.H., & Smyrnios, K.X. 2005. The F-PEC scale of family influence: Construction, validation, and further implications for theory. **Entrepreneurship Theory & Practice,** 29(3): 321-340.

Ling, Y. 2002. Parenting rationality and the diversity in family firm governance. Paper presentated at the **Academy of Management meetings** in the Entrepreneurship Division Doctoral Consortium.

Litz, R.A. 1995. The family business: Toward definitional clarity. **Proceedings of the Academy of Management:** 100-104.

Miller, D. 1981. Towards a new contingency approach: The search for organizational gestalts. **Journal of Management Studies,** 18: 1-26.

Miller, D., & Friesen, P. 1984. **Organizations: A Quantum View.** Prentice-Hall, Englewood Cliffs: NJ.

Miller, D., & Le-Breton Miller, I. 2005. **Managing for the long run: Lessons in competitive advantage from great family businesses.** Harvard Business School Press, Boston Massachusetts.

Sharma. P. 2003. A typology of family firms using internal stakeholders. **Proceedings of the Administrative Sciences Association of Canada's** annual conference in Halifax. Entrepreneurship division, 24: 149-163.

Sharma, P. 2004. An overview of the field of family business studies: Current status and directions for future. **Family Business Review,** 17(1): 1-36.

Sharma, P., & Manikutty, S. 2005. Strategic divestments in family firms: Role of family structure and community culture. **Entrepreneurship Theory and Practice,** 29(3): 293-312.

Singer, J., & Donohu, C. 1992. Strategic management planning for the successful family business. **Journal of Business & Entrepreneurship,** 4(3) : 39-51.

Todd, E. 1985. **The explanation of ideology, family structures and social systems.** Oxford: Basil Blackwell.

Ward, J.L. 1991. **Creating effective boards for private enterprises.** San Francisco: Jossey-Bass.

Westhead, P. & Cowling, M. 1998. Family firm research: The need for a methodology rethink. **Entrepreneurship Theory and Practice,** Fall: 31-56.