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The Importance and Characteristics of Family Governance for Firm Performance and Competitive Advantage: A Short Literature Review*

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Abstract

The importance of corporate governance is growing due to globalization and the current changes in the business environment caused by the Covid 19 pandemic. The application of good corporate governance practices can prepare small businesses for future development. The purpose of this paper is to present a short literature review on the concept of family governance and the value it provides in family businesses, by highlighting its most important aspects, and mechanisms, identifying the elements of corporate governance that contribute to performance and competitive advantage. Our study suggests that the interaction between family administration properties can produce significant adaptability and competitive advantages, especially when the CEO is not a family member and reduced corporate performance is found when control is in the hands of the next generation. Furthermore, the extent of family control and role of family CEO can significantly reduce the contribution of independent directors. Finally, we highlight topics that should be researched in the future to achieve family business sustainability.

Keywords: Family Governance, Family CEO, Independent Directors, Firm Performance

Introduction

Family firms are considered to be the backbone of the economy, as they are the majority of SMEs, that are responsible for the growth of an economy (Basco and Bartkevičiūtė, 2016). According to the European Commision family businesses account for more than 60-90% of the total number of firms in the EU, and are responsible for almost the 2/3 of the GDP (European Commision, 2009). In the Greek economy, family businesses play a crucial role in the economy, as they account for almost 80% of the total number of firms according to the European Family Businesses Association and are considered to be a key factor in the development of entrepreneurship, economic development, and growth.

Considering the importance of family businesses for the economic growth of a county, it is important to understand the governance of these firms and the mechanisms and relationships that are developed, not only within the firm but also between the members of the family and their role in a family firm. That can be seen through the lens of corporate

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governance, that will provide a framework for examining family businesses and the ways it affects performance and competitive advantage.

The flexibility and close personal ties in the context of traditional continuity have made family businesses a basic cell of Greek entrepreneurship. The family that controls the business is the driving force behind choosing how the business operates, and how it defines its success. These choices are often based on the common goals of the family and business. Many family business leaders point out that, as their businesses grow and mature, there is a clear need to establish formal governance practices. This landmark comes when it is deemed necessary to create appropriate frameworks and structures to ensure the existence of safeguards for the successful development of the company. Good family governance practices are a key factor in fulfilling the family's purpose and creating value for customers, employees, shareholders, and society (Poza, 2010; Xanthopoulou et al., 2022).

It can be difficult to discuss the changes that need to be made in business and to agree on the ways in which evolution will occur from one generation to another (Poza, 2010; DellaPeruta, 2011). Therefore, as businesses mature and grow, family governance mechanisms become even more necessary. These mechanisms may include the management of assets and wealth through family councils, family assemblies, and family statutes and help strengthen cohesion throughout the family, especially when more distant relatives begin to enter the stage of cooperation.

Notwithstanding the importance of the subject research on family businesses and governance are mainly focused on North America (Botero et al. 2016). The purpose of this paper is to examine briefly the literature concerning the issue of family governance and discuss its importance in the success and viability of family businesses, along with the unique characteristics of family businesses that influence their governance. We review some of the most important organizational and managerial aspects of family governance, and offer the main aspects that affect the governance of family businesses and the ways it can improve their competitive advantage, to provide an insight for the readers on the issue. To achieve that we present the application of the more important aspects of family governance, as presented in the literature, offering a brief review in a subject that is important, for both academics and practitioners alike, as the majority of firms in the world are run by families.

The remainder of this paper is organized as follows. The following section discusses the nature and characteristics of family businesses, their governance, and the role of various leadership aspects in a family business within the theoretical framework of family governance and the presence of independent directors. Section 3 examines two important aspects of family governance, namely the CEO, and independent directors. Section 4 provides an overview of the association between family governance and business outcomes. Finally section 5 concludes the paper and offers suggestions for further research.

The nature and characteristics of Family Business and Governance

Family businesses are the full range of businesses in which a next-generation entrepreneur or CEO and one or more family members have a significant impact. Family members influence the firm through their participation in the management or the board of directors, ownership control, the strategic choices of shareholders, and the culture and values transmitted by shareholders who are family members in the company. The nature of family members' involvement in the firm as members of the management team, board members, shareholders, or supportive members of the family institution is referred to as participation. Ownership control is the management of the representation relationship and the rights and obligations of family members resulting from a sizeable portion of voting shares. Strategic choices refer to the risk choices and strategic directions that family members set for the business through their involvement in senior management, consulting processes, the board of directors, and family councils. Culture is the set of values that are defined by behaviors and incorporated into the business as a result of the leadership provided by family members, both in the past and present. Family unity and the nature of the relationship between the family and business also define this culture.

Family businesses can exist in many forms: sole proprietorships, limited liability companies, type S joint stock companies (taxation through owners/shareholders), type C joint stock companies (independent company and owner/shareholder taxation), holding companies, and still listed, yet family-owned companies. There are two types of family governance: formal (contractual) and informal (relational) (Parada et al. 2020). The adoption of one of these two types of family governance greatly depends on culture. For instance, in Europe and North America, the formal type was selected, since there are strong institutional frameworks. In this case, there are not many formal structures, and there is a strong spirit of family cohesion; the informal type is chosen. The informal type is selected mostly in developing economies, where legal mechanisms enforcing contracts may be less prevalent. There are mixed results regarding the most efficient type of family governance. For example, formal family governance is thought to help businesses in times of crisis by making it easier to anticipate the effects of external shocks and to make more effective decisions. In contrast, informal family governance is linked to stronger emotional attachment; thus, it is regarded as more efficient (Howorth & Kemp, 2019).

The five theoretical dimensions are relevant to all businesses, but also have a special relationship within family controlled businesses (DeVries & Carlock, 2007): a) networking: deeper information sharing and strong relationships developed within family and business systems; b) goal alignment: balancing individual and collective goals; c) control: determining the power of the family in the company, the board of directors, and the ownership team; d) timeframe: long-term commitment to family investment and business strategy; and e) organizational structures: use of both flexible and rigorous controls to support a clear family business philosophy.

Family governance consists of a set of internal business rules for the operation and transparency of the business roles assigned to family business members in terms of their effectiveness. Family governance clarifies the stages of decision approval, such as financial exposure, recruitment of employees, collaboration with new suppliers, presence in new markets, liquidation of cash, consumption of funds, investment movements, etc., so that there are no initiatives on the part of the leader that might bring surprises to the company (De Massis et al., 2015). Furthermore, with corporate governance, the critical issue of succession, that is, the transfer of leadership from a family business to the next generation as well as digital transformation, comprise the main challenges of a family business's competitive environment. These challenges, as well as the required openness and flexibility, force companies to turn to specific features that drive their competitive advantage, with family governance being a critical point (De Massis et al. 2014).

Families in business might develop their own distinct family governance systems to balance their finances with family goals and translate them into a shared vision for the family. They also assist the family in keeping the necessary balance between what the business is attempting to achieve and what the family desires (DeVries & Carlock, 2007).

According to Miller and Le Breton-Miller (2005), family firms tend to have stewardship attitudes because CEOs frequently come from the same family, share a strong commitment to the company's mission, promote family and business welfare, and improve relationships and cohesion. While stewardship theory can bring benefits to family firms in terms of governance, agency cost theory underlines the disadvantages of family governance. Family members who manage family businesses may receive private benefits in the form of related-party transactions, overcompensation, and huge receivables, particularly if they have control rights that extend beyond cash flow rights (Anderson & Reeb, 2004).

Other issues that have also been examined include the link between family governance and a variety of subjects, such as business performance (Berent-Braun & Uhlaner, 2012), strategic decision-making, succession, and family unity. However, despite the growing number of articles devoted to family governance in recent literature reviews, there is neither an overview nor a prevailing view as to why business families decide to apply family governance mechanisms, or how family governance can improve the functioning of the family and the long-term success of the business (Vieira, 2020). The family can be either a competitive advantage for the business or an obstacle to the destruction of the business. The success of a business is greatly influenced by the way the family manages itself and its relationship with it. Thus, business families need to perform their duties efficiently and effectively. These tasks have direct consequences for the family business, its financial performance, and, therefore, for the maintenance of family wealth (Gersick & Feliu, 2014).

Family governance, therefore, is characterized by a unique set of resources created by family and business interactions. This interaction can affect how resources are managed and developed in family businesses (Sirmon & Hitt, 2003). This unique set of characteristics created by family-business interaction is referred to as "family feeling." This feeling is created by the family's presence in the structures of power and by the experience and connection between the existing culture in the family and that within the company (Klein et al., 2005).

Moreover, research by Berrone et al. (2012) has provided overwhelming evidence that family businesses make decisions considering those who have the greatest power in the business. These individuals make decisions in such a way as to maintain the "socio-emotional wealth of the family business", which consists of the "emotional heritage" of the family owners, including the family's desire for power, the enjoyment of family influence, maintaining family status within the company, appointing trusted family members to important positions, maintaining a strong family identity, continuing the family "dynasty" (Gomez-Mejia et al., 2007).

Recent studies reveal that family businesses can attain better levels of financial performance over time because to their irreplaceable resources (Zahra et al., 2008). Especially, family members with significant, concentrated ownership have greater incentives to improve a firm's performance and achieve sustainable performance (Aronoff & Ward, 2016). Families may therefore have longer time horizons than other shareholders, indicating a propensity to invest in long-term initiatives as opposed to those with shorter management time horizons. Families perceive their firm as an asset to be passed down to future generations rather than as riches to be consumed in the present. As a result, business survival is a major priority for families, suggesting that they may be long-term value maximization proponents (Azizi et al., 2021).Consequently, the family governance structure influences the creation of long-term competitive advantages in family businesses.

Another important aspect of corporate and family governance is the role and composition of the board of directors. Boards with a majority of independent external directors who have no affiliations are characterized as independent and effective (Ayuso and Argandona, 2007). Stewardship and agency cost theories provide a framework for understanding the operation of board governance in family businesses (Miller & Le Breton-Miller, 2006; Antoniadis et al. 2008).

Family Governance mechanisms and management

Family members as CEOs

The impact of family CEOs on corporate performance is unclear, but several conclusions have been drawn from studies of businesses in a variety of geographic contexts (see Table 1). More investigation is needed to determine the relationship between performance and family CEO. There is empirical evidence that family management is positively associated with firm performance (Adams,et.al.,2009; Chahal & Sharma, 2022).In addition, according to Anderson and Reeb (2004), the founding CEO of a family positively affects the performance of a company, but not in the same way as the next generation. Furthermore, family CEO and founder CEO positively moderate the effect of family ownership on firm performance (Jiang & Peng, 2011). However, the positive impact on firm performance in family businesses can become stronger when the company has a CEO who is not a member of the family, have many family owners, or are controlled by later generations (Arteaga & Menendez-Requejo, 2017).

On the contrary, Liu et al.(2014) argue that family members are less productive and can have a negative impact on company performance due to inefficient and unfit management and their personalities(Kelleci et al.,2018). This result is consistent with other studies such us Pandey et al. (2011) and Saidat et al. (2020). Also, Bertrand et al. (2008) found a negative effect of family CEOs on performance, and this effect gets worse when the founder's son becomes CEO.

Table 1. Summary of studies on the relationship between Family CEO and Firm Performance

Authors/ Year	Country	Sample & Period	Performance	Findings
Anderson & Reeb (2004)	S & P 500	2,686 firm-years (1992)	ROA & Tobin's Q	Positive Relationship
Bertrand (2008)	Thailand	93 large family firms	ROA	Negative Relationship
Adams et al. (2009)	USA	336 publicly-traded firms (1996-2003)	Tobin's Q and ROA	Positive Relationship
Jiang & Peng (2011)	East & Southest Asia	744 large, publicly listed family-owned and -controlled firms	stock market performance	Positive Relationship
Pandey et al (2011)	Indian	131 biggest family firms (2008)	Tobin's Q	Negative Relationship
Liu et.al. (2014)	China	2000 listed firms in Shanghai and Shenzhen Stock Exchanges (1999 to 2011)	ROS & ROA	Negative Relationship
Arteaga & Menendez-Requejo (2017)	Spain	530 family businesses (2003-2013)	ΔROAsector, ROAt-1	Positive Relationship
Kelleci et al. (2018)	Belgian firms	44 privately held family firms	ROA & ROE	Negative Relationship
Saidat et al. (2020)	Jordan	Jordian family firms listed in the ASE (2009-2015)	Tobin's Q and ROA	Negative Relationship
Chahal & Sharma (2022)	India	family firms listed on the NSE 500 (2011–2020)	ROA, Tobin's Q	Positive Relationship with ROA & Negative Relationship with Tobin's Q

Independent Directors as a Corporate Mechanism

The active participation of independent directors on the board tends to be associated with an improved corporate governance system (Cerbioni & Parbonetti, 2007). According to agency theory, directors on boards work to align (support) the benefits of management and stockholders by observing the attitudes of management and the quality of

their decisions. In reference to stewardship theory, people in leadership positions may govern in a way that promotes decision making, fulfilling the tasks and responsibilities assigned to them. Furthermore, managerial opportunism can be significantly reduced in family businesses, as the directors of these companies, who are often family members with substantial involvement, may be inherently motivated to work toward their improvement.

It is argued that, although management is primarily responsible for corporate strategy and decision-making regarding the day-to-day operations of the company, corporate boards are responsible for controlling, validating, and monitoring management decisions. Oversight board committees are considered more effective if they consist of non-executive directors with a majority of independents (Higgs, 2003). Setting up independent board committees can strengthen corporate governance, especially in the case that the CEO serves on the appointment committee, or in the case that the CEO and the chairman of the Board of Directors are different persons (Antoniadis and Ananikas, 2005). Evidence shows that the representation of independent directors on the board improves corporate performance (Arora & Bodhanwala, 2018) and highlights the competitive advantage of independent boards on innovation (Zhang, 2022). However, research has shown that the inclusion of independent directors does not always lead to improved performance (Mishra, 2020), due to lack of knowledge, difficulty or mismanagement (Ribstein, 2002).

There is evidence that family managers aim to maximize the family's benefits rather than follow the recommendations of independent directors. When independent directors express independent views opposing the family manager's philosophy and firm's strategies, family companies are less likely to appoint them to board committees (Anderson & Reeb, 2004). Controlling family members for fear of losing autonomy and control may make them reluctant to share information and power with external board members, thus reducing their cooperation.

Due to the concentration of family ownership and management control in family firms, it is not expected that the presence of external independent directors will significantly improve firm performance. Leung et al. (2014) found that, whereas board independence is positively linked with firm success in non-family firms, there is no significant association between the independence of corporate boards or board committees and firm performance in family enterprises using a sample of Hong Kong firms. Independent directors also have an impact on the direction and strength of the relationship between ownership structure and company success. When the board of directors and shareholders' interests are aligned in a corporation where directors own controlling shares, independent directors perform better (Kallamou, 2016). Furthermore, the findings confirm that in family firms, the contribution of independent directors is moderated by the generational stage of the family firms and leadership structure of the firm (Garcia-Ramos et al., 2017).

Family governance and family firm objectives

An important aspect of family governance that has been examined in the relevant literature is related to the association between family governance and the outcomes of family businesses. Within this framework, it is suggested that family governance may not always aim to achieve economic goals, but rather aims to preserve socio-emotional wealth, improve the emotional attachment between the members of the family, enhance the bonds that exist among the family members, or preserve family ownership or the involvement of the family in the management of the firm (Berrone et al., 2012). Consequently, family governance may differ in terms of the final goal of the firm’s objectives.

In the context of entrepreneurship study, a number of scholars have also examined SEW, recognizing that corporate entrepreneurship enables a firm to greatly boost its competitive advantage (Corbett et al., 2013) and also SEW can be viewed as a significant strategic antecedent to firm performance (Myśliwiec et.al.,2019; Konstantinidis et al., 2022). On the other hand, socioemotional wealth may spur or restrain family enterprises' strategic initiatives that eventually form their competitive edge and leads to specific strategic orientations (De Massis et al., 2012). According to recent studies, the level of innovation in family firms is also influenced by the degree of family control (Filser et al., 2016).

Li and Daspit (2016) examine the concept of innovation regarding family governance and its association with the preservation of socioemotional wealth. The findings of their study indicated that the intention to preserve socioemotional wealth, along with the degree to which family members are involved in the governance of the firm, may affect the degree and level of innovation that is adopted and pursued. Chang and Noguera (2016) examined the differences between family owned and professional firms in terms of the effect of family governance. The main difference was that in family-owned businesses, the main goal was the preservation of socio-emotional wealth.

Conclusions

Family governance is a field of research of great interest because of the continuing changes in business behavior and technological innovations that industry 4.0 is bringing. The present paper is part of an ongoing research on the importance of family governance for family businesses to the goal of achieving competitive advantage. We have briefly examined the issue of family governance in relation to family CEO, independent directors, and firm

performance, with a focus on organizational and leadership issues that can lead to increased firm performance and long term competitive advantage.

Considering the above arguments and empirical research, some interesting conclusions can be drawn. Regardless of ownership structure, what distinguishes family businesses from those run by professional managers are commonly the aims, values, and relationships of owners who are members of the same family, which shape the strategy of a family owned and run business. As a result, the family business system is shaped by a special blend of family, management, and ownership subsystems. The interaction of family administration and family ownership can lead to notable levels of adaptability, and more importantly, to competitive advantage. Otherwise, it can be a significant source of risk and volatility, especially when coping with generational change or gaining a competitive advantage.

Family governance is of growing importance and cannot be examined within the limited scope of this paper, that serves as an introduction of an ongoing research. Therefore, more research should examine the linkage between financial issues concerning capital structure, investments decisions, firm performance, and the preferred types of family governance that lead to competitive advantage for family businesses.

More specifically, future research should examine other issues concerning family governance, such as the effect on the decision-making process, adoption of innovations, strategy followed, and financing methods. It is necessary to examine the effects of family governance on corporate performance and competitive advantage. Further research on the trends and factors that influence family governance can provide useful insights to academics, policy makers and practitioners, to provide an institutional framework for family businesses that will enable them to achieve sustainable growth, resiliency in a changing economic and social environment and hence sustainable competitive advantage.

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