

***An Introduction to INSEAD Research on Family Firm
Governance***



Corporate Governance Initiative
www.insead.edu/governance

Wendel International Centre for Family Enterprise
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Editorial

A November 2014 report in *The Economist* reveals that family-controlled firms now make up 19% of the companies in the Fortune Global 500, which tracks the world's largest firms by sales. That is up from 15% in 2005, according to new research by McKinsey, a consulting firm (which defines such firms as ones whose founders or their families have the biggest stake, of at least 18%, plus the power to appoint the chief executive). Since 2008 sales by these firms have grown by 7% a year, slightly ahead of the 6.2% a year by non-family firms in the list. McKinsey sees these trends continuing for the foreseeable future. This is largely because of rapid growth in big developing economies where family ownership is the norm among large businesses.

On this report, we review some of the recent research on family firms, with a particular focus on governance and performance. And we have three good reasons for doing this. First, we demonstrate that our professors are very productive in the fields of family firms and governance, which is a consequence of the breath and quality of INSEAD faculty. Secondly, these contributions are remarkably global in nature due to the international outlook of the institute, which provides a unique window on the world (and not merely on one country). Thirdly, these contributions provide important insights that reveal a convergence of results obtained by other researchers. Yet, some results run counter to prevailing wisdom and represent a real 'delta' in knowledge on family firm governance – such as the specific contribution that family firms make towards a country's economic growth.

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From our Faculty: Family Firm Governance

The distinctive assets provided by family firms and the barriers these have to overcome



Looking at family firms across diverse countries and cultures, **Morten Bennedsen and Joseph Fan** have been struck by the difference in focus when it comes to governance. In their book **'The Family Business Map: Assets and Roadblocks in Long Term Planning'**, they emphasise that the corporate governance debate - both in these countries and also in these family firms (as well as in consultancy firms that service the family firms) - needs to better understand the differences in context that shape the value generating models in different countries.

One of the common mistakes service providers make is to impose a 'best practice' ownership structure that works well in one environment which they present as a blueprint for any firm elsewhere in the world. One major point of the book is to remind us again of the importance of understanding (cultural, national, industrial, family) contexts when studying firms - that there is 'better practice' and 'worse' practice, but the term 'best practice' shows little understanding of local contexts.

The major focus of the book is to give an in-depth global perspective on long-term planning both for families and their firms. It helps guide families to identify and appreciate family-specific assets that they bring to the business venture, which results in improved performance over non-family firms that do not dispose of these assets; and at the same time, makes families aware of the barriers that they must confront in order for these unique assets to contribute to value creation.

Superior innovation capability and performance of US publicly listed family firms



In a study of US public firms, **Massimo Massa, Sterling Huang, and Hong Zhang** find that family firms not only produce more innovations when compared with non-family firms, but also that these innovations are of a higher quality.

In their paper, **'The New Lyrics of the Old Folks: The Role of Family Ownership in Corporate Innovation'**, the authors attribute this to three channels: focus on long-term value, reduced financial constraints, and improved governance. While it has been recognised that family firms could be more innovative, the focus on the quality of the innovation is a striking point, as are the factors that contribute to the superior performance.

Superior labour protection by family firms with its corollary on labour productivity and commitment



Morten Bennedsen, Sterling Huang, Hannes F. Wagner and Stefan Zeume make a fascinating addition to the performance literature of family firms by looking at the impact on and by labour.

In their paper, **“Family Firms and Labour Market Regulation”**, the authors find that in countries with weak labour market protection for employees, family firms remedy this situation by providing some of this protection, contributing to greater labour commitment and ultimately better performance. Labour protection programmes and improved job security are some of these measures, allowing such firms to dispose of superior labour contributions at a relatively lower cost. Of course, non-family firms could also do this, but such measures appear much more natural and even desirable for family owners.

The advantage offered to investors by family firms in weak governance countries



In their paper **“Every Family Has a White Sheep: Between Vertical and Horizontal Governance”** **Andriy Bodnaruk and Massimo Massa** find that family firms represent vehicles that allow international investors to enter a country in which governance is worse, as well as a useful vehicle of investment for domestic investors in bad governance.

Given that a country’s performance is very much fuelled by foreign direct investment, these authors thus show the particular role that family firms play in weak governance countries, not only for the value-creation role of family firms but further for their contribution to economic growth in these countries.

The advantage offered to investors by family firms in weak governance countries



While much of the research on family firms has been carried out in more mature markets, a small but burgeoning literature is examining the role of family businesses in emerging markets.

Xiaowei Rose Luo and Chi-Nien Chung, in their paper **“Filling or Abusing the Institutional Void; Ownership and Management Control of Public Family Businesses in an Emerging Market”**, compare family firms with non-family firms in Taiwan. Taiwan is a country with significant institutional voids for labour, products and capital, such as lack of market intermediaries (e.g. professional recruitment agencies, credit rating agencies, qualified security analysts, etc.) and legal protection of shareholders.

The authors find that family owned firms with partial control perform better than non-family firms - a result that converges with findings obtained by other colleagues mentioned earlier.

Private Equity and Family Businesses: Making the Partnership Work



In selecting strategy, family owners are regularly confronted with the issue of whether, as a family firm, private equity funding is the right choice for them. Maybe, say **Claudia Zeisberger, Michael Prah and Jean Wee**, in their paper “**Private Equity and Family Businesses: Making the Partnership Work**”.

These authors identify instances when this partnership is valuable to the family firm, though the answer, in their view, depends on how they plan to spend the proceeds. Is the family hoping for liquidity to get some chips off the table? Or does the family like to sell the entire business for succession or strategic reasons? Or does it wish to take advantage of an expansion opportunity? Whatever the family aims to achieve, family boards are well advised to have members around the table who can evaluate the quality and goals of any partner, and how to manage the relationship with private equity partners, before entering into such relationships.

Big governance question: Who sets strategy- owners or managers?



This is a highly debated question in the strategy and governance literature, as to whom, amongst managers and owners, sets strategy? **Harry Korine and Pierre-Yves Gomez**, in their book “**Strong Managers, Strong Owners: Corporate Governance and Strategy**”, argue that the critical question that the board must ask is not ‘what is the best strategy’, but rather, ‘who is the strategy for?’ Depending on the nature of ownership and the control exercised by the latter, different answers emerge.

The ‘best’ strategy ought thus to be seen through the lens of the winners of the tug of war between managers and owners. Of course, the issue is more complex, as Korine and Gomez show, because owners and managers also form coalitions amongst themselves.

One contribution made by this book is to underline the central role that the board needs to play in understanding the political nature of the strategy setting process, and be well advised to explicitly consider the interests of the different stakeholders, as well as the long-term interests of the firm, with a certain degree of independence from its current owners or managers

The value of partners: relationships between family firms and private equity What is control for?



In a discussion about “**Control, performance and shareholder value**” **Ludo Van der Heyden and Theo Vermaelen** opine that families are - and one might say rightly - obsessed with control. However, they both make the point that if family owners don’t have a project, control is worthless. It’s not control that should be the obsession, but the long-term goal of the project. So the key question is not how to maintain control, but rather what is control good for? Control by itself has no value unless it is used to execute a long-term project. It is the capacity of a family to persevere and adapt to a long-term project that is often valued as the ‘family firm premium’.

Report available online: <http://perspectives.pictet.com/wp-content/uploads/2013/03/201104-Pictet-Report-EN.pdf> (page 9-13)

Transition is a crucial step in the life of a family business



Talking about control and succession issues, in his article '**Transition is a crucial step in the life of a family business**', **Morten Bennedsen**, says it is no longer axiomatic that the next generation will take over the running of a family company - many younger people choose to pursue other careers and lifestyles. Society is changing all around us, and families change with them. These societal and social changes will invariably affect family firms. Bennedsen argues that these changes in context also offer opportunities to ensure the continuing success of the business – as well as more freedom in the family. Things are changing in successions because society is changing, and so are families. Report available online: <http://perspectives.pictet.com/wp-content/uploads/2013/03/201204-Pictet-Report-EN.pdf> (page 25-27)

A Historical Perspective: From Hidden Giants to Visible Leaders? The Evolution of Women's Roles in Family Businesses



In her chapter '**A Historical Perspective: From Hidden Giants to Visible Leaders? The Evolution of Women's Roles in Family Businesses**', **Christine Blondel** makes a similar point. She argues that unless family firms are more proactive in passing on the value of collective work and goals, without making it gender specific, there are expectations that there will be significant changes in future generations with a very strong proportion of women starting their own businesses.

Past, Present, Future: Passing the Baton



Continuing this discussion on succession issues and the long term sustainability of family firms, **Randel Carlock** in his article '**Past, Present, Future: Passing the Baton**', talks about the importance of the power of stewardship that supports a family legacy of shared success beyond the business.

Report available online: <http://np.netpublicator.com/netpublication/n19888998> (page 4)

Governance for Family Businesses: Leveraging Sustainable Growth Perspectives



Finally, a report by **ecoDa** – the European umbrella organization for Directors Associations with whom ICGI is partnering with - on '**Governance for Family Businesses: Leveraging Sustainable Growth Perspectives**' emerged from a roundtable discussion in Europe, which again states the insufficiently known fact that family businesses represent a fundamental economic force in the EU (about 50% of jobs) and play an important role in bringing stability with a responsible ownership approach and strong ethical values.

The objective of this roundtable discussion was to better understand the strengths of those family businesses, but also the challenges that they might face. One interesting point made by the report is that, in some countries, a lot of family companies belong already to the 5th or 6th generation while in some other countries there is a large fall-out over the third generation

The major focus of the book is to give an in-depth global perspective on long-term planning both for families and their firms. It helps guide families to identify and appreciate family-specific assets that they bring to the business venture, which results in improved performance over non-family firms that do not dispose of these assets; and at the same time, makes families aware of the barriers that they must confront in order for these unique assets to contribute to value creation.

Report available online:

http://ecoda.org/uploads/media/EU_ecoDa_event_governance_family_businesses-Outcome_Report-FINAL.pdf

The Family Business Map

Assets and Roadblocks in Long Term Planning

By Morten Bennedsen and Joseph Fan

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In China, the average private firm is not even 20 years old, while Indian families at the helm of some of the world's biggest conglomerates are already looking to transfer their wealth to second and third generations. In Europe, however, some established family enterprises have been working for over 100 years to keep the family and the business moving forward together. After many years spent teaching owner-managers, families and heirs on every continent, we felt there was a need for a global perspective on long-term planning both for families and their firms. Talking to people 'on the ground', we realised that the industries serving family businesses are very much experience-based, and that knowledge of the field is fragmented.

Our book offers a blend of case studies and research insights designed to provide a blueprint for families in business, drawing on the many commonalities that unite them, while emphasising the need to implement strategy and governance according to the specific cultural and business environment. We present a unique framework for family firms as well as a novel hands-on approach to planning that has successfully been used with hundreds of family firms on every continent. Unlike books based simply on Western experience, our global comparative approach encompasses family businesses world-wide, be they in Africa, America, Asia, Europe or Latin America. The contents are derived from courses, interventions and research that we have conducted over the years.

Some of the major questions addressed in this book are:

- What are the special contributions of families to their businesses, i.e. family assets?
- How can families build business strategies based on their unique contributions that allow companies to thrive in a competitive environment?
- What are the roadblocks unique to family businesses?
- How can families develop governance strategies that mitigate the corporate (and family) costs of such roadblocks?

The FB Map

Our aim here is to help family stewards and other stakeholders answer the above questions by identifying the unique contributions (family assets) and specific constraints (roadblocks) and to match these with appropriate business and governance strategies to get the most out of their ventures without sacrificing the family or destroying value in the business.

The optimal ownership structure, succession model, long term planning, exit plan, etc. all pertaining to sustainable and improved governance of family firms, involves two fundamental issues - understanding the family's unique assets, such as value driven leadership, the family network, legacy, religion, culture, etc.; and understanding the specific roadblocks of the firm. Research shows that in answering these questions corporate governance can provide tools so that costs are mitigated.

Furthermore, the book details the different levels of roadblocks:

- **Family** level – This has to do with the family behind the firm, as it grows over time. It concerns ownership design of the family, career path selection for the future generations, conflict management and resolution within the family, etc.
- **Market** level – This is related to the ownership structure and control of the firm.

“The two most important questions for each family business to specifically answer are - what are its assets or contributions and what are its challenges or roadblocks?”



Image courtesy: franky242; www.freedigitalphotos.net

One of the important contributions in the book is to look more objectively and deeply at both the costs and benefits of ‘trust ownership’ – which can be a serious source of conflict, sometimes developing into very disruptive family fights.

Market challenges might make it difficult to continue as a family firm, and so it is important to prepare for options.

- **Institutional** level – This is dependent on different cultures and societies. For example, the Chinese one-child policy of 1974 means that today there are serious succession issues.

The family business (FB) map provided in the book helps you in a structured manner to go from family assets and roadblocks to finding the correct corporate governance mechanisms for your family business. The FB map, through many key questions, proposes a three-step process:

1. Identify the assets and roadblocks of the family and the firm.
2. Plan the path to succession and associated governance structure.
3. Cultivate the right form of governance given the choice of succession model.

It is significant to highlight that the two most important issues for family businesses outside Europe and the US are to do with ownership design and succession.

Ownership

The most common challenges in designing ownership structures in family firms are: raising capital to expand without giving up family control; counteracting ownership dilution as a result of the power of numbers; going public, listing the businesses either as a whole or in part; and institutionalizing ownership using trusts and foundations. Given the current popularity of trusts in Europe and Asia, it is important to understand that trusts and foundations can raise additional challenges such as deadlocks and free-rider problems. Our recommendations are to have procedures for dissolving a trust and to be careful in choosing competent trustees. One of the important contributions in the book is to look more objectively and deeply at both the costs and benefits of ‘trust ownership’ – which can be a serious source of conflict, sometimes developing into very disruptive family fights.

One of the mistakes service providers still make is impose an ownership structure that worked well in one environment as a blueprint for elsewhere in the world. But in many family firms the contributions and roadblocks are different. A model that works well in US companies will be extremely costly for Asian families. Similarly, in regard to the firm going public, families can be quite naïve and don’t often understand the long term consequences of these decisions.

The Cadbury example is a telling story. The family business was floated in 1962, at a time when little thought was given to the issue of control in the future. After all, the family and the trusts were majority owners with more than two thirds of the shares, so how could their control be challenged? In 1969, Cadbury merged with Schweppes creating one of the largest confectionery companies in the world. Over the decades of rapid global expansion that followed, there was a sharp reduction in the ownership stakes of the family. The charitable trusts and foundations sold their shares to reduce the risk of being over-dependent on one company. The share structure of Cadbury Schweppes had become very diluted, and a majority was now owned by institutional and private investors outside Britain and Europe. In January 2010, after over 40 years of going public, Cadbury experienced a hostile take-over by Kraft! The loss of Cadbury as an independent company was a shock to the family and the British public. But in retrospect, it was simply a logical consequence of the way ownership had been designed and developed over time. What is the learning? How, control of even the biggest family businesses can be lost if the listing process is not carefully designed.

Succession

Evidence from three continents reveals that succession is very challenging for business families, regardless of its size, country and culture. The most common succession challenges include: planning the best possible succession model given the cultural reality of the firm and the family; transferring the intangible family assets across generations; planning for changes to business strategies, organizational structure and governance often associated with the transition from one generation to the next; equipping the next generation with the best possible skills for taking over the

responsibility, including nurturing, education, and relevant experience outside the family firm; working around institutional barriers such as inheritance laws and taxes; and finally, undertaking transparent long-term planning which is communicated and shared among family members increases the likelihood that the firm will prosper after succession.

We are convinced that the key to a successful family succession is to understand the 'caveats' that too many business families ignore. It takes long-range planning and robust governance for any family to own and manage a company on a long-term basis.

Corporate Governance: Similar or Different?

Looking across diverse countries and cultures, we have been struck by the difference in focus when it comes to governance. The corporate governance debate needs to better understand the context of the differing value generating models in different countries. By and large, families are less involved in publicly traded American firms than Asian firms. The two biggest questions in the US for the last 20 years, have been how to control external management, which has led to the role of the board, monitoring, incentives, remuneration, pay for performance, etc.; and the other is wealth management since many families' wealth is outside the business. Conversely, in Asia where family firms derive enhanced value from strong family assets and there are no significant constraints on family ownership, then family will remain in control and there is less need for external management; also when the family CEO is also the owner, the structure of his remuneration will not be a major incentive. Furthermore, most of family's wealth is embodied in the firm. Therefore, the questions in Asia are not about the role of the board and compensation, but more about ownership structure, succession and how to plan for family assets.

An American model of succession of optimizing shareholder value cannot work in China if it violates some rule of the game intrinsic in their culture. Even roadblocks differ tremendously, for example, 'trusts' are using as aggressive tax planning devices in Europe and USA, but in the Middle East and Asia, it is less useful.

Yet, each can learn something from the other. Since, many European family firms have proven longevity of over 100-200 years it is worth analyzing the factors that constituted their success. Whereas, what is lost in the West is the understanding of how business strategies in Asian family firms are still based on using the opportunities of families' intangible assets and contributions, and how these can be cultivated and nurtured through the generations.

“We are convinced that the key to a successful family succession is to understand the ‘caveats’ that too many business families ignore. It takes long-range planning and robust governance for any family to own and manage a company on a long-term basis.”



Image courtesy: xedos4; www.freedigitalphotos.net

One of the mistakes service providers still make is impose an ownership structure that worked well in one environment as a blueprint for elsewhere in the world.

Full publication available at

<http://www.palgrave.com/la/book/9781137382351>

<http://www.familybusinessmap.com/>

Family Ownership Channels to Innovation



Family companies may have a conservative heritage, but new research suggests they can teach us a lot about innovation

Family firms are generally characterised by their lack of social capital and trust in an economy. It's said they rely too much on familial ties; are often conservative in outlook; and are reluctant to take on additional debt or other external financing measures fearing the dilution of control. All attributes which are thought to hinder innovation.

Another train of thought however suggests businesses under family ownership are less motivated by short-term profits and show greater alignment between ownership and management; characteristics which are known to stimulate innovative behaviour.

All of which paints a particularly paradoxical picture, and raises the question does the family-owned business model stifle or enhance a company's capacity to innovate?

Latest research supports the latter suggesting family-ownership boosts both the quantity and quality of innovation as evidenced by the number and substance of its firm level patents.

To test the strengths of opposing theories associating family ownership and innovation, my study, *The New*

Lyrics of the Old Folks: The Role of Family Ownership in Corporate Innovation, co-authored with Po-Hsuan Hsu Associate Professor of Finance at the University of Hong Kong, Sterling Huang, Assistant Professor of Accounting at Singapore Management University and Hong Zhang, Assistant Professor of Finance at INSEAD, researched a comprehensive sample of U.S. public companies between 2000 and 2010.

The results were illuminating. We found family firms were associated with 11 percent more patents filed and 12 percent more citations of filed patents received. They scored 14 percent higher in originality (innovation output which considers the creativity of the firm's patents) and 30 percent higher in generality (which considers the patents' versatility), indicating that not only is there more innovation happening in these organisations, but it is of a higher quality than non-family companies.

Surprisingly, family firms spent less on research and development (we observed a negative relationship between family ownership and R&D input) but were significantly more efficient with what they did invest in this area, when measuring R&D spending against patent output.

That is, they produced more and better patents.

So what are family firms doing right?

A closer look at the data identified three channels which promoted innovation.

Focus on long-term value. By sheltering managers from the short-term pressures of irrational and myopic investors, the family ownership model encouraged them to pursue technological advantages with long-term value.

Reduced financial constraints One train of thought suggests that in their efforts to retain control, families may be less willing to resort to capital markets, investment partners or other external financing methods. However we found that lenders had a tendency to trust family firms more, thus reducing financial constraints that hinder innovation.

Improved governance Based on the widely-accepted assumption that the presence of institutional investors indicates better governance and encourages innovation, we found family ownership serves as a substitute for these investors and replaces other

governance mechanisms in spurring innovation by lowering agency costs and strengthening monitoring. The role of family ownership in corporate innovation changes over time. Innovation efficiencies in the firms studied were found to improve with the reduction of the estate tax, suggesting family-owned firms adapt to their institutional environment.

Family firms account for a significant portion of business activities and constitute the backbone of economic development worldwide. But their link to innovation is less obvious. While family ownership can hamper a firm's innovation – conservatism and nepotism can result in family businesses adopting suboptimal investment policies and there may be higher capital costs due to under-diversification or exacerbating agency issues - family firms can also stimulate innovation. By taking advantage of economic channels that focus on long-term value, alleviating financial constraints and improving governance, family firms can make up for these negative characteristics - and through a balance of tradition and modernity- adapt to survive change.



Massimo Massa is the Rothschild Chaired Professor of Banking and Professor of Finance at INSEAD. He is also co-director of the Value Creation for Owners and Directors Programme. He is also a contributing faculty member to the Corporate Governance Initiative.

Find article at

<http://knowledge.insead.edu/corporate-governance/the-case-for-two-board-governance-3119>

Family Firms and Labour Market Regulation**By Morten Bennedsen, Sterling Huang, Hannes F. Wagner
and Stefan Zeume***SSRN/INSEAD Working Paper, October 2014***The Authors**

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Many studies have shown that family firms perform differently from non-family firms. However, only recently have scholars started opening the black box of why family firms are different by focusing on families' special contribution to their firm.

This research paper focuses on the country level differences in labour market regulation (laws that protect employees with restrictions in hiring and firing rules) to explain the performance difference between family controlled and non-family controlled firms.

Effect of Labour Market Regulations

Various studies have shown the correlation between labour regulations' impact on growth in a nation on a macroeconomic level. It has been established that tight regulation of labor markets results in lower growth and higher unemployment. Our study further analyses the effects of these labour market regulations on the performance of family controlled and non-family controlled firms.

When labour regulation is strong in a particular economy, it increases the cost of firing employees and makes it more difficult for firms to be flexible in using temporary workers, thereby increasing the challenges to adapt to fast changes in the business environment. So, in countries with tighter regulations, there is more costs and risk to the firm in hiring and firing employees. On the flip side, the protection of jobs that employees enjoy under these regulations can increase their production and motivation. Furthermore, it can serve as a barrier to entry for new foreign firms.

So, how do labour relations interact with family control? Generally speaking, research has shown that family firms are better at managing stakeholders and have a more loyal labour force. However, recent firm level studies have found significant differences in management practices for family controlled firms, so it is possible that family firms have a different trade-off between employee incentives and insurance compared to non-family firms.

Our Method

With the documented notion that family firms are better at insuring employees and paying lower wages, we dig deeper to find out which environment is the most beneficial given the implicit regulations. We investigate whether labour market regulation affects the performance difference between family and non-family firms across a large panel of more than 6,900 public firms in 28 countries over 10 years. Surprisingly, some of the countries with low LMR are UK and Australia; those with high LMR are France, Portugal and Mexico, showing a mixture of emerging and developed economies. We use a strict 25% shareholding to define family firms in our benchmark analysis. We measure labour market regulation using an OECD index that focuses on the cost of firing

“In countries where there is weak protection for employees then family firms will provide this protection measure and improve performance.”



Image courtesy: njaj; www.freedigitalphotos.net

Non-family firms can initiate some labour protection programmes or provide better security for their jobs so that employees are more committed and performance will increase.

employees. We claim that family firms shall have a competitive advantage in countries where there is less labour market regulation. We used performance advantage measures, such as ROA (return on assets) and ROE (return on equity), and found that family firms did have a significant advantage over non-family firms.

Our Findings

We establish two main results:

1) Family firms have a performance advantage over non-family firms in countries with less regulated labour markets. In a sense, the job security created by family firms in these markets results in better performance.

2) Similarly, in less regulated labour markets, there is a higher performance advantage for family firms compared to non-family firms in industries which are less labour intensive and which have a more temporary labour force. This is because that labour intense industries often require less skilled workers who can easily be replaced, therefore, it is less beneficial for the firms to invest in labour specific investment.

Corporate Governance Highlights

Our results are robust and consistent with the notion that family control and labor market regulation to some extent are substitute governance mechanisms, such as anti-director measures, shareholder power, anti-self-dealing, etc. These indexes measure various governance factors, including to what extent the majority shareholders can exploit minority shareholders, which can have an impact on firm performance. On top of all these governance measures that affect family and non-family firms, LMR also has an impact on the performance of the company.

When we say that family control or ownership and LMR are substitutive governance mechanisms, we mean that in countries where there is weak protection for employees then family firms will provide this protection measure and improve performance. In countries with strong protection, family firms don't give any additional performance advantage.

There is important learning here for non-family firms too, and that is the understanding that providing job insurance would be beneficial for its employees and the firm. We find that on average the benefit is greater than the cost. So, non-family firms can initiate some labour protection programmes or provide better security for their jobs so that employees are more committed and performance will increase.

However, on the flip side, countries with high LMR have a higher cost for both family and non-family firms, when they need to downsize and adapt. So, logically, it seems that if a family firm wants to grow internationally, it might better to expand to countries with low LMR, so that the firm has more control, and improve performance. Furthermore, it can also potentially attract better employees.

Working Paper Available at:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2511044

Every Family Has a White Sheep: Between Vertical and Horizontal Governance

By **Andriy Bodnaruk** and **Massimo Massa**

Finance Seminar Paper, 2011 (Mendoza College of Business)

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We study how different dimensions of family ownership make family firms appealing to investors. We focus on the family's ability to provide political connections. We argue that this 'service' is particularly relevant in countries characterised by bad state governance. These 'services' are appreciated by portfolio managers who reduce their reluctance to invest in family firms and their fear of being expropriated by majority shareholders. Investors trade off the value-destroying dimension of family ownership, i.e. minority shareholder expropriation and scarce business performance – with its value-creating side, i.e. political connections. Looking at a comprehensive sample of worldwide firms between 2001-2009, we identify family firms and compare them to non-family firms conditioning on the degree of 'usefulness' of the family in the country.

The evidence on the value of family ownership is at best mixed. On the one hand, families seem to underperform, which is in large part related to the intergenerational transfer of control within the family firm. On the other hand, families seem to create value as they manage for long-term capital and better manage human capital. Various studies find higher performance for family firms in the U.S., India, South Korea and Israel.

One dimension along which there is consensus on the value-creation role of family firms is in their ability to deal with weak governance situations. This is due to two reasons. First, family ties serve as a solution in countries with weak legal structures as trust between family members substitutes for missing governance and contractual enforcement. Second, family firms are especially well-positioned to benefit from transfers resulting from political connections since they often have extensive kinship networks that stretch across politics and business.

Family ownership is more efficient in weak governance situations

Family-run firms are perceived to be less efficient and prone to 'tunneling' (where a majority shareholder or high-level company insider directs company assets or future business to themselves for personal gain). Issues such as the inability to manage succession as well as myopic pay-out policies have played a paramount role in creating a negative view on family-run firms. The lack of clear evidence in terms of industrial performance has made the analysis even gloomier for families.

However, when legal institutions are weak in a particular jurisdiction, family ownership is seen as a more efficient organisational structure. A longer history of ownership helps to forge and maintain ties with the government as well as with the major political parties. These political connections have two facets. The fact that families tend to be better connected with the government makes them better suited to protect their interests and therefore the interests of the other shareholders of the same firm. The other aspect is related to the ability to provide easier access to government-sponsored capital, to facilitate the award of government contracts and, in general, to make it easier to run business in countries in which bureaucratic corruption and incompetence as well as lack of clearly defined rules make managing business more complex. This also provides a sort of insurance. And indeed, there is evidence that companies with

“There is consensus on the value-creation role of family firms in their ability to deal with weak country governance situations.”



Image courtesy: Arztsamui; www.freedigitalphotos.net

Family-ownership is most appreciated by investors in countries with bad vertical governance and good horizontal governance.

political connections are more likely to be bailed out (even if less deserving) than similar non-connected firms.

Investor Interest: Vertical vs. Horizontal Governance

‘Horizontal governance refers to a set of rules that regulates transactions between private parties, such as the company and shareholders. ‘Vertical governance’ describes institutions constraining government and elite expropriation and regulates transactions between the state and citizens. Good horizontal governance protects the shareholders from expropriation from the managers or the majority shareholders. Good vertical governance protects all the shareholders from expropriation from the government. Countries differ in terms of both vertical and horizontal governance.

We define countries with ‘useful’ families if the quality of vertical governance is low (below median) and the quality of horizontal governance is good (above median). These are the countries in which families help to protect against expropriation from the government and, at the same time, minority shareholders are relatively less expropriated .

In countries in which shareholders are less protected from government expropriation, the political coverage provided by family ownership offsets the lower value induced by the majority-minority conflict; while in countries in which political connections are of lesser importance, families reduce value. We therefore expect family-ownership to be most appreciated by investors in countries with bad vertical governance and good horizontal governance.

In general, family firms are not loved by foreign institutional investors. However, when the combination of bad vertical governance and good horizontal governance make family ownership ‘useful’, we do not observe any economically or statistically significant difference between institutional ownership of family and non-family firms.

Furthermore, an experiment concluded that the improvements in anti-corruption practices experienced by some countries exogenously changed the quality of vertical governance and therefore drastically reduced the value of family firms as providers of political connections.

Evidence on various parameters

We provide first evidence on the impact of family ownership on institutional investor portfolio choice, by showing how family ownership and governance affect investor demand, focusing on one dimension that has been less explored: the appreciation of investors for the help that the family firm provides vis-à-vis the government.

In regard to corporate governance, the one major classification of ownership which has not been fully investigated is ‘family ownership’, and we show the role played by a concentrated owner – the family – in providing political coverage. In regard to country governance, we find that stronger shareholder protection laws make strong ownership less important.

Studies show that politically connected firms suffer more when a macroeconomic shock reduces the government’s ability to provide privileges (i.e. cheaper financing, lower stock performance) and benefit more when the imposition of capital controls allows a higher level of subsidies. For example, firms with pre-established ties with the Nazi party had their market value increase by 5-8% when the Nazis ‘seized the power’ in 1933. Another example is when the Republicans won the 2000 presidential elections, a study of firms in the US showed a positive abnormal return following the announcement of a politically connected individual to the board of firms connected to Republicans and negative returns to those connected with Democrats. However, political connections promote inefficiencies, such as lower productivity, lower performance ROA and lower market-to-book value .

One element we need to control for is the fact that family controlled economies are less developed. For example, one study argues that the poor performance of the

French economy, throughout the 19th century, compared to those of Germany, Great Britain and the United States, was generally caused by the predominance of family firms in France. French family firms were more interested in survival and succession than in growth and innovation. This made them reluctant to go public or to undertake high-risk ventures. According to the study, this profound conservatism retarded the performance of the overall economy because family businesses lobbied for protectionism and bailouts, and regarded the state as “a sort of father in whose arms [they] could always find shelter and consolation”.

Family Firms and Value Creation

As we argued, this usefulness can be interpreted as a sort of hedge that reduces cash flows volatility especially in bad times, lowers the firm riskiness and therefore lowers the required rates of return of the stock. The alternative interpretation is that political connections makes the firm more competitive - or reduces the ability of the firm's non-family competitors to compete - and therefore increases its cash flows and margins. To distinguish these two channels, we relate family usefulness to both the firm's stock return and its profitability.

What are the sources of value creation in politically connected firms? Different studies have found the following values: cheaper or easier access to financing, judiciary protection, granting of important licenses contracts, tax discounts, regulatory benefits, subsidies and direct state support in distress, creation of barriers for non-family affiliated entrepreneurs, stronger market power, better protection of property rights, better access to government resources helps politically connected firms create more cross-border strategic alliances, but the opposite true for the firms tied to the political enemies of the regime, politically connected firms have lower need for foreign based financing.

Our results provide a first step in the analysis of how institutional investors - and among them especially the international ones - invest to deal with country governance. These are the highlights:

- Investors trade off the value-destroying dimension of family ownership, i.e. minority shareholder expropriation and scarce business performance – with its value-creating side, i.e. political connections.
- Family ties serve as a solution in countries with weak legal structures as trust between family members substitutes for missing governance and contractual enforcement.
- Family firms are especially well-positioned to benefit from transfers resulting from political connections since they often have extensive kinship networks that stretch across politics and business.
- When legal institutions are weak in a particular jurisdiction, family ownership is seen as a more efficient organisational structure.
- Family-ownership is most appreciated by investors in countries with bad vertical governance (higher probability of being expropriated by the state) and good horizontal governance (i.e. lower probability of being expropriated by majority shareholders).
- Stronger shareholder protection laws make strong ownership less important.
- Politically connected firms suffer more when a macroeconomic shock reduces the government's ability to provide privileges.

“Political connections of families, are appreciated by portfolio managers who reduce their reluctance to invest in family firms and their fear of being expropriated by majority shareholders.”



Image courtesy: Ambro; www.freedigitalphotos.net

Family firms represent vehicles that allow international investors to enter a country in which governance is worse, as well as a useful vehicle of investment for domestic investors in bad governance

Full publication available at: <http://mendoza.nd.edu/>

Filling or Abusing the Institutional Void? Ownership and Management Control of Public Family Businesses in an Emerging Market

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While much of the research on family firms is carried out in mature markets, a small but burgeoning literature has examined the role of family businesses in emerging markets characterised by an institutional void. We examine publicly listed family firms in Taiwan to shed light on a key debate: is family control beneficial because it fills the institutional void or is it harmful because it abuses it.

One side of the debate holds that informal family norms, such as trust and obligation, substitute for weak formal institutions and hence reduce costs that stem from owner-management conflicts (i.e. PA agency cost). The other side of the debate argues that the lack of legal protection for minority shareholders gives the family more incentive and leverage to exploit minority shareholder wealth, which can lead to costs from conflicts between family owners and minority owners (i.e. PP agency cost). International organisations, like the IMF and World Bank, and emerging market governments tend to favour the latter view and have advocated or mandated the appointment of independent directors in order to provide checks and balances between family and minority shareholders.

Many of the institutional voids in emerging markets such as absence of laws protecting shareholders or difficulty in enforcing contracts, resulting in more opportunities to abuse shareholders, have corporate governance implications. Furthermore, the lack of trust between owners and professional managers is another serious governance issue with the latter not always working in the best interest of the former. Due to weaker market institutions, i.e. lack of sophisticated firms that help connect buyers and sellers, such as stock analysts, head hunters, market research firms, lack of monitoring and sophisticated information gathering, etc. there is a higher chance for professional managers to deceive owners or for family insiders to deceive external shareholders.

Different types of family firms

Under this setting, whether family governance fills or abuses the institutional void depends on the particular firm's pattern of family control. Our approach underscores the importance of unpacking the heterogeneity within family firms, and of examining the performance implications. We look at the different types of family firms and analyse which one is the best configuration for the company: 1) family ownership control alone; 2) family ownership control plus control over strategy but not operation; 3) family control in ownership, strategy and operation.

Our finding is that there is an optimal pattern of family ownership and control that fills the institutional void and contributes to better business performance - the combination of family ownership and partial management control, i.e. the family

“We argue that because family affords trust based on family relationships and informal channels of information gathering, so family owners tend to have more trust with family executives and have faster communication resulting in better decision making for the business.”



Image: posterize; www.freedigitalphotos.net

Firms with family ownership and strategic control enjoy a performance premium over firms with family ownership control alone due to reduced managerial misbehaviour.

member is also the top executive, resulting in a better alignment of goals between the largest shareholders and top management.

Furthermore, the rigour of our study is highlighted by the fact that we also compare with publicly listed non-family firms and find that the family firms with this optimal pattern, tend to do better than non-family firms because they are able to fill the institutional void, especially in regards to the distrust between owners and managers, and between external shareholders and internal family owners.

We argue that because family affords this trust based on family relationships and informal channels of information gathering, so family owners tend to have more trust with family executives and have faster communication, resulting in better decision making for the business. Furthermore, the goals of owners and managers are better aligned. A case in point is Puteng Electronics in Taiwan, where the non-family top executive pursued cost cutting without the owners' knowledge, damaging the product quality and brand image that the family owners had build over five decades! When the family took back the leadership, it spend seven years restructuring the product lines to repair the damage. Firms with family ownership and strategic control enjoy a performance premium over firms with family ownership control alone due to reduced managerial misbehavior.

Non-family firms have more of a challenge in filling the institutional gaps because they don't have that level of trust. In our analysis we compare a bank as the largest shareholder with professional top executive and find that indeed it does perform worse compared to a family firm that has a family top executive.

Finally, we find that family firms that have complete control (ownership, strategic and operational) suffer from heightened PP conflict i.e. problems between majority family insiders and minority shareholders, and under conditions of weak external governance, the presence of an outside executive who is in charge of operations inside the firm can serve as an important information mechanism to curtail the family's self-dealing, which can derail the firm.

Corporate Governance Implications

In our study, we look at three major dimensions of family firms – shareholding or ownership; strategic control; and operational control. This mainly constitutes owners and managers, and we have not looked at board control, due to the reality in many emerging markets, including Taiwan, which is our empirical site, that the board has not become powerful or relevant enough yet to make a difference - at least not in the time period of our study 1996-2005. The board as a whole, to a large extent, has not played an independent function and so it wasn't an important dimension in our focus.

However, in the second part of our paper, we look at a very important phenomena of corporate governance, and that is the role of the independent director in the firm. We find that the independent director has different levels of impact on the family firm's performance, depending on the levels of family involvement.

Comparing the different types of family firms, we find that if the family control is too strong (ownership, strategic control and operational control), then the independent director is suppressed and essentially is considered a rubber

stamp, whereas when the family is not involved beyond ownership, the independent director's impact is greatest for firm performance. The independent director also contributes to the performance of the optimal family business – which has ownership and strategic control, but hires a professional for operational control.

Conclusions

We establish that performance is enhanced (relative to non-family firms) under the combination of family ownership and strategic control but not under other patterns. In other words, combined family ownership and strategic controls fills the institutional void yet avoids abusing it, thus generating the best performance.

Taiwan is regarded as a relatively advanced emerging market, though during our study period, it was characterised by an important institutional void, which shaped the value of family governance. In emerging markets with even less developed market intermediaries and poor protection of investors, we may see a larger performance premium for family firms with strategic control in comparison to other family firms. In this particular context, then, strategic control by family is even more important for reducing the exploitation risks by outside management and the presence of an outside executive in operational control is even more instrumental to enhance monitoring over family owners. Our argument and results indicate similarly that, in markets with more advanced institutional development than Taiwan, we may not observe a significant performance advantage of family firms with strategic control over other types of family control.

Finally, our study throws light on a better understanding of a key corporate governance issue worldwide: the performance effects of independent directors. Research findings on their effectiveness are mixed, and this paper demonstrates an important contingency factor – the pattern of family governance in which independent directors operate and the various family control patterns shape the effectiveness of independent directors.

This implies that the push by many governments in emerging markets for adopting independent directors is unlikely to improve governance unless it affects the top family decision makers in firms with complete family control.

“The various family control patterns in which independent directors operate shape the effectiveness of their role.”



Image courtesy: Ambro; www.freedigitalphotos.net

Independent directors have the most impact when family firms are not involved beyond ownership control.

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Private Equity and Family Businesses – Making the Partnership work

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1- The need for capital

When John, the 55-year-old owner of a fast growing medical devices company, was looking to finance his expansion, the banks balked at his company's risk profile and lack of collateral. Despite a unique portfolio of products, he lacked the experience and resources that were necessary to compete with the multinationals or the network to expand overseas. He also thought it might be time to search for a successor. So when a friend introduced him to a Growth Equity firm specializing in minority investments for fast-growing enterprises, he thought it an avenue worth exploring. A subset of the private equity (PE) industry, these firms are known to provide more than just capital.

2- What a Growth Equity partner offers

Most family businesses like John's are managed by the founder or family members through a fairly informal structure, which makes it hard to attract quality external professionals. Whilst such a lean set-up is advantageous in the early stages of a company's development, many family businesses reach a point where they require different skills and resources to fully capitalise on growth opportunities.

The right Growth Equity partner can very well add substantial value beyond the provision of capital for the considered expansion:

- **Support for Growth and Expansion**

The experience of the PE partner can provide the owners with the confidence to structure deals outside their comfort zone.

- **Transformation of structures & processes**

PE partners often act as an external catalyst to develop a strong corporate governance structure and formalize the management of human capital, financials and internal processes.

- **Succession Planning**

By backing first- and second-generation owners of family businesses in their search for a successor, the Growth Equity firm can help identify the best possible candidate by establishing a strong corporate governance framework and mentoring internal (often family) candidates or by tapping its wide network for external candidates. On a practical level, succession planning raises questions around financial, tax, legal, and equity issues, which an experienced partner can help to resolve.

- **Performance improvement**

Given their fiduciary duty towards their investors, PE firms focus single-mindedly on performance improvement and profit maximisation of their investments by leveraging their know-how and relationships. Aside from top line expansion, be it through new product development, a new sales framework or entry into new markets, cost measures can be equally important to improve the long-term viability of the business.

- **Balance Sheet Optimisation**

On the debt side, improving the structure of the balance sheet through the restructuring of credit lines can not only optimize the cash flow of the firm but also enhance the credit standing of the company and provide ample headroom for future business expansion. In terms of equity, the investor's capital can be used to consolidate family ownership in the hands of members active in the business and provide an exit for passive family members to pursue other interests or diversify their assets.

"What we've seen time and again in these businesses ... if that's 100 percent of my family's net worth, the natural instinct is to get cautious with that business ... So our job is to provide the capital ... to get to that next stage of growth."

*- Walter Florence, MD
at Frontenac*

3- The challenges of working with PE

With those benefits in mind, let's consider the potential pitfalls before entering such a partnership.

For one, PE *is an expensive source of capital*. PE firms' high return expectations derive from information asymmetry (the PE firm has only a fraction of the information the owner possesses) and the specific risk of entering a business at the transformational stage. Yet returns also need to cater for the management and performance fees PE firms charge to their investors. The PE industry has further developed a whole universe of fees (although mostly in buy-out transaction) which they attempt to extract from their investees (e.g. transaction, monitoring or exit fees). These are often introduced late in the process.

"The plan was to expand rapidly with private equity.... But after raising the money there were so many changes that my company was no longer the way I wanted it and many of my old employees, the ones who help me build it, left."
- Family business owner

At times, the hands-on engagement of PE firms can be perceived by the family owner as if he is gradually *losing control* over his company. While PE firms need to have some influence in order to deliver the expected results, an owner should look for a partner with a proven ability to add value without micromanaging day-to-day business decisions. A clear partnership agreement can also help to allay fears and preemptively abort misunderstandings.

Yet, written agreements cannot fully anticipate and resolve the frequently arising *culture clash* between a family business and new partners. Family members strongly vested in the culture, and/or "character" of the business might resist required changes, preventing the very transformations they are trying to achieve.

Family business owners should also be aware of the *difference in transaction experience* between their management and the PE partner. The latter are repeat sophisticated players at the transaction game, so family business owners, who are usually not transaction experts, are strongly recommended to look for an independent experienced advisor to guide them, lest they trade away a substantial portion of their potential returns.

Finally, *exit plans may differ* greatly between family owners and their PE partners. PE firms' holding periods (4-7years) are generally much shorter than the often inter-generational timeline family business owners operate on. This might create conflicts at the time of exit when the PE firm will naturally prioritise the most attractive exit route (e.g. strategic trade buyer), possibly against the owner's wishes. The parties therefore need a clear understanding about the exit from the outset, considering both the wishes of the owner and providing a fair exit for the PE partner.

4- Conclusion: An Uneasy Marriage or a Perfect Union?

The search for the right partner is therefore crucial and is often compared to a dating or courtship ritual, where the "marriage" should only be finalized if each party is able to respect the other's values and priorities.

In John's case, after carefully looking at several Growth Equity firms, he finally settled on one with the right industry experience, rooted in trust that was built during the negotiation process. This necessary trust helped him overcome several hiccups throughout the investment period, such as when the CEO brought in by the Growth Equity partner did not work out. Ultimately the business was sold for an attractive return to a strategic buyer. With cash in hand, and realizing he was not, after all, ready to retire, John spun-out a unit from his former business that had an exciting beta product, and began a new journey.

Due diligence on PE partner:

- *Talk to other portfolio companies of the firm*
- *Find out more about a PE firm's investment style from advisors and former portfolio managers*
- *Look at other PE investments in your industry and where the value add came from*

Strong Managers, Strong Owners

Corporate Governance and Strategy

By Harry Korine and Pierre-Yves Gomez

Cambridge University Press, November 2013

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What has changed over the last 30 years in both the publicly listed and the private firm is that the non-shareholder manager can no longer be seen to work in opposition to shareholders and their interests (as previously propounded by agency theory), but today rather works in full recognition of the interests of ownership. However these interests differ both between managers and shareholders, as well as within the two groups, and strategic and governance decisions are always closely linked to the interests of the different parties. The aim of the book is to persuade academia and business to do away with the time-honoured illusion that firm ownership, management and strategy can be considered in isolation from one another. The family firm preparing generational change, the partnership that welcomes new partners and the shareholders of a firm that chooses to go public are making decisions that will have an impact on strategy and management. The critical question that everyone, including the board, must ask is not 'what is the best strategy', but rather, 'who is the strategy for?'

This book, a culmination of a decade of extensive work, several books and articles, with many cases and detailed examples, presents a narrative that questions how strategic choices are made and proposes that this is a political process. Does the board really formulate strategy or does it in fact play more of a role of arbitrator among the main interest groups – i.e. different shareholders and different managers. So, a particular strategy might be the preferred solution only for a particular group; while some shareholders and managers will benefit, others may be poorly served or less well off. If strategy, and by extension, the board of directors, do not always promote the 'general good', then every strategic decision needs to be reviewed in terms of the question '*cui bono*' (to whose benefit). This means that the idea of one best strategy cannot always be upheld.

The magic triangle

There is always going to be a debate both between and among shareholders and managers, and a company's strategy will move in the direction of the group that wins the debate. This could be called the magic triangle of the corporation, with the three corners being the shareholders, the managers and the strategy. If there is a change in any one, the others will also change.

As different managers and different shareholders play tug of war, forming coalitions among themselves, what is the role of the board? And what does it do when there is a stalemate?

The role of the board

The book proposes that the board should be the place where disagreements are openly discussed, and where a dominant coalition is allowed to emerge. Unfortunately, on the whole, boards are quite ineffectual, and often find themselves outside of the magic triangle, rather than being in the centre of it as they should be. How can boards be more influential and effective in improving the governance of the firm they are entrusted with?

1. Directors need to be aware of the tug of war among different managers and different shareholders and need to figure out who is aligning with whom and why?

“As different managers and different shareholders play tug of war, forming coalitions among themselves, what is the role of the board? And what does it do when there is a stalemate?”



Image courtesy: franky242; www.freedigitalphotos.net

The board should be the place where disagreements are openly discussed, and where a dominant coalition is allowed to emerge.

2. It is also vital that the board put much more effort into the decision-making process. One of the problems, particularly in family firms, is that outside directors do not invest enough time and commitment.

3. Another important duty of a director, especially for those who are independent, is that he or she must formulate and express an opinion about what is best for the company and be willing to take a stand.

4. Finally, directors need to get involved in the company, to really understand what is driving the interests of shareholders and managers, and to develop their own sense of the firm's strengths and weaknesses. A good example is Hilti that requires its directors to spend a minimum of twenty days a year inside the company and to participate in one major corporate project, in addition to the usual board duties. Only when they are thus committed and integrated, can directors meaningfully stand up for the general good that they are supposed to defend.

Strategic choice and coalitions

An important point to note in the book is the idea of coalitions. A manager in a family firm might be incentivised for performance and growth and thus take on more risk; shareholders who also want growth will be supportive, thus forming a coalition with the manager. However, those shareholders whose interest was primarily in dividends and do not want more risk will be disadvantaged. In such a case the latter type of shareholders needs to be clear about what kind of a new senior manager they want and what incentives would be appropriate to match their interests, before the person is hired. The board would need to arbitrate between these different coalitions. As a director of a board one needs to understand who really is in power and whose interests are being served by the strategy being proposed.

How does corporate governance best shape strategic decisions?

A key point of the book, especially for family firms, is that corporate governance and strategy are inextricably linked. However committed and involved, the board is just one element of the corporate governance system of the firm. In general, a dynamic corporate governance system should protect the firm from one or another interest group 'hijacking' the firm for its own purposes. This is why it is important to have information and control structures set up in such a manner that the potential conflicts are given adequate consideration. In practice, this means that changes in ownership, management and strategy require adaptation of governance systems. The sophistication of the corporate governance system in place needs to reflect the complexity of the interactions among shareholders and managers, and the difficulty of the strategy.

Strategy is about risk, but often the corporate governance systems that deal with risk are discussed and put in place only long after strategic decisions have been made. More often than not, a strategic decision is made - for example, to expand the company geographically or to diversify into a new industry - and only later does the company start thinking about the right board members, systems and control.

Some examples that illustrate the need for strategy and corporate governance to go hand in hand:

- An IPO that brings in new, substitutable shareholders with different values and methods should be accompanied by the introduction of mechanisms to track the identities of the new shareholders.
- The appointment of a new CEO with a track record of radical change is the right occasion to rethink how the performance of management is measured and rewarded.
- A major change in corporate or business strategy, finally, necessitates a new assessment of risk and the monitoring of risk.

What is at the heart of strategy making?

The difference in strategic choices made by the ailing automobile manufacturer PSA (Peugeot/Citroen) and the more successful Renault, provides a fascinating example of the interaction of ownership and strategy. The failure of PSA to internationalise, while paying generous dividends, has been criticised in the press with the blame put on the Peugeot family, who owning 25% and controlling 38% of the voting rights, is supposed to have influenced the firm's strategy, to maintain control and benefit financially - to the detriment of the long-term health of the firm. In comparison Renault internationalised early and is doing better today. While diluting the control the firm has over its own fortunes, the equity partnerships with first Nissan and then Daimler have allowed Renault to tap new skills and new markets and eventually paid handsome financial dividends.

Operating in the same industry and faced with the same pressures arising from globalisation, the two firms made very different strategic choices. This illustrates two key points articulated in this book – first, there can be significant disagreement about what constitutes the 'right' strategy (and 'correct' governance structure), between shareholders and among managers. Second, and more fundamental to the argument, where there is disagreement over strategy, there will also be a political conflict over strategy, with a dominant coalition that eventually imposes its views, based on its own values and methods.

At Renault, the French government was the largest shareholder at the time of the decision to partner with Nissan, and went along with management's proposal to internationalise the firm, in full awareness of the possibility that its stake and influence would be diluted. At PSA, the Peugeot family apparently weighed in against such a move for a very long time.

In order to understand the strategic choices of firms, in other words, it is necessary to understand what drives the formation and evolution of dominant coalitions between and among shareholders and managers.

Boards must understand that strategy needs to explicitly consider the interests of the different shareholders. It is important that the board don't just discuss the economics of strategic choices, but also what these choices mean for shareholder structure and governance.

“Corporate governance & strategy are inextricably linked. Boards must understand that strategy needs to explicitly consider the interests of the different shareholders.”

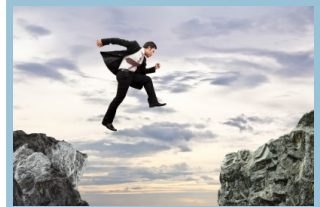


Image courtesy: suphakit73 www.freedigitalphotos.net

Unfortunately, on the whole boards are quite ineffectual and often find themselves outside of the magic triangle, rather than being in the centre of it as they should be.

Full publication available at:

**[http://www.cambridge.org/gb/academic/subjects/management/governance/
strong-managers-strong-owners-corporate-governance-and-strategy](http://www.cambridge.org/gb/academic/subjects/management/governance/strong-managers-strong-owners-corporate-governance-and-strategy)**

A Historical Perspective: From Hidden Giants to Visible Leaders?

The Evolution of Women's Roles in Family Businesses

By Christine Blondel

Gower Publishing (Dec 2011) and Cambridge University Press (Sept 2013)

The Author



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“Family firms have to be proactive in passing on the value of collective work and goals, without making it gender specific.”

Women have always been pillars of family business endurance, in many different ways, even though their contribution has, most of the time, hardly been visible or even recognised. The evolution of society, alongside the ‘professionalisation’ of family business leadership and governance, all contribute to the opening of new possibilities as well as increased visibility for women.

Tradition and Invisible role of Women in Family Firms

The traditional elements of the contribution of women in family firms have been the care of the family relationships and cohesions, spousal support, influence on the business, cultivation and development of networks and in handling ownership matters. The women of the family had an implicit responsibility to nurture the ‘social capital’ that would be useful for business and family, which they also transmitted to the next generation as ‘cultural capital’.

Scholars have suggested that spirit and the virtues essential for building a financial enterprise are not produced automatically – they need to be cultivated, and these are traditionally done by the mother in the home from the early years.

During the leadership transmission itself, mothers and wives play the important role of conciliators, especially between father and son. In a striking illustration of this phenomenon, the fifth-generation male leader of a multi-billion dollar company introduced – at a conference – the moderator who had facilitated the transition between his father and himself: those present were treated to the surprise of seeing his mother come on stage. More generally, women often assume the role of emotional leaders of the family. When the ‘matriarch’ dies, the resulting emptiness and void can be felt.

Challenges and Changes in Family Firms

It is important to note that the evolution of the role of women in family businesses mirrors their evolution in society and business at large.

The rise of individualism in society, creates a challenge in family firms, which are organically focussed on ‘collective-goals’.

Family firms have to be proactive in passing on the value of collective work and goals, without making it gender specific. This is where family governance plays an important role to help foster the unity of family, with a sense of belonging and shared vision. The family council needs to work more explicitly on this, including ‘doing good’ to society, not only through philanthropy but also through the business itself. This creates a strong sense of meaning in families, which brings them together.

With more women joining the workforce, there is a challenge in filling the gap of the very important though ‘invisible’ role that women traditionally played as ‘chief emotional officers’, i.e. relationship moderators. These ‘hidden giants’ are now being celebrated and recognised, but unless men also purposefully take on this role, there

“We should see more significant changes in future generations with the very strong proportion of women starting their own businesses.”



Image courtesy: Imagerymajestic www.freedigitalphotos.net

Today, with women studying even more than men, excluding women from succession paths can deprive the company of human and financial resources.

could be consequences to the business. There is a need to have this dialogue on the family board. Will this role still be held by women? Can it be recognised professionally?

Furthermore, where does the support system for the women leaders in business come from? Men and women do not face the problem of making family life and professional life compatible in the same way. A recent survey of one thousand senior executives illustrated this point: 74% of the women in the survey had a husband working full time, whereas 75% of the men had a wife without a full-time professional activity.

However society is changing as the millennium generation of both genders want careers with a better work-life balance, and the corporate culture needs to reflect this in accommodating and retaining talent. Recent studies show that instead of the traditional quest of prestigious title, powerful position and high compensation, both men and women value challenging and diverse job opportunities, a collaborative workplace and flexible work options, and a commitment to corporate social responsibility initiatives, values that are typically classified as ‘female’; with 89% of ‘Gen Ys’ affirming that flexible work options are an important consideration in choosing an employer. To obtain that balance, they are becoming agents of change, pushing flexibility to the top of the workplace agenda.

Succession Issues

Today, with women studying even more than men, excluding women from succession paths can deprive the company of human and financial resources, and even sometimes generate resentment toward both the family and the company.

Studies in succession in diverse countries and cultures from the daughter-father perspective, confirmed the impact of culture, but found that daughters seemed particularly cautious about preserving good relationships with their predecessors and within the family.

It continues to be tough for daughters, and is often ingrained in family values that leadership roles in the business are for sons. An instant survey done with voting devices at the Family Business Network Summit in Berlin (2007) showed an interesting twist in perception: when asked the likeliness of a woman becoming the next family business leader, 30% of the men in the room replied positively, compared to 50% of the women! Families in which these issues remain buried, rather than being exposed, weighed, discussed and translated into decisions that can be accepted by all, are running increasing risks of fracture.

They are also running up against a particular form of the diversity business case, the argument that talent pools for winning enterprises must recruit as widely as possible. In family firms where development, especially in new businesses or subsidiaries, is entrusted to family members, rapid growth can quickly exhaust the possibilities of executive staffing through male offspring only. Instead of widening its resources and influence, the family ends by restricting them – almost imperceptibly at first, but progressively.

In a recent study of career choice intentions of adolescents it was found that girls showed a greater inclination to start a new company, rather than to be a successor in the family business, contrary to some previous studies. Many women from family firms do seem to be moving into the entrepreneurial space, where they find freedom and fulfilment.

A member of the third generation of a family firm summarizes the evolution of the role of women, which she classifies by generation: *“The women of the first generation were invisible, unacknowledged spouses. I acknowledge the role of these women who were the main parts of the family unity: one year after my grandmother’s death, the family split. The women of the second generation are daughters and in fact, their fathers, the entrepreneurs, often see future mothers in them, not directors of the company. Finally, as a third-generation woman, I created my own company and thus became a first-generation entrepreneur. In this activity, I do not feel any discrimination.*

I have to face up to the same hardships as men.”

We should see more significant changes in future generations with the very strong proportion of women starting their own businesses. And the fact that men are increasingly aware of these questions in family firms presages continuing transformations.

Role of Governance in Family Firms today

From a governance perspective, there are important issues that boards of family firms need to consider:

- There is a need to raise awareness that women can be both leaders and can raise a family, with active support from the family and firm towards a work-life balance.
- The board needs to be genuinely diverse (in regards to age, gender and race) and have independent directors, to avoid biases and allow best decision-making.
- It is vital to have a fair process embedded in the firm values, so that candidates are chosen according to meritocracy, and what is best for the firm. A family charter explains how people are appointed with an explicit process that goes with it, such as the board's input, a committee, head-hunters and HR specialists appointed, etc., so that the correct people are considered for succession.
- The family must be aware of the impact of ownership distribution on future generations: including women in shareholding will enable their descendants to be potential participants in the firm, thereby increasing the human resource capital; also, there will be no need to 'compensate' them for ownership, hence money can be kept to develop the business expansion.

In some families, corrective actions have been taken: in the most generous instances, shares have been redistributed by men who wished to restore balance and peace in the family. Other families initiate new communication, recognizing the difference in treatment carried out in the past, and engage women in the family or business governance. These changes are not always easy to bring about, as they are highly dependent on the culture of the surrounding society/the culture in which they are embedded.

The 2010 Global Gender Gap Report also confirm the correlation between gender equality and the level of development of countries, thus providing support for the theory that empowering women leads to a more efficient use of a nation's human talent.

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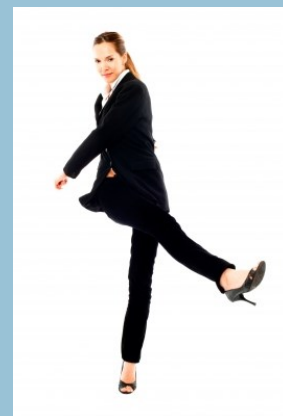


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There is a need to raise awareness that women can be both leaders and can raise a family, with active support from the family and firm towards a work-life balance.

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