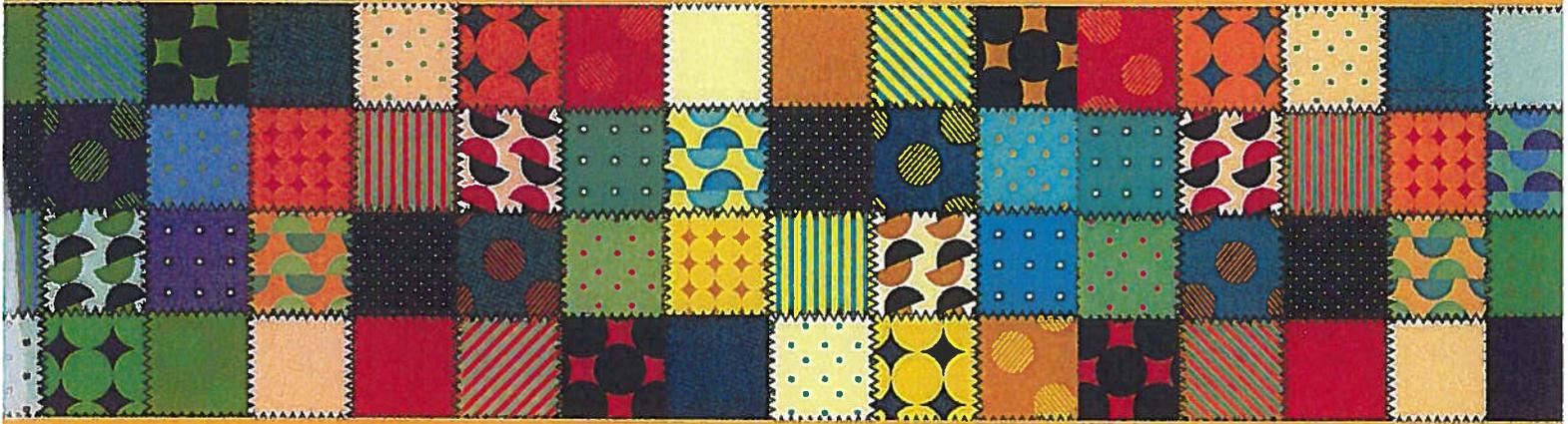


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# Governing the Family Enterprise: Practices, Performance and Research

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## INTRODUCTION

Organizational researchers are increasingly drawn to family businesses because they illuminate so many important models and theories: family dynamics and human development, theory of the firm, agency theory, economic development, labor market theory, social capital theory, and many others. Consultants and professional service providers are also attracted to family enterprises as clients. In fact, over the recent decades, there have been many more professionals working with family firms than studying them. As a field, our best opportunity to maximize our understanding of family businesses is to utilize both of these sources of data on family firms; that is, to integrate formal research and theory with documented implementation experience to build a platform for future development.

This is critically important in the area of governance. Research on corporate governance has proliferated in recent decades, generating a huge literature on the legal,

financial, and strategic control of organizations. But a very small part of that research has taken into account family ownership and the special nature of family firm governance over time and across generations (Le Breton-Miller and Miller, 2009). In particular, only a few researchers have looked at governance systems as they are actually implemented in family firms, assessing their successes and failures in overseeing such core outcomes as ownership continuity, business performance, stakeholder benefits and satisfaction, emotional ownership, leadership development in sequential generations, and entrepreneurship.

Similarly, the primary interventions by consultants in the family business field over the past three decades have been in governance: family councils, family assemblies, boards of directors, family offices, family foundations, shareholders agreements, and financial planning tools such as trusts and limited family partnerships. However, publications based on that body of work very rarely go beyond the descriptive, and sometimes prescriptive. Consultants offer advice

based on their experience, and rely on logic and common sense to persuade potential clients that they see the problem accurately and the solution clearly. Where there is research evidence some advisors make use of it, but many of our often-repeated 'best practices' are supported by face validity rather than empirical assessments. We have come to a moment of challenge to our understanding of governance in the field. If we are to move forward we need to consolidate the existing empirical work and integrate it with what has been learned from experience, to generate both a confident basis for our advice to families, and a comprehensive agenda for future research.

In this chapter we review the existing literature on governance implementation in family enterprise. The chapter begins with a brief discussion of the domain of governance, first in corporations in general, and then in family business in particular. Then we review the literature on governance implementation in the business, ownership, and family circles, sampling both the academic research literature and the reports of professionals in the trade and general press. We reviewed more than 400 articles and books, and have included over 200 in the bibliography, but this is only a sample. In making choices about which publications to include, we considered direct relevance in the practitioner articles, and research design, contribution, and cites by others for the academic papers. We have also relied heavily on our own professional experience with hundreds of business families over the past 30 years, which undoubtedly shapes our interpretations of the body of research and our proposals for filling gaps. Each section ends with suggestions about the most promising areas for future work, and the most interesting dilemmas for the continuing evolution of our research canon.

## **DEFINITIONS AND DOMAIN OF FAMILY BUSINESS GOVERNANCE**

Pieper's (2003) excellent review reaches the conclusion that there is no consensus on the

definition of governance, either in corporations in general or in family enterprise. Keasey et al. provide one often-quoted definition for corporate governance in general: 'Corporate governance is the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interests of other stakeholders' (1997: 288). This is a somewhat different focus from the perspective of researchers in economics or finance: 'Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment' (Shleifer and Vishny, 1997: 737), or the law: 'Corporate governance refers to the monitoring and control over how the firm's resources are allocated, and how relations within the firm are structured and managed' (McCahery and Vermeulen, 2006:1).

In these professions, governance refers to ownership of business organizations (in fact, governance and ownership are often treated as synonymous) (Carney, 2005). In two ways, that is too limited for our purposes. First, ownership is a financial and legal reality; governance is an organizational one (Uhlener et al., 2007: 227), including both structural and process components. In this review of governance practices in family enterprise, we are not only interested in ownership rights, but rather in how oversight and control are exercised, and in how governance contributes to firm performance.

Secondly, we are using governance in reference to all of the sub-sectors of a family enterprise, not just the business ownership, because what is being governed is the family capital in all its forms: financial, human, intellectual, social, and organizational (Hughes, 2004; Sharma, 2008). Family enterprise governance oversees all the collaborative operations of the family, including wealth management, philanthropy, and human development (Gersick, et al., 1997; Neubauer and Lank, 1998; Lansberg,

1999; Mustakallio et al., 2002). Goldbart and DiFuria give an example of a very different definition of governance, appropriate particularly for family business: ‘Governance is the means of stewarding the multigenerational family organization ... [It] establishes the processes whereby: strategic goals are set, key relationships are maintained, the health of the family is safeguarded, accountability is maintained, and achievement and performance are recognized’ (2009: 7). This chapter uses this broader definition as its domain for governance implementation, reviewing the research and professional literature on the practice of governance in family enterprises.

### **THEORETICAL MODELS FOR GOVERNING THE FAMILY ENTERPRISE**

In contemporary organizational studies, the dominant theoretical foundation for research on corporate governance is agency theory. (For a full discussion of agency theory in family business governance see Goel et al., 2014, in this volume.) Agency theory focuses on the differentiated needs of two categories of stakeholders: principals (the owners) and agents (their employed managers) (Berle and Means, 1932; Jensen and Meckling, 1976; Fama and Jensen, 1983; Jensen, 1993). The goals of principals and agents are inherently different, and since the prime purpose of the corporation is to serve the economic interests of the owners, it falls upon them to design mechanisms (governance) to control the behavior of their agents so that the organization operates in service of the owners’ interests. However, those control mechanisms come with costs. Minimizing agency costs is therefore an important contributor to organizational success, and a useful measure of governance implementation and effectiveness.<sup>1</sup>

However, the agency model is more complex in family-controlled companies with the addition of a third key stakeholder – the family – which creates additional demands for appropriately balanced and coordinated

governance procedures (Corbetta et al., 2002; Corbetta and Salvato, 2004; Braun and Sharma, 2007; Lambrecht and Lievens, 2008). With this elaboration, agency theory merges with the dominant conceptual model for family business, the Three-Circle Model. This model, first articulated by Tagiuri and Davis (1996) and elaborated into a three-dimensional developmental model by Gersick et al. (1997), conceptualizes family enterprise as a Venn diagram of three subsystems – the owners, the business (or other operating organization[s]), and the family – each with its distinctive membership, agenda, and developmental processes. The Three-Circle Model helps clarify the tasks and purposes of governance in reference to each of the key subsystems – the essential work that governance must accomplish if the family enterprise is to succeed – and therefore the basis for evaluating governance implementation in research and practice.

In the **ownership circle**, the governance system must serve the actual equity owners of the enterprise (individual, partners, and/or shareholders). Its goals and obligations in this circle are to protect both the security of the asset base and the return on those assets. The specific tasks of governance include establishing and monitoring the structures that actually hold the owners’ equity, guaranteeing compliance with all legal and accounting requirements, setting risk and return parameters and tracking all of the data on performance, generating capital from whatever sources are most advantageous, communicating effectively with current (and sometimes prospective) owners to minimize the cost of capital, determining the amounts and formats of distributions, and all other tasks that serve the owners as investors. These tasks are most often carried out by a board of directors, but that depends on the legal form of the organization – they can also be assigned to partners, trustees, or the sole or controlling owner as an individual. Governance failure in this circle risks *loss of capital* if owners lose confidence in the enterprise as an investment.

In the **business circle**, the governance system must serve the operating company, most often through its executives and managerial leadership. Here governance adds value by determining and enforcing standards for executive performance; articulating the core values and cultural norms that the governors expect managers to rely on in making choices and decisions; defining short- and long-term strategies; overseeing human resource management; and all other tasks of selection, supervision, assessment, and development of the senior operational executives that maximizes their performance in line with the overall objectives of the owners. Especially in closely-held businesses, well-functioning governance also helps to avoid destructive interference by individual owners into the domain of management, which if unchecked can undermine professional management as much as neglect. Once again, these tasks are most often assigned to a board of directors,<sup>2</sup> but the structure may vary. Governance failure here carries the risk of *loss of competitiveness*.

Those first two sets of governance tasks are generic to all corporations. It is the governance tasks in the **family circle** that are distinctive in family enterprise. Here the effectiveness of governance depends on its ability to serve the needs of the family, extending beyond current shareholders to include all those who are related by blood, adoption, or marriage and share a psychological sense of enterprise ownership – past, present, and future. The purposes of governance in this circle are to clarify the demands and rewards of family membership in relation to the business, to define and communicate the opportunities for involvement in all of the family's collaborative ventures, to facilitate information flow in ways that maximize trust and minimize manipulation, to establish and oversee the non-business/non-financial aspects of the enterprise (often including philanthropy), and most of all to enhance a sense of belonging throughout the extended family, across the subcategories of branch and generation. When governance in the family circle

is working well, it nurtures the emergence of the family's shared dream (Gersick et al., 1997; Lansberg, 1999), and then it structures the operationalization of that dream in organizational practice. Governance failure in this circle risks *loss of commitment* and, as a result, *loss of continuity*.

It is the effort to balance the agendas of these three classes of stakeholders – owners, managers and employees [agents], and family – that sets the agenda for governance, and the criteria against which research on governance implementation can be assessed. Therefore, we have organized this chapter around the Three-Circle Model, dealing in turn with governance implementation in ownership and the business, and then in the family.

## RESEARCH ON GOVERNANCE IMPLEMENTATION IN THE OWNERSHIP AND BUSINESS CIRCLES

Although the purposes of governance are different when serving the needs of owners and managers, the governance structures and the literature about them are for the most part the same. Therefore, to avoid duplication in reviewing the body of research, we have combined the literature review for those two circles. We review the core research literature on boards of directors first, and then cover the much smaller body of work on other governance mechanisms: blockholding, dual stock classes, CEO/Chair duality, shareholder agreements, shareholder assemblies, and trusts.

### *Boards of Directors*

In contemporary private-enterprise economies, nearly all legal systems specify some kind of board of directors as the ultimate governance authority in a corporation (Mintzberg, 1983; Fama and Jensen, 1983; Cadbury, 1992, 1999; Monks and Minow, 1996; Gomez and Moore, 2009). The literature on boards in general is large; the literature on boards in family businesses is still

very small (Bettinelli's review concludes: 'Research on family business boards is almost nonexistent'; 2011: 152). Furthermore, most of the research on boards that does exist draws samples primarily from family-controlled, publicly-traded companies, rather than from the much larger group of privately-held family companies, despite the prevalent advice from practitioners that they too benefit from well-functioning boards (Teksten et al., 2005; Voordeckers et al., 2007).

A high percentage of the general organizational literature on boards of directors looks at the basic demographics and formal structure of the board, primarily the number and type of directors and the makeup of board committees. Some of the research is purely descriptive, while other studies look for associations between various characteristics and firm performance.

### **Board Size**

The earliest and still most common research topic on boards of directors concerns the number of directors. Finegold and Lawler, in a recent survey of a sample of Fortune 1000 company directors, concluded that board size has been relatively stable in recent years, averaging just over 10 members, including the CEO and one or two other insiders (2009). The consensus is that smaller boards are more efficient, but in the extreme may limit the available range of skills and expertise among directors (Setia-Atmaja et al., 2009). Lane et al. (2006) summarize a group of studies and conclude that the optimal range for public, non-family firms is 5–9 directors, and 7–12 for family-controlled companies. There is some discussion of the special advantages of larger boards in family-controlled companies, in part to satisfy representational dynamics among family shareholder blocks (usually family branches) and in part because the concentrated authority of founders and large family blockholders is less dangerous within a larger group of directors. However, researchers in Europe have reported samples of family businesses with smaller boards than

their non-family counterparts (Navarro and Ansón, 2009). We found many suggestions from practitioners on the preferred size of a family business board (Ward, 1989, 1991), but no empirical findings on the consequences of board size for board performance in family firms.

### **Categories of Directors**

No topic in the general governance literature has generated more heated debate than the optimal mix of directors from management, ownership, and outside the company (for example, Baysinger and Hoskisson, 1990; Judge and Zeithaml, 1992; Raheja, 2005). Practitioner and academic authors have traditionally favored strong, independent boards (Johnson, 1990; Pendergast et al., 2011), especially following the high-profile governance failures of the past decade, and the legislative responses such as Sarbanes–Oxley. In one of the few empirical studies, Millstein and MacAvoy review the recent history of boards from the legal perspective, and then test two measures of board professionalism, concluding that there is 'a statistically significant relationship between an active, independent board and superior corporate performance as measured by earnings in excess of costs of capital over the industry average' (1998: 1318). They also offer some hypotheses about why most research produces mixed results on the link between board structure and firm performance (complexity of the causal links, environmental events, and non-transparency).

In the family business literature, academics and practitioners alike have been nearly unanimous in endorsing the value of a strong board of directors with a presence, and often a majority, of independent outside directors (Zall, 2004; Brenes et al., 2011; Pendergast et al., 2011). This is one of the most frequently recommended governance 'upgrades' for family firms of all sizes, from small privately-held ventures to large traded firms (Jaffe and Lane, 2004). Sir Adrian Cadbury, commenting on the application of his influential report on

family enterprise in the United Kingdom to family firms, summed up his conclusions with, 'the continuing success of a family firm is best assured if it is headed by an effective Board ... One with competent, independent-minded, outside directors on it' (Cadbury, 2000: 33). The most consistent and articulate academic voice for this view has been John Ward, who along with his colleagues, in numerous articles and presentations and more than a dozen books, has made the case for independent family business boards (Ward, 1988, 1991; Ward and Handy, 1988). Ward's recommendations are always well argued, and he has probably had more influence on the field's normative consensus on governance structure in family businesses than anyone else.

But the support for independent boards in the family business literature has not been unanimous. Ford (1988, 1989) raised a challenge to the assumption that outside directors add benefit: 'Unfortunately, there is a noticeable lack of empirical data to support the notion that outside directors actually make a difference on the boards of directors of privately-owned firms' (1988: 50). Ward's rejoinder was that, while the data on firm performance and board composition in family firms was still scarce, a purely financial assessment of the impact of non-family directors is only part of the story (1989). He and others argued that there are corollary benefits from a professional board that may not be picked up by traditional secondary analyses or surveys (most of which have extremely low return rates). The existence of a board, especially if it includes directors who are not employees or advisors of the controlling owners, leads to more transparency, more objective decision-making, more data-based evaluations and career oversight for family employees, more efficient use of executive time and meetings to accomplish governance tasks, and as an overall result, a higher probability of continuity. Reporting on the results from 360 responses to their Family Business Board Survey, Pendergast and his colleagues found that only 48 per cent of those family

companies self-define as having a 'functional board'; 67 per cent consider their board 'effective' or 'highly effective' with a steep curve from 54 per cent among those who have a family-only board, 83 per cent of those who have two or more independents, and 96 per cent of those who have a majority of independent directors (2011: 252). The self-report data is strong, and the data on board task activities and business performance may follow.

However, in both public and closely-held companies, whether or not family-owned, the research findings to date on independent directors are mixed. In the general corporate governance literature, research on the impact of independent directors on firm performance, share value, strategy, and operations most often finds little or negative impact (Agrawal and Knoeber, 1996; Coles et al., 2001; Daily et al., 2003; Bartholomeusz and Tanewski, 2006; Gordon, 2007; Finkelstein et al., 2009), and in some cases a decrease in firm performance when the percentage of independent directors goes up (Schulze et al., 2001). Other studies have reported a positive effect of independent boards under certain conditions (Baysinger and Butler, 1985; Filatotchev et al., 2005; Han and Celly, 2011), usually later in the firm's life cycle. Some studies, especially in non-US economies, find a positive impact of an independent board on firm value or lower cost of capital, while not measuring firm performance (for example, Yeh and Woidtke, 2005). Earlier work by Yeh and colleagues (Yeh et al., 2001) found that, in a Taiwanese sample, the combination associated with the highest firm performance was high family ownership and low family representation on the board – an intriguing finding that suggests important follow-up research to test its cultural specificity. Overall, for public corporations as a whole, the record is inconclusive. As Gordon (2007) put it, 'Independent directors – that is the answer, but what is the question?'

For large family-controlled corporations, the strongest data on this topic are the extraordinary findings of Anderson and Reeb (2003,

2004) on family control in S&P 500 firms. These researchers are best known for documenting that family-controlled publicly-traded companies outperform their non-family counterparts on a variety of profitability and market measures. However, they also looked deeper into the ownership and governance mechanisms that may lead to that advantage, and found a strong positive effect on firm performance in those family firms with greater board independence (they found no similar benefit from independent directors in non-family firms). Going further, they found a curvilinear relationship between board structure and firm performance:

At low levels of family board representation relative to independent director representation, increases in the presence of family directors exhibit a positive relation to firm performance. But after the ratio of family board representation to independent director representation exceeds 0.50 (one family director to two independent directors), firm performance deteriorates. At higher levels of family representation relative to independent directors (beyond one to one), firm performance deteriorates even further. (Anderson and Reeb, 2004: 224)

They conclude that independent directors provide direct benefit in 'tempering agency problems between founding-family owners and outside shareholders' leading to 'performance premiums for family firms with greater levels of board independence relative to non-family firms or family firms with insider-dominated boards' (2004: 231). They do acknowledge that they are making causal inferences from correlational data, so they call for more detailed follow-up research on board structures, committees, nominating procedures, and the implications of these findings for smaller firms.

In both the general corporate governance literature and the work on family companies in particular, after several decades of inconclusive results looking at different percentages of directors from each category measured against a wide range of performance indicators, the tone of the research is changing. More authors are moving away from a blanket

endorsement (or critique) of independent-director-dominated boards for all family businesses, and advocating the need to be situational, concluding that not one board style fits all (Corbetta and Salvato, 2004; Lane et al., 2006). They call for much more specific research linking board configurations to company lifecycle, industry, history, and particular task responsibilities (Sharma et al., 1997; Nicholson et al., 2009). For example, R&D firms may need more insiders who know the technology and the players; larger, diversified firms need a broader range of expertise, and therefore a larger board (Coles et al., 2001, 2008). Additionally, some authors suggest a transitional stage of an advisory board, to help overcome family fears about losing control. Lambrecht and Lievens (2008) see this structure as a way to introduce outsiders in a 'safe mode', as it has no legal status (the power remains in the hands of the owners) and it is easily dissolved.

There are also calls for clarifying the role of outside director in the family business board. Some writers suggest that for family companies, purely independent directors may not be as important as 'affiliate' directors, who are not family members or managers, but who come to the board with a prior business connection, professional service history, or investment link to the family or the company. Jones et al. (2008), for example, found that directors of this type have valuable information and familiarity with the family firm, and more at stake, than unaffiliated independents, and therefore offer specific value in encouraging product diversification, overcoming a family-firm bias toward persistence with over-mature product arrays. Practitioners are also calling for more specific guidance from outcome research so that they can design board development interventions and better orientation for new directors, helping them 'fulfill the functions they are uniquely positioned to serve within family companies that have public shareholders' (DeMott, 2008: 825).

In particular, it is vital to further investigate the suggestion from several key studies

of a curvilinear relationship between family engagement in governance and performance (Anderson and Reeb, 2003). These studies suggest that for the first generation of entrepreneurial firms, focused on survival and growth, more family involvement is better, aiding capital retention, lowered costs of labor, and high energy and commitment. But as the firm matures, especially after the departure of the founder, less family involvement on the board may be correlated with better financial performance, more appropriately aggressive risk-taking and growth, and more accurate assessment of successor family managers. If those findings hold up across a variety of situations, it would be extremely valuable to practitioners as a guide to their advisory work with families on evolving the structure and membership of the board across time.

In addition, for the more complex family enterprises, the questions of board structure, composition, and size need to take into account the overall organizational structure (Jara-Bertin et al., 2008). Which board? Serving what governance purpose? For example, the owners/investors may form a holding company, a family partnership, or a private trust company, each requiring a separate governing board to oversee their asset-management and asset-allocation functions. At the same time, in the business circle each operating company may have its own board, also with governance responsibilities but for a different set of constituents, with very different demands.

Actually, the list of potential boards in the complex, later-generation family enterprise is longer, including the family office board, the family foundation board, the boards of subsidiaries and joint ventures, and the 'pseudo-board' created by interlocking groups of trustees. As a result, the questions of insider/outsider representation, or optimal number of directors and frequency of meetings, or transparency and information flow, have no general answer. The relationships among all of these family business boards within the same family enterprise raise many

interesting questions about appropriate representation, optimal number and category of directors, legal and tax beneficial structures, required expertise, goal setting for return on assets, and liquidity and exit provisions.

Finally, regarding board structure, there are also interesting researchable questions about different skill sets required for directors at different levels, and the critical issue of the allocation of the family's human capital across governance roles in these organizational hierarchies. Is it beneficial for family members to follow a maturational progression from divisional board to operating company board to holding company board? Does it serve the family's interest for that to be an automatic sequence based on age or years of service, without consideration of competencies? What about branch representation on boards – is branch equality more relevant, or more tenacious, at one level than another, and with what consequence for both the financial and interpersonal well-being of the extended family? To date there is no broad-sample empirical data reported in the literature about the structure, function, or impact of these networks of boards in the increasingly complex structures of family-controlled enterprises.

### ***Board Process***

The literature on boards has been dominated by studies of board structure and demographics, with much less attention to board process and functioning (Forbes and Milliken, 1999; Ricart et al., 1999; Carver and Oliver, 2002). Zahra and Pearce in their excellent literature review conclude:

There is a wide gap between the normative literature's recognition of these board roles and empirical documentation of the extent to which each is performed in reality ... There are countless lists of what boards should do. Yet, evidence on what boards actually do is not well documented. (Zahra and Pearce, 1989: 304, 325)

Some critics argue that, regardless of their makeup, boards are ill-equipped to

accomplish the governance tasks that have been assigned to them, because of lack of time (corporate boards meet an average of 18 hours per year), lack of specific information (due to sheer volume and to willful withholding by managers), and lack of the full range of skills that are required (Eisenberg, 1976; Shleifer and Vishny, 1997; Baird and Rasmussen, 2007). It has been suggested that the gap between implementation and effective performance is even larger in family firms than in corporations in general, as the owners' ambivalence about board-dominated governance in general leads them to create boards and then ignore or circumvent them (Corbetta et al., 2002).

Forbes and Milliken studied boards as decision-making groups. They express a general negative view of the potential for boards, describing them as large, elite, and episodic decision-making groups – the kind of groups particularly vulnerable to ‘process losses ... It is often difficult for the board to do these [control and service tasks], ... and on many boards the quantity and quality of substantive interaction are, in fact, minimal’ (1999: 490). They posited that board functioning depends both on board demographics and on board processes such as conflict management, norms on levels of effort, and level of cohesiveness on the board. They offer a set of testable hypotheses about the direct and indirect impact of board process on firm performance. James (1999a) discusses the purposes and constraints on reciprocal relationships in governance, comparing family-based informal ties with formal contractual relationships. He generates hypotheses about the conditions that make one or the other more appropriate and effective, particularly in the extended time horizon of family continuity (James, 1999b). Neither set of hypotheses has been tested.

The interpersonal process in family business boards in particular has generated a very small literature, despite the opportunity to test many family dynamics models and theories in the working context of business governance (e.g., family lifecycle models, Bowenian theory, structural family analysis,

psychodynamic theories). Johnson (2004) presents a conceptual analysis of a case study, but few other articles go beyond pure description, with an emphasis on the drama of conflict. There is to date no significant empirical study relating board process (task clarity, conflict management, team development, leadership style, generational and branch collaboration and competition) to governance effectiveness (financial oversight, strategy formation and implementation, succession planning) in family companies.

### ***Board Tasks of Special Importance in Family Business Governance***

One of the board's tasks that has special meaning in family companies is determining appropriate distributions to owners (Easterbrook, 1984; Farinha, 2003). Distributions are an important governance responsibility in all corporations, affecting capital-raising and shareholder behavior in general, but in family-owned companies they take on special financial, lifestyle, and symbolic importance. Setting dividends serves the purpose of maintaining investor commitment and defusing anxiety about insider expropriation, even though in economic terms dividends are often a low-efficiency method for providing return on investment, particularly when they are paired with raising capital through debt (Shleifer and Vishny, 1986; Setia-Atmaja et al., 2009; Yoshikawa and Rasheed, 2010).

Some agency theorists argue that one of the purposes of dividends is to reduce the amount of free cash under the control of managers, in order to reduce Type 1 (owner-manager) agency risks and costs (Gugler, 2003). It is also hypothesized that dividends reduce Type 2 (owner-owner) agency costs by ‘leveling the playing field’ between insider shareholders (who may have a number of different financial prerequisites and benefits that are not available to minority and non-managerial owners) and the shareholder group at large (Faccio et al., 2001; Setia-Atmaja et al., 2009: 864). Given the importance of financial rewards, it is

surprising that there is not much literature on the particular meaning of dividends in family companies, particularly the impact of percent ownership, generation in control, family branch involvement in management, geography, and liquidity needs of the family members. There is also no empirical research exploring whether or not there are typically different levels of dividends between wholly-owned or closely-held family companies and family-controlled publicly-traded companies.

A second board governance task of particular importance to family businesses is succession planning. There is an extensive family business literature on succession planning; in fact, it is the most written-about topic in the field (Sharma et al., 1997; Chrisman et al., 2003). However, most of that research is on development and selection procedures, and the incumbent-successor relationship. Only a small number of studies address the governance aspects of succession: the organizational location of control over the succession process, the role of the board, and the performance outcomes of different succession procedures (Handler, 1994). A paper by Phan et al. (2005) offers an excellent review of the governance dynamics in succession planning. They find only one empirical study of 'the link between succession and firm performance'. That study (Morris, 1997) found that while the succession process can be enhanced through successor preparation, clarity on the decision-making procedures, and open communication, the relationship between the process and firm performance was mixed. Phan also found a negative correlation between the stakeholder satisfaction with the succession plan, and revenue growth; that is, the more the family liked the succession process and outcome, the less well the company performed after the transition. This is a provocative early finding on a very specific governance-succession dynamic, representing the great opportunity for interesting research on this topic.

In summary, there is no area of family business research more promising or consequential than empirical investigations of the

governance performance of boards of directors in family-controlled companies. The descriptive practitioner literature is extensive, but outcome research is scarce. Huse (2000) identifies four seminal review papers on board performance and impact (not specifically on family company boards, but on SME boards, which overlaps significantly but not completely with the family-controlled territory): Zahra and Pearce (1989), Pettigrew (1992), Johnson et al. (1996), and Forbes and Milliken (1999). All four reviews suggest detailed and well-considered research agendas. More recent review articles have continued the call (Daily et al., 2003; Uhlaner et al., 2007). Most of the authors offer theoretical models or extensions of classical theory such as agency, stewardship, stakeholder analysis, behavioral economics, and all end their presentations of hypotheses and propositions with a call for empirical research. It is time for the field to catch up.

### ***Other Mechanisms of Governance in the Ownership and Business Circles***

In publicly-traded companies, families have other techniques in addition to board membership to exercise ownership control. Research on these ownership features has for the most part not been reported in the family business literature, even though the research samples heavily represent family-controlled, publicly-traded companies. We are including these ownership vehicles and processes in this review of the research on governance implementation, because they have a major impact on governance and are particularly important in family-controlled businesses.

### ***Blockholding***

This term refers to the concentration of ownership in the hands of individuals and voting blocks. The general rule is that any shareholder who owns directly or controls 5 per cent or more of the voting shares of a corporation is a 'blockholder'. This ownership concentration is the classic characteristic of

family-controlled firms. In the general organizational literature, there are many warnings that this kind of concentrated ownership is a threat to rational governance, but in the growing number of published studies on the impact of organizational blockholders, the results are unremarkable. For example, Bozek and Laurin (2008) found that firm performance may be negatively affected when a blockholder has the incentive and opportunity to expropriate resources from minority shareholders, but that special voting rights, as in many family firms, does not itself lead to poorer performance. La Porta and colleagues (La Porta et al., 1999, 2000) analyze large samples of international data on ownership dispersal, generally finding that the weak regulatory and judicial conditions that exist in most non-US economies favor family consolidation of governance authority.<sup>3</sup> A fair summary of this literature would be that there is no strong evidence of a general detrimental impact of blockholding (Holderness, 2003; Ben-Amar and Andre, 2006), particularly in economies like the USA where there are strong legal and normative protections for the rights of minority shareholders (Burkart et al., 2003). Nevertheless, there is a need for more study of the power dynamics among large and small blockholders in family firms (Jara-Bertin et al., 2008), and in particular the governance consequences of various representation solutions.

### *Dual stock class systems*

This is the second control mechanism often used by families at the point when they seek outside capital, and transition from a privately held to a traded company. In these companies one class of stock, widely traded or at least transferable, holds the majority of the equity of the firm; a second class of stock, very closely held (in these cases most often within the family, or even in one sector or generation of the family) controls the governance (voting) rights (Masulis et al., 2008). The most common ratio is 1:10; that is, each supershare carries 10 votes (Gompers et al.,

2007). It is estimated that 5–8 per cent of US publicly-traded corporations have more than one class of common stock. Economists who study corporate finance have suggested a negative impact of supershares on the ability to attract investment capital, and hypothesized Type II agency costs of expropriation of minority shareholder rights and benefits by the controlling elite (Harris and Raviv, 1988; Bebchuk et al., 1999; Bozek and Laurin, 2008). But other studies have found no overall detrimental effect in family companies (Grossman and Hart, 1988; Barontini and Caprio, 2005; Villalonga and Amit, 2008). The consensus is that dual-class stock structures are very effective at warding off potential hostile takeovers, and while they definitely carry some cost in the capital markets, that is often seen as worth it to insiders (Gompers et al., 2007). DeMott (2008) suggests that some wealthy owners will gladly sacrifice a marginal portion of share value to secure continued control. Nevertheless, there are situations where single-class, one-share-one-vote rules appear to lead to better choices and more merit-based decisions, particularly when assessing the performance of managers (Harris and Raviv, 1988). Studies on the impact of dual-classes of stock on generational dynamics among family branches, board performance, and succession planning in family firms has not been reported.

### *Chair/CEO role duality*

One aspect of corporate structure that has generated some empirical research, concerns the advantages or disadvantages of the same individual serving as board Chair and CEO (duality). The US tradition has been to emphasize efficiency and alignment, leading to more frequent duality. In Europe and the old British Commonwealth, with a stronger tradition of checks and balances, the roles are rarely combined. But the situation may be different in family firms. Bartholomeusz and Tanewski (2006), for example, found that family firms in an Australian sample were four times more likely than non-family public firms to have one individual as CEO and

Chair; Navarro and Ansón (2009) found that 55 per cent of their sample of Spanish family businesses had one person serving in both roles. Kor (2006) found a similar percentage in Asian family firms.

For publicly-traded corporations in general, there are numerous studies testing the impact of duality or separation of the CEO and Chair roles on a number of organizational outcomes: performance, operations, strategy, conflict, liquidity, cost of capital, reputation in the market, and human resource management. However, as in the other topics of governance assessment, no conclusion seems to be very strongly supported. The trend in the USA over the past two decades has clearly been toward separation of the roles, as endorsed by the Sarbanes–Oxley requirements for publicly-traded companies (Braun and Sharma, 2007). However, there are a growing number of studies challenging the empirical justification for opposing duality in family firms (Boyd, 1995; Baliga et al., 1996; Coles et al., 2001; Daily et al., 2003; Kor, 2006; Braun and Sharma, 2007). For example, Braun and Latham (2009) found that in a recession, dual leadership companies recovered faster. Daily and Dollinger's early work (1992) on owner-managed and professionally-managed family companies found a small, non-significant advantage for duality. Westphal (1999) presents some interesting findings that even when the roles are split, strong social ties between CEOs and directors can actually improve board input in strategic decision-making, without an accompanying loss in board oversight. In contrast, there is a small literature on the entrenchment of owner-family CEOs in the face of poor performance. Hillier and McColgan (2004, 2009), for example, find that family CEOs are less likely to be fired after business downturns than non-family CEOs, independent of the CEO's personal shareholding. In addition, they report in a sample of UK listed companies (50 per cent with CEO/Chair duality) that stock prices, sales growth, and employment all climb following the departure of a family CEO, if the

successor is not a family member (see also Pérez-González, 2001). It may be that, in good times, duality fosters efficiency and lowers agency costs, whereas in bad times, it insulates poor executive performance and slows needed change. There is clearly a need for more specific research on duality in family companies that takes into account industry, generation of the leader, board membership and activity, and capital structure.

### *Shareholder agreements*

Shareholder agreements have been traditionally discussed in the literature as part of the legal and financial infrastructure of the business, but not as a governance tool. They are most often drafted to control the transfer of voting shares, in order to restrict dispersal, to retain desired balance among family branches through a sequence of rights of refusal for tendered shares, and/or to specify the process for valuation in an effort to reduce conflict in within-family transfers. The governance implications of these agreements are becoming better understood, alongside their tax and financial consequences (McCahery and Vermeulen, 2006), but the core governance questions have not yet been addressed. For example, what is the link between the terms of the share-transfer provisions and the engagement of branches in the succession process? Do liquidity options available to minority family shareholders affect the engagement of family members and branches in governance, and if so, with what consequences for process (board-manager cooperation or conflict) and outcomes (firm performance)? What difference does it make to governance if in-laws are permitted to be owners, either through inheritance, gift, or divorce?

A special subcategory of shareholder agreements with particular relevance to family companies is prenuptial agreements. Like all forms of shareholder agreement, these are designed in part to control the dispersal of ownership shares, in this case as a result of (usually later-generation) marriage. Once again, there is a fairly broad descriptive literature about prenuptial agreements (Estess,

1996), and some informal literature by legal and other advisors either advocating or opposing them in principle (Griffiths, 2011), but no systematic empirical research on their impact on governance process, firm performance, and ownership continuity, or on their effect on the process of sibling partnerships and cousin consortiums (for example, are talented and appropriate in-laws still eligible for board service if a prenuptial prohibits them from inheriting shares, and if so, are they entitled to distributions that may be available to other directors?).

### *Shareholder assemblies*

The shareholder assembly is typically described as an expansion of the company's annual meeting, a standard in corporate governance. Well-designed shareholder assemblies are usually organized so that owners hear from business leaders about company performance, interact with the board of directors, and ratify (sometimes with discussion or even debate) the overall strategy and financial plans of company leadership. The shareholder assembly also typically elects the family directors.

Family business advisors have routinely advocated convening such meetings as high-involvement, face-to-face events, rather than relying on the proxy-based rituals that are common in traditional public companies. Consultants have written about the benefits of integrating geographically-dispersed family branches; highlighting company accomplishments in an effort to sustain long-term financial commitment; motivating potential next-generation members to be willing to participate in governance by filling family-designated seats on boards, councils, and committees; demonstrating family engagement to employees, managers, outside directors, and current and potential investors; and explaining or justifying decisions about distributions (Elstrodt, 2003; Poza, 2008). However, the impact of the design, attendance, and agenda of shareholder assemblies on the board and managerial behavior that follows, on relationships among shareholders, or on company

performance in family firms remains to be studied.

Sometimes in the descriptive literature and in practice, shareholder assemblies are not clearly distinguished from family assemblies, which appropriately belong in a different circle with different membership, tasks, and sources of legitimacy. In first-generation controlling owner businesses, there may be no practical difference. However, as the company grows and there are both owners and non-owners in the expanding family, the distinction has important governance implications. For example, especially in families who have a newly formalized governance structure, the shareholder assembly may elect the family council, which may be a practical convenience but actually is not a shareholder responsibility. Alternatively, sometimes family assemblies take it upon themselves to select family directors, also a blurring of the circles unless the shareholders have formally delegated that task to the council. In either direction, this crossover can be a transitional step, when the family is too large for all members to participate actively in governance, but not large enough to support separate gatherings of current shareholders and the extended family. This illustrates a core gap in the governance implementation literature. Research on the optimal timing of a separation of ownership and family governance, and the performance and continuity consequences of being either 'too early' or 'too late', would be a significant contribution to the literature.

### *Trusts, private trust companies, estate planning, and other wealth transfer structures and mechanisms*

Even further from the mainstream of governance research are the systems that families put in place to preserve and transfer wealth. These structures are discussed in the legal, financial, and business literature as financial entities, but they also have serious governance implications, both obvious and hidden. The use of trusts as estate planning tools, primarily to shield large inheritances from

taxes, exploded in the second half of the 20th century. As state and federal laws permitted and encouraged a wide range of trust structures, clients turned to their legal advisors to suggest best practices. Hughes (2004) was one of the first voices to point out that the criteria that attorneys used to choose trustees and frame their roles – financial expertise, credibility, and dependability – were ignoring a critical part of the role. Trustees are governors. During the settlor's lifetime, they have ready access to his/her judgment and priorities. But what about subsequently? Trustees fulfill their fiduciary responsibility to the beneficiaries by making critical investment choices, and in many cases those choices have profound impact on strategy, financial structure and risk profiles, and viability of the companies – which often come to be owned not by the family descendants of founders, but by the trusts themselves. Some of the newer structures, such as private trust companies, may add even further to the governance complexity.

Professionals have begun to think and write more about the governance aspects of wealth transfer in families. However, a significant, formal research literature has yet to emerge testing the effectiveness of various solutions, such as the impact of the particular kind of trust (for example, revocable, irrevocable, GRATs (Grantor Retained Annuity Trust), GRITs (Grantor Retained Income Trust), generation-skipping, beneficiary-controlled) on performance in the owned companies. This is a great opportunity for legal scholars and family-business researchers to collaborate on investigating the consequences beyond tax minimization of trust design: for example, the policies for the selection of initial and successor trustees, the trustee-director relationship, the role and membership of private trust company boards, differences in the behavior of successor generations depending on whether they are outright inheriting owners or trust beneficiaries, consequences of the age at which the beneficiary has access to trust capital, and the impact on governance and strategy of different kinds of trustees (such as

institutional trustees, family trustees, and private trust companies). The number of significant family-controlled enterprises that will become trust-controlled in the coming decades greatly increases the urgency of generating good data and analyses as soon as possible.

### ***Summary of Governance Implementation in the Ownership and Business Circles***

A very high proportion of the published literature on governance concerns boards of directors. The practice literature is strongly supportive of independent boards for family enterprise. The research literature lags behind (true for non-family businesses as well). Correlational data on the relationship between board structure and firm performance is beginning to accumulate; data on board process is still rare.

We briefly summarized the literature on six other governance topics in the ownership and business circles that have particular importance for family enterprises: block-holding, dual class stock systems, CEO/Chair duality, shareholder agreements, shareholder assemblies, and trusts. For all of these topics, there is some research on their design and operation in corporations in general. What remains to be developed is a broad literature on their particular implementation in family owned and controlled companies, and the integration of financial, legal, business, and family variables in assessing their impact on governance and continuity in family enterprise.

### **GOVERNANCE IN THE FAMILY CIRCLE**

We are stretching the traditional definition of governance when we include the family circle, because there are no 'owners' in a family. Nevertheless, families need governing as well – not only in the sense that all human systems may benefit from leadership and structure, but because business-owing

families have organizational work to do *as families*, and their ability to do that work efficiently and effectively has material consequence for business and financial operations, and for the preservation of family wealth.

However, we are not proposing that all aspects of family process are usefully called governance. There is a difference between family relationships, harmony, or communication, and governance. Family governance is specifically concerned with enterprise goals. We consider the family to be engaged in governance only when they are attending to the financial and operational interdependence of family members in their businesses, foundations, offices, investment portfolios, and assets held in common. This distinction is important because it provides the justification for formalizing family governance, while freeing the family to think about its organizational control functions separately from its network of personal relationships.

Governance in the family circle, as in the business and ownership, is enacted through one or more organizational settings and procedures. We will review the literature on implementation of governance in family councils, family assemblies, family mission statements, family offices, and family foundations.

### ***The Family Council***

The family council is the board of directors for the family circle (Poza, 2009). It can be an all-inclusive, self-appointed, or elected work-group of family members, whose main tasks are to make decisions about the business of the family and to educate families about the enterprise (Lansberg, 1999; Dickstein, 2003; Jaffe, 2005; Goldbart and DiFuria, 2009). Gersick et al. define the family council as ‘a group who periodically come together to discuss issues arising from their family’s involvement with a business. The fundamental purpose of a family council is to provide a forum in which family members can articulate their values, needs, and expectations

vis-à-vis the company and develop policies that safeguard the long-term interests of the family’ (1997: 237).

Like boards of directors, family councils have been very widely advocated by family business advisors for decades (Ward, 1987; Lansberg, 1988, 1999, 2007; Herz-Brown, 1993; Aronoff and Ward, 1996; Gersick et al., 1997; Jaffe et al., 1998; BDO Center for Family Business, 2004; Jaffe, 2005; De Visscher, reported in Cruz, 2008; Poza, 2008, 2009; Parada et al., 2010). *Family Business Magazine* archives include almost 200 articles describing family councils. Most of the professional literature focuses on the general benefit of the council for both the family and the firm (Gray, 2009), particularly in later stages of family firm development (sibling partnership and cousin consortiums) (Lansberg, 2007; Moore and Juenemann, 2008). Advocated functions of the family council include:

- forging family consensus, and counteracting declining family bonds and low identification with the firm, as families grow and spontaneous social contacts among family members decrease (Kets de Vries, 1993; Mustakallio et al., 2002);
- articulating a family strategy for business and wealth management (Goldbart and DiFuria, 2009), including planning, rule setting, and collaborative asset allocation, which are ‘not natural activities for families’ (Dickstein, 2003);
- limiting family conflicts that could negatively affect the business (Benson et al., 1990; McManus, 1990);
- supporting succession planning (Handler, 1994; Leon-Guerrero et al., 1998; Lansberg, 1999), particularly in facilitating the family’s exploration of their ‘collective dream of continuity’ (Lansberg, 1997), and in conveying a policy-driven, stewardship culture and enthusiasm for the business (Aronoff and Ward, 1996);
- educating and welcoming younger generations (Lansberg, 2007; Poza, 2009), as ‘a forum for lifelong learning’ (Aronoff and Ward, 1996: 282).

Many articles include case stories. For example, Lamp presented the case of the first six years of the Eddy Family Council. The Eddy Family framed the role of the Family Council

as the caretaker of ‘investors’ relations’. They believe the family council has ‘clearly strengthened the business ... and the family’ (2007: 5). The author concludes that the critical conditions for the family council to accomplish its tasks are education and socialization of new family council members, and an independent budget for funding its activities. Daugherty (2009) illustrates a case of a family council that led a transition in both the management and ownership of a family firm. This case portrays the governance functions of the council, fostering and enhancing ties among family members, allowing it to frame the policies of restructuring and redesign.

Nevertheless, after 25 years of both family firm research and extensive consulting interventions in business families, there is essentially no evaluative outcome research on family councils.<sup>4</sup> Many articles propose roles for the family council in key governance functions, and may provide case examples, but they do not present aggregate data on the councils’ implementation or performance. As a result, there is no consensus as to the design details: the most effective size, composition, frequency of meetings, election process, roles, or specific tasks of the family council. And, most importantly, there is no longitudinal, controlled research to actually test the effectiveness of family councils at achieving their objectives.

Looking forward, a first step might be the creation of typologies, which will allow testing the impact of the different legal, financial, and organizational forms that family councils take. The interesting work will be in the details: Who pays for them? How are their budgets managed? Where does the membership come from – election, appointment, volunteerism, or some other process? For elected councils, are they at large or representative, and if the latter, representing what constituencies? What tasks tend to lead to experiences of success for council members, and what other tasks are experienced as frustrating or failed efforts?

Second, research on the impact on council structure and process of specific family

characteristics such as marital stability, variance in number of offspring across generations and branches, emigration and geographic mobility, traditions of inheritance, and gender dynamics, would add to our understanding of their governance functions. Researchers can also explore the impact of culture, geography, and ethnicity on council design (for example, Brenes et al. (2011) found that Latin American business families use Family Councils as communication facilitators, not governance tools).

Then, the most pressing need is for basic performance metrics for family councils. We need to build a body of research on the four main outcomes most commonly sought by family councils: (1) finding the family’s ‘common ground’ on business values, business culture, philanthropy, and wealth management; (2) educating family members, particularly the rising generations, about the family enterprise; (3) facilitating communication between the extended family and the leaders in the ownership and business circles; and, as a result of the other three tasks, (4) enhancing the family’s commitment to the enterprise. Impact studies are always difficult, requiring inspired selection of dependent measures, and most often multi-method longitudinal data gathering. But considering the extensive endorsement of this governance solution, it is clearly one of the topics most deserving of the effort.

### ***Other Family Circle Governance Structures***

#### ***Family assemblies***

Family assemblies are the periodic (typically annual) gathering of an extended family. These events often include formal meetings where information is shared about investments and operating companies, speakers and facilitated discussions, and other recreational activities that are common in family reunions. Ward argues that ‘the best practice’ that is most important to long-term family business growth is the process of holding family meetings’ (1997: 335). Other advisors

suggest that family meetings can help families achieve consensus regarding family mission, family values, and the *raison d'être* for the sustainability of the family business over generations (Vilaseca, 2002; Jaffe and Lane, 2004; Montemerlo, 2005; Gimeno et al., 2006). Family Assemblies are often recommended as particularly useful in large family groups with broad geographic dispersal, highly diffused ownership, and a desire to sustain economic interdependence through subsequent cousin generations.

It is a reasonable hypothesis that shared experiences with the extended family will facilitate governance implementation: selection of directors, trustee-beneficiary relationships, capital retention, and broad support for investment and distribution policies. However, as for family councils, the overall impact of family assemblies, as well as specific operational questions such as the differentiation between family assemblies and shareholder assemblies, and the most effective frequency, agenda, and choices about who gets invited, are interesting and as yet unexplored research topics.

#### *Family constitutions, protocols, and mission statements*

Many advisors work with families on creating mission statements or family constitutions and protocols, beyond the shareholder agreements that govern ownership. The recent increase in interest in family constitutions may be in response to the maturation of a large cohort of entrepreneurial post-World War II nuclear families through sibling and multi-generational partnerships to complex, geographically-dispersed family networks (Gersick, 2002a, 2002b). In addition, popular culture presents young adults in these extended families with an unlimited array of alternative value systems and lifestyles. Senior generation leaders who are concerned about the continuity of the enterprise in this 'competitive market' for the family's attention, may use a constitution to articulate their values and culture, to formalize the 'rules of engagement', and to emphasize the obligations and

requirements for participation in the benefits of future ownership.

Family constitutions have been seen as a nice-to-have accessory in the USA, and more of a first-choice governance option in Latin America and parts of Europe. Brenes et al. (2011) found them to be very popular in concept in Latin America, although often not implemented or adhered to. In the USA, they received a flurry of attention after Covey identified mission statements as a habit of successful individuals and families (Covey, 1989; McClain, 2006).

So far the literature on family mission statements and constitutions is primarily descriptive; the value is seen as self-evident by the professionals who advocate them (for example, Hauser, 2003; Coombes and Wong, 2004). Some case studies conclude a benefit of formal statements (Lewine, 2006). Other authors discuss the value of protocols to promote particular outcomes, such as 'fair process' (Van der Heyden et al., 2005; Blondel et al., 2001), or the avoidance of later problems such as 'reputation exposure, wealth entropy, family division and legal costs' (Griffiths, 2011). We could not identify any formal study aggregating governance provisions from a large sample of family constitutions, or assessing the impact or specific benefit of family mission statements on governance or family firm performance.

#### *Family offices*

The term 'family office' is used to cover a very wide range of service centers, investment oversight functions, back office operations, and other support services for family members (Murray et al., 2002). Some family offices are closely linked to operating businesses, using company staff to provide financial and legal support for family members. Other family offices are actually just one individual or a collection of independent contractors from various professions, designed primarily to enhance coordination among investment, legal, insurance, and tax advisors. However, a growing number of families have created something much more

formal: an independent partnership or corporation with a significant budget and staff who operate the business of the overseeing the family's private wealth. Professionals estimate that there are 3,000 family offices of this type in the USA, and the number is growing annually. The concept of governance is clearly relevant for these organizations.

Once again, most of the literature on family office governance is advice-giving from experienced professionals, and case examples (for example, Hauser, 2001; Families in Business, 2003 [brief articles by Maslinki, Youngman, Stern, Beyer and Brown, Patterson, and Ward]; Jaffe and Lane, 2004; Griffiths, 2011). Lansky and Pendergast (2010) offer some interesting observations that generate testable research hypotheses, such as that wealth management does not provide the same 'glue' for extended families as governing an operating company, that individual rights are more relevant in family office governance, and that the wide range of services make family office governance more complicated. Additional questions that are raised in case studies include: What constituencies have a legitimate right to governance authority in a family office: investor-funders, clients for services, or the entire family? What governance mechanisms work to integrate and balance the goals of these stakeholders? Can family councils effectively act as boards of directors for family offices, and if not, what structure is most effective?

The family office industry has matured well beyond its former preoccupation with service menus and the selection of money managers, and some aggregate data are emerging. The Wharton Global Family Alliance publishes results of their research program on family offices, concluding that 'family governance is key' (Amit et al., 2008: 31; see also Knowledge at Wharton, 2008; Amit and Liechtenstein, 2009). Their survey and interview data summarize both operational practices and governance structures.

However, family office research highlights one of the special features of the family business field: a significant amount of the

research that is conducted is proprietary, available only to clients or members and subscribers of private associations. For example, the Family Office Exchange ([www.familyoffice.com](http://www.familyoffice.com)) publishes a number of survey reports, case studies, and papers by practitioners about family offices, but they are not published in the academic literature. They are available to fee-paying members or, in some cases, for purchase by the public. This blending of fee-for-service products with knowledge generation is complicated for the field. It is not peer reviewed like journal articles, but the work may represent the insightful conclusions of experienced professionals. For example, FOX publishes *50 Best Practices for an Enduring Family Enterprise*, described as 'a comprehensive guide to the proven strategies and approaches family offices have used to improve nearly all aspects of their operations ... It highlights proven governance and operational practices your management team and governing board can use' (Family Office Exchange, September 2008: list price, \$4,500); or *How Wealth Owners Measure Value: Evaluating the Performance of Your Wealth Advisor or Family Office* (Family Office Exchange, October 2010: list price, \$1,500). There are similar other sources. Campden ([www.campdenresearch.com](http://www.campdenresearch.com)) publishes reports such as an annual European Family Office Survey (for 2011 entitled *Beyond Uncertainty: Family Offices Adapt to Unpredictability*: price, \$3,140). The integration of valuable proprietary findings and data into the mainstream is a policy and professional challenge, and is discussed in more detail in the section on future research below.

### *Family foundations*

The research literature on family foundation governance is even more limited than the work on family businesses. There are estimated to be more than 40,000 private foundations in the USA alone, and many more donor-advised funds and corporate giving programs in family-controlled companies. The Family Foundations division of the Council on

Foundations has been that organization's fastest growing sector over the past several decades. Philanthropy in general has benefitted from an enormous increase in attention to professionalism, transparency, fiscal accountability, strategic planning, impact assessment, and all aspects of organizational functioning. However, the focus of the literature in the field has been and continues to be on program – the work of grantmaking, analogous to operations in the family business – with much less attention to governance.

An early small-sample study of family foundations (Gersick et al., 1990) proposed a set of hypotheses for further study, but until very recently there had been few empirical studies of governance structure in family philanthropy. The publications that do address governance are almost exclusively case stories and best-practice suggestions written by experienced family participants in philanthropy or by professional advisors to foundations from a variety of disciplines (Esposito, 2002; Angus, 2004), or guides for regulation-compliant governance, written primarily by attorneys (McCoy and Miree, 2010). Examples of more formal research on family foundation governance include one study sponsored by the National Center for Family Philanthropy (Gersick et al., 2004), another by the Foundation Governance Project of the Center for Effective Philanthropy (CEP, 2004, 2005), and a recent study on the effects of governance on grantmaking strategy by Lungeanu and Ward (2012). The Gersick et al. (2004) study of governance and continuity in multi-generational family foundations found a range of governance practices that evolved through successor generations, but in general an under-investment in board structure and development, preparation of rising generations, and operational and financial oversight, when compared with grantmaking activities. The CEP study is straightforward in acknowledging that, 'given that there is no universal, comparable performance measure for foundations – no analog to a company's stock price or profitability, for example – it is difficult to connect governance practices to foundation performance' (Center

for Effective Philanthropy, 2005: 2). As a 'proxy' for direct measures, they rely on CEO and trustee perceptions of foundation board effectiveness.

Angus and Herz-Brown (2007) found in an online-based survey that most families are 'informal' in their governance structure and processes for philanthropy, and have not specifically discussed or chosen governance procedures. Nevertheless, most philanthropy consultants observe that family philanthropy has been dramatically professionalized in recent decades, and data on governance needs to catch up. Most of the governance implementation issues described earlier for the business circle are relevant for family foundations, in particular: (a) the correlates of governance behavior with foundation performance; and (b) the differentiation and integration of the different vehicles for family philanthropy, including corporate philanthropy in family-owned firms, family foundations, and personal and branch giving within philanthropic families. How are each of the streams governed to collectively reflect the family's philanthropic values, and how are the family's human capital resources most optimally allocated among them? The professional literature estimates that up to \$6 trillion will be transferred in the United States through philanthropy over the next few decades (Havens and Schervish, 1999; Journal of Gift Planning, 2006). The need for more quality research on governance in this sector is urgent.

### ***Summary: Governance Implementation in the Family Circle***

There is a small but developing literature investigating more differentiated family governance roles across stages of development (Leon-Guerrero et al., 1998). In particular, governance can act as a counterbalance to the negative effects of increasing family and ownership complexity (Jaffe and Lane, 2004) as the ownership governance system evolves from a controlling owner to a sibling partnership and further to a cousin consortium

(Gersick et al., 1997; Lansberg, 1999; Steier, 2001). Some research addresses the consequences of increasing family complexity: decreases in entrepreneurship, capability development, business growth and family firm financial performance (Lambrecht and Lievens, 2008); a decline of family satisfaction regarding family-company relationships (Gimeno et al., 2006); a decrease in family interrelation and cohesiveness due to increasing differences in personal goals, values, and commitment to the business (Ward, 1997); and a rise in the agency cost of conflict (Schulze et al., 2001). These authors and others (Montemerlo, 2005; Vilaseca, 2002) conclude that family governance can diminish the de-stabilizing pressure of complexity and growth, and enhance the owing-family unity and commitment to the business by formalizing family-firm relationships and regulating the role of the family in the business.

But this optimistic hypothesis, endorsed in practice by most family business consultants, needs empirical testing (Astrachan, 2009). Future research can articulate the criteria that distinguish effective family governance from ineffective efforts, and to apply those criteria to both case examples and large samples to assess outcomes. This is a different task from the ownership and business governance circles, because in those cases there is an existing full literature on corporate governance, both theory and practice. The work in those arenas is to adapt, refine, and apply those theories and general hypotheses to family owned and controlled firms. In contrast, in the family circle, while there is plenty of work in print on family dynamics, relationships, roles, communication, and conflict, there is very little organizational literature on how those dynamics play out in family governance. The field is wide open for new empirical studies.

### ***Summary: A Research Agenda for Family Enterprise Governance***

New research over the past several decades on corporate governance in general, and the increasingly sophisticated studies on family

business, are the foundation for a major leap forward in governance implementation research. The work of practitioners with family councils, boards of directors, family offices, succession planning, strategy, and corporate finance, has raised a clear and compelling set of hypotheses that need testing. In addition, leaders in the field are calling for research with practical implications – relevant works that reduce the knowing–doing gap (Sharma, 2010). New web-based techniques for broad sample data gathering are widely available. A very large population of senior and junior generation family leaders have participated in executive education, joined family business forums, and been introduced to scholarship and theory in graduate programs. They understand the value of research, and are eager for normative data. There is also a growing cadre of students at all levels of graduate and professional education who are more aware of family enterprise, and looking for interesting and consequential research topics. The opportunity is there to return to the theories and models that have been presented by academics, and the prescriptions and experience of consultants, and to use rigorous sampling, data-gathering, and data-analytic tools to look at what is actually in place in family business governance and how it is working. We do have some exemplary beginnings. The 2012 FFI Best Quantitative Dissertation award was for Memili's work in just this area: an extensive investigation of the impact of governance mechanisms on firm performance, and the link between family involvement, corporate governance provisions, and profitability in publicly-traded family firms (Memili, 2011). Her complex analysis is a major contribution, and should be emulated.

In each of the sections above, on business, ownership, and family governance, we have summarized ideas for further research that are suggested in articles in the existing literature. In addition to these specific topics, there are a few major themes in research on governance implementation

that deserve attention from multiple studies and approaches.

- 1 *The development of governance through stages of formalization and growth.* As the level of expertise required to govern effectively increases, and the percentage of family members in each generation who can actively participate in corporate governance goes down, roles for family members must become differentiated. There is a pressing need for more research on the ways families govern over time (for example, how families evolve from selecting family directors as a symbolic or representational right of shareholding, toward choosing individuals who are prepared to be value-adding contributors to the bottom-line performance of the enterprise). There is also an immediate need for research on the governance role of non-director family owners, particularly in family businesses owned by second, third, and later generations.
- 2 After 30 years of intensive advice, education, and encouragement for governance implementation in family firms, how are families dealing with 'governance fatigue', later-generation leadership, and the threat of inadequate talent or interest in governance? Legal and financial advisors have done a powerful job in recent decades helping families secure their financial resources for current and future generations. Their success takes some of the pressure off rising generations to commit themselves to family governance, especially the most talented, who have other attractive and lucrative options. The family business is no longer the only, or even necessarily the best, game in town as it was for the founding generations. What rewards will be required to sustain governance implementation in the future?
- 3 *More cross-cultural and international research.* The bulk of research on agency theory and corporate governance has been conducted on the largest US corporations. Now there is a growing body of studies from other countries, many of which highlight the dominant role of family enterprise in their economies.<sup>5</sup> Some of the articles point out particular features of the legal system, capital market, or cultural traditions that affect governance structures in different economies (for example, the two-tiered board system in Europe, discussed in Huse, 1998; Licht et al., 2001, 2007; Tabalujan, 2002; Pieper, 2003; Filatochev et al., 2005). Others test key hypotheses in new settings, such as the relationship between family

control and organization performance in Europe (Barontini and Caprio, 2005), or the effect of weak or strong legal protection for minority owners in various countries on the felt need of controlling shareholders to maintain voting control (Morck and Yeung, 2003). However, as in the US-focused writings, there is still very little empirical research on governance implementation that goes beyond case stories and general models. Many academics are calling for more focus on outcomes and for cross-cultural replication of promising research from one region to another (Uhlener et al., 2007).

- 4 *Integrating research and practice.* The combination of research and practitioner experience provides an excellent platform for the next stage of knowledge generation. This goal has been put forward by Sharma and Nordqvist (2008) in their article on value creation within family-owned business. Their study makes an elegant case for the uniqueness of family governance for each family enterprise based on the underlying values that each family holds. We suggest that researchers follow their initiative and look closely at family heterogeneity (Davis, 1982; Hollander, 1983; Ward, 1987; Lansberg, 1988), identifying the core attributes of family business and relating them to different governance structures and designs.

But the integration of formal academic research and practice reporting will not come easily. In the section above on family offices, we mentioned the extensive research on governance sponsored by professional associations. While some of their work is understandably aimed at advocating for their constituents, emphasizing accomplishments and successes rather than rigorously testing hypotheses, they also conduct studies that document the prevalence of governance structures, and in some cases the demographics, typical budgets, and activities of boards, family offices, and foundations.<sup>6</sup> Much of this research on governance implementation is in the form of case studies and aggregated experience; there is little outcome or impact research concerning governance. Nevertheless, their work provides a very promising platform for the academic researchers to build on, to the extent that it is available to them.

The association-sponsored research issue is only a special case of a more general dilemma with two parts: constraints on sharing proprietary data, and on the best methods for investigating complex phenomena. Throughout its relatively

short history, family business has been a practitioner-driven field. While the involvement of scholars from the relevant social and behavioral sciences has been accelerating, it is still primarily a guild of professionals delivering services to clients while building both a proprietary and a disseminated knowledge base. The bulk of our shared understanding at present about family enterprise governance has come from their careful observations, action research, case methods, and post-hoc analyses.

However, as in all professional fields, competitive success among providers is based in part on knowing more, and having better answers, than others. It is natural for practicing professionals to be prescriptive rather than equivocal, and there is little incentive to engage in rigorous research that would highlight variability,<sup>7</sup> or commoditize best practices. In contrast, academics have institutional and career-advancing incentives to challenge common knowledge, and a tradition that until something is true at least 95 per cent of the time it cannot be considered to be anything but chance. But they have their constraints as well. The more complicated, quantitative/qualitative designs are expensive and take too long for most academics. Longitudinal, intensive, multi-method data gathering in large samples of operating family enterprises is a dream design that will always be rare. So in a field like family business, with complex phenomena and little guiding theory, the practitioners tend to rely on untested conclusions on big questions, and the researchers focus on rigorous detail for manageable small ones. We need to find a way to capitalize on and integrate the best of both approaches.

In summary, we need more research addressed to the issues and fascinating unknowns of family enterprise governance in all three circles: the structure and process of boards; the fair, productive, and collaborative management of wealth; and the effective organization of families across time and generations. Governance implementation is a sector of our field that is hungry for well-designed studies and well-analyzed data. As we meet that need, it will help us to move beyond broadly-accepted ‘common knowledge’ about governance practice, and keep us focused on the core task at hand – discovering

what is really true so that we can intervene in ways that are truly helpful.

## NOTES

- 1 A huge body of literature has developed to explore the conditions that either create or reduce agency costs and risks. Fama and Jensen (1983) suggested that family businesses minimize agency costs, since ownership and management are unified in the same individuals, which creates a significant advantage for family companies in the marketplace. That conclusion was challenged by other researchers, who countered that while some kinds of agency costs might be ameliorated (owner-manager costs, sometimes called Type I agency costs), a different set of costs (called Type II) were much higher – the split between those owners in control (through majority holdings, executive roles, or both), and more peripheral and minority owners (Burkart et al., 2003; Morck and Yeung, 2003; Morck et al., 2005).
- 2 The assignment of the board of directors to either the ownership or the business circle is arbitrary, but it illustrates an ambiguity in the Three-Circle Model that may actually be the best evidence of that model’s conceptual usefulness. In fact, the board of directors must reside in both circles. How a board sorts out its different (and sometimes misaligned) obligations to the ownership and business circles on such issues as dividends, debt, risk, expansion, compensation, and career development for owner-employees, is exactly the kind of dilemma that the model illuminates.
- 3 There is a very large literature in corporate economics on the relationship between the level of regulatory and judicial protection of investors and the sources and cost of capital across regions and countries. This work suggests one very interesting explanation of the global prevalence and persistence of family ownership (as a capital-protection mechanism in economies with weak or unenforceable public policy), but it falls outside the domain of this chapter.
- 4 This may indicate that the professionals, associations, and scholars in the field have institutionalized the family council as a sign indicator that a family enterprise has been ‘professionalized’, without any requirement to assess its functioning or impact (Melin and Nordqvist, 2007). A recent study on family firm governance practices from an institutional theory perspective (Parada et al., 2010), pointed out the influence of collective norms, such as those that emerge in professional associations, on the establishment of formalized family governance systems. Families model other families in business in their responses to the challenges they face as family enterprises (mimetic forces), and family firm associations and professionals have identified a loosely-constructed set of best practices that are most frequently recommended to their clients (normative forces). Creating a family council is one of these practices. We agree with Parada et al. (2010) that

institutional pressures help organizations evolve, but sometimes the structures are endorsed without attention to specific content, tasks, authority, and functionality.

- 5 Exemplary articles include: Australia (Bartholomeusz and Tanewski, 2006; Setia-Atmaja et al., 2009), Europe (Corbetta and Tomaselli, 1996; Huse, 1998; Ricart et al., 1999; Klein, 2000; Gubitta and Gianecchini, 2002; Van den Bergh and Carhon, 2002; Barontini and Caprio, 2005; Bennedson et al., 2006; Voordeckers et al., 2007; Jara-Bertin et al., 2008; Sciascia and Mazzola, 2008; Navarro and Ansón, 2009; Kowalewski et al., 2010; Bettinelli, 2011), Ghana (Abor and Biekpe, 2007), Indonesia (Tabalujan, 2002), Japan (Yoshikawa and Rasheed, 2010), Latin America (Brenes et al., 2011), Lebanon (Fahed-Srieh, 2009), Malaysia (Amran and Ahmad, 2009), and Southeast Asia (Suehiro, 1993; Chang, 2003; Filatochev et al., 2005; Peng and Jiang, 2010).

As would be expected given the development of the world economy in recent decades, there is a particularly active literature about Asian family enterprise (Khan, 1999; Faccio et al., 2001; Yeh et al., 2001; Yeh and Woidtke, 2005; Lee et al., 2008; Lee and Li, 2009; Shyu and Lee, 2009), with a focus on the cultural and economic characteristics of mainland and overseas Chinese family companies (Lawton, 1996; Carney and Gedajlovic, 2001; Filatochev et al., 2005; Wu, 2006; Chen and Hsu, 2009; Lansberg and Gersick, 2009).

- 6 For example:

- The National Association of Corporate Directors (NACD) publishes white papers and booklet series on leadership and governance, addressing specific challenges facing boards and directors from both public corporations and private and family owned business.
- The *FFI Practitioner*, an electronic journal edited by the Family Firm Institute, provides practical advice on governance practices and professional interventions, with a cross-disciplinary perspective (it is published in both English and Spanish). Articles in the *Practitioner* have covered such topics as compensation (Schneider and Schneider, 2005), family member employment policies and procedures (Krasnow, 2005), innovation (Craig and Moores, 2009), wealth management (Greenberg, 2006), and consulting challenges (Ginsburg and Saunders, 2011).
- The Family Office Exchange (FOX) Research Studies include numerous survey and data-based analyses of family office practices and wealth management activities of its member offices and, to some extent, of the broader population. While they have focused more on services than on governance, FOX Research Studies have addressed topics such as investment risk planning and management, wealth transfer, multi-family and family office sustainability and performance, selection and oversight of professional advisors, and development of successor generations.
- In philanthropy, The Council on Foundations reports on governance and board composition in family foundations, and publishes case stories and common practice

written by participants and professionals in family philanthropy (for example, Stone, 1993). Similarly, the Association of Small Foundations publishes *The Essentials*, a quarterly publication that includes practical articles on governance practices, grant-making processes, and the management of small foundations. The National Center for Family Philanthropy (NCFP)'s newsletter, *Passages*, often presents case examples, survey results, and references to research literature. The NCFP Pursuit of Excellence Project is a specific effort to gather and disseminate implementation data on governance and operations to a broad audience of family foundations, particularly those not large enough to hire consultants and engage in their own more elaborate research and benchmarking efforts.

- 7 Researchers are happy to explain small percentages of the variance; clients expect a bit more.

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