European Foundation for the Improvement of Living and Working Conditions

Family businesses: do they perform better?

Literature review by London Economics

european monitoring centre on change

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Executive summary

This report reviews the literature related to the performance of family businesses (FBs), which will focus on two lines of discussion. The first surveys the theoretical arguments that emerge from literature discussing the key characteristics of FBs. The second examines the empirical evidence comparing performance of family businesses and non-family businesses (NFBs).

To place the analysis in context, we begin by providing a brief discussion of how best to define a family business. We note the lack of consensus in this area, particularly over the qualifying criteria that should be used, with many authors noting the complexity of the interactions between the family as an entity, individual family members and the business itself.

We develop the context further by reviewing the facts and figures on the historic and current importance of FBs in the UK economy and internationally. We find that FBs have accounted and continue to account for a large majority of businesses in many countries, including the United Kingdom (UK). However, despite this presence, several studies have questioned the longevity of FBs, as many fail to pass down successfully to second and third generations.

We next review the theoretical literature linking the key characteristics of FBs with firm performance. Four themes appear salient: ownership and control, management strategies and style, long-term view, and human resources. We review each theme in turn in relation to its potential impact on the performance of FBs and note that, overall, the literature does not yield clear and unambiguous conclusions. A summary of the potential performance enhancing and performance limiting characteristics of FBs can be seen in Table 1 below.

Table 1: Positive and negative effects of characteristics of FBs on firm performance

Performance enhancing	Performance limiting
Agency cost efficiencies – family management mitigates the principal-agent problem.	*Non-profit maximising objectives* – lower risk approach to debt leverage and company growth than NFBs.
Leadership efficiencies – improved leadership from centralised decision-making, greater flexibility and lower transaction costs.	*Differing goal prioritisation* – emphasis on non-pecuniary goals, stability and succession.
Stakeholder efficiencies – increased trust, loyalty and motivation by managers, employees and customers alike.	*Inefficient management* – desire to secure family succession may produce sub-optimal outcome versus market determined management choice.
Longer-term time-horizons on decisions relating to investment and growth. Not constrained by pressures of quarterly reporting.	*Low innovation and slow adaptation* – family members constrained by pressures to maintain traditionally successful business practices.

We then move to the second line of discussion, the empirical evidence regarding the performance of FBs. We again find that empirical studies of this nature are inconclusive, and note that this may in part be related to the many differing definitions of FBs used in the empirical studies at hand, and the use of different samples of firms in different countries and different industries over different time periods.

In light of these findings, we conclude that further work is needed if more robust results are to be found. This research must adopt a consistent framework over a sufficiently long time frame in order to assess robustly whether FBs outperform NFBs on a range of short and long-term financial and non-financial measures of performance.

Introduction

The sharp downturn in stock markets, and a general disillusion with the performance and the ethics of a number of capital markets agents have led some financial markets observers to wonder whether the business model of the family firm, which, in the heydays of the stock-market boom, had been largely written off as a relic from the past, might be a valuable model after all. Symptomatic of such new thinking is the recent article ‘A second Spring’ in the German periodical *Manager Magazin* (2002) which argued that, in ‘bad times’, family businesses are the better survivors.

Theory and practice suggest that, in family businesses, the interaction of the family, individual family members and the business itself constitutes an intricate system with important implications for the firm’s overall economic performance. The link between the family business (FB) and performance is therefore extremely complex. Yet, the literature focusing on this particular topic is relatively limited, especially the non-Anglo-Saxon literature (Allouche and Amman, 1999). In contrast, the literature on how to manage family businesses, deal with conflict within the family owning the business and how to plan a proper succession is extremely voluminous and has been the topic of many conferences and studies.

This review of the literature will examine the main schools of thought on the different nature and performance of family businesses by providing first an overview of the theoretical approaches to examining and conceptualising FBs. Next this review provides the empirical evidence comparing the economic performance of FBs and non-family businesses (NFBs).

Studies that have attempted to explain and/or quantify the performance of FBs cover a wide range of subject areas and disciplines. For example, the performance of FBs can be analysed in relation to an already large literature on ownership structure, such as the implications of corporate governance structures, or in relation to the particular systemic, psychological or economic characteristics that make FBs unique units of enterprise.

The review comprises five chapters. The first chapter presents different definitions of an FB that have been used by researchers. Of particular note is the lack of consensus in this area, particularly on the degree of family ownership required for an FB to be classified as such.

The second chapter discusses the importance of the FB as an economic unit and the role played by FBs in the aggregate economy. Again, the lack of consensus on definitions makes any international comparison difficult, but it is clear that FBs continue to play an extremely significant – and often surprisingly understated – role in many economies. Often, family firms are equated with small ‘pop and mom’ operations with no or only a few employees. While the large majority of the small firms are indeed family firms, the reach of the family firm model across the firm size spectrum is much wider. In fact, many of the largest and well-known businesses in the industrialised world are family firms.

The third chapter provides a review of the theoretical FB literature on performance related characteristics of FBs. The latter are addressed under four different key themes: ownership and control, management strategy and style, a company’s strategic long-term view, and human resources characteristics.

- The first theme relates to the wider and voluminous literature on the impact of the separation of ownership from control, one of the central characteristics of the modern corporation. With this separation comes the familiar principal-agent problem, with management and ownership suffering from possible conflicts of priorities and interests (Berle and Means, 1932). The FB potentially mitigates this problem, leading to agency efficiencies, with both management and ownership residing in the family.
- Our second theme addresses the issue of strategy and style of management. Under this heading we examine the potential performance-enhancing characteristics of increased trust, loyalty and motivation amongst FB management, and the impact of the centralised family decision-making process. These may well contribute to stakeholder and leadership efficiencies in FBs, leading to performance advantages over NFBs.
- Thirdly, we consider the arguments that FBs adopt longer-term views in their investment, growth and other strategic decisions. Indeed, some argue that the freedom from the constraints of market-based pressures and the absence of short-termist non-family managers allow FBs to achieve a better performance over the longer term.
- Finally, the fourth theme relates to the nature of human resources at FBs. A particular issue is the problem posed by potential nepotism. The desire of many FBs to secure a successful succession to the new generations of the family may cause an inefficient distribution of managerial and executive positions within the firm. Performance may therefore be weaker than if the positions were allocated on the basis of merit to the most able candidates.

We conclude the third chapter by summarizing the characteristics of FBs that are considered in the theoretical literature of FBs to be either performance enhancing or performance hindering.

Following this theoretical discussion, chapter four examines the empirical evidence on the economic performance of FBs. It should be noted that, in some cases, the outcome of an assessment of firm performance is likely to be heavily conditioned by the type of performance variables used in the study. For example, a performance assessment based on financial measures is likely to show better results for NFBs because their executive managers' remuneration frequently includes a substantial component that is linked to the firm's financial performance. However, when considering other performance measures, such as turnover or profit growth, it is less obvious that differences between FBs and NFBs should be observed.

The review of the studies that examine whether FBs and NFBs show different economic performances is divided into three parts.

- The first part focuses on the studies that compare the performance of FBs and NFBs using simple statistical measures of performance (average sales, number of employees, profit margins, growth rate of sales, etc.) without attempting to explain the causes of any observed differences.
- In the second part, we review the studies that have looked at the implications of the principal-agent problem for performance. Reflecting the conflict of interest between managers and owners in NFBs, many believe that strong shareholder control and ownership, and a better alignment of managers' and owners' interest should help contribute to better performance. We review the empirical evidence of a number of studies that focus on the link between control of ownership and economic performance.

- In the last part, we review how specific characteristics of the FBs – such as reputation, quality, and efficient recruitment – are likely to impact on different measures of economic performance.

The main conclusion of the review of the empirical literature on potential differences in performance between FBs and NFBs is that the various studies yield often contradictory results and there is no overwhelming evidence that either group systematically outperforms the other in terms of turnover or profitability.

However, with regards to the conflict of interests between managers and owners of modern corporations, the empirical evidence shows that strong controls over managerial discretion enhance firm performance. There is some lack of consensus on how this control should be exercised but studies suggest that it should be based, at least in part, on shareholder ownership. This argument would give a strategic advantage to FBs where the agency problems arising from separation between ownership and management are small or inexistent.

In the fifth chapter we review how a comprehensive and consistent cross-country study of the economic and financial performance of family businesses in Europe would significantly contribute to enhance our understanding of the advantages and disadvantages of this form of business organisation. At the present time, it is impossible to draw any firm policy conclusions as the few European studies are based on different definitions of a family business, examine the performance of FBs over different time periods and focus on different indicators of performance.

Finally in the last chapter, we summarise the key conclusions of the review of the literature.

Definition of family businesses

Family businesses (FBs) have had an important economic presence throughout history. This importance has not declined and FBs are still a dominant force in many economic activities and sectors. FBs are present in industrial sectors and service sectors, they include small and large units and they are part of the economic activity in many different countries.

A key question of interest is how an FB should be defined. Up to now a variety of definitions have been provided:

Some authors take as a criterion the level of equity held by a single family (Alcorn, 1982, Barnes and Hershon 1976, Barry 1975, Landsberg, Perrow and Roglosky, 1988).

Others identify an FB on the basis of the degree of implication of the family in the management structure (Beckhard and Dye, 1983, Keppner, 1983).

Finally, for some authors the concept of FB is related to the willingness to transmit the ownership to the next generation (Churchill and Hatten, 1987, Ward 1987), or the commitment to transgenerational wealth creation (Habbershon, Williams and MacMillan, 2001).

In recent years, multi-criteria definitions have also been proposed. For example, for Smyrnios, Romano and Tanewski (1997), a business should meet at least one of the following four criteria for it to be considered as an FB:

- More than 50% of ownership is held by a single family.
- More than 50% of ownership is held by more than one family.
- A single family group effectively controls the business.
- A majority of senior management is drawn from the same family.

Other authors (Westhead, 1997; Gallo, Tapies and Cappuyns, 2000) base the definition on the perceptions of the managers, i.e. an FB would be one in which managers perceive their firm as such.

Most recently, Colli (2002) has stressed the need for a broader definition, including all cases where the family maintains an equity stake sufficient to appoint top management and influence firm strategy, thereby limiting the choices available to non-family management.

The lack of consensus on the definition of an FB might reflect the relatively short history of FBs as a topic of research and/or the wide range of disciplines that approach the topic – the subject of FBs draws researchers from a wide range of disciplines such as economics, psychology, sociology, anthropology, education, social work, family science, etc.

However, while the precise definition varies from author to author, common to most working definitions is the understanding that the FB is a complex system of interactions between the family as an entity, individual family members, and the business itself.

Small size and family ownership are often interrelated. However, it is worth noting that, in this review of the literature, we are not only interested in the particularities of a small or medium-sized family enterprise but also in the special characteristics of large family businesses that rank among the business elite in each country. In fact, we are mostly interested in comparing the performance of those family and non-family businesses that are faced with similar problems. Thus, the vast literature comparing the performance of SMEs to that of larger firms is outside the scope of the present review.

It is also important to note that not all FBs are fully privately held. Some FBs may be listed on stock markets even though one or several families retain full control, *de jure* or *de facto*, of the business.

Facts and figures about family businesses

Before proceeding to a detailed discussion of FB performance, it is useful to review first the importance of FBs in the UK and internationally. However, as has already been noted, the lack of consensus over the appropriate definition of an FB often limits any direct comparison of many studies seeking to quantify the importance of FBs in different countries.

Two important studies assessing the international importance of FBs are those of Neubauer and Lank (1998) and Bornheim (2000). Fortunately, both use a very similar broad definition of FBs as ‘businesses in which voting control is in the hands of the family’. They can thus be combined to give a broad overview of the importance of FBs internationally.

Neubauer and Lank find that FBs account for 75% of all businesses in the United Kingdom, 70% in Portugal, 80% in Spain, 85% in Switzerland, 90% in Sweden, and 95% in Italy and the Middle East.

Bournheim finds similar results for the countries listed above and provides additional figures for Chile (90% of all businesses), Mexico (80%), the Netherlands (52%), Austria (80%) and the US (95%). From these estimates of the economic importance of FBs, it seems clear that FBs play an extremely significant – and surprisingly understated – role in many economies. Indeed, it has been claimed that FBs make up over two-thirds of all businesses worldwide and are becoming more prevalent (Harvard Business School, 2001).

It is worth repeating here that some of the largest and better known corporations are family-owned firms such as Benetton in Italy, Bertelsmann in Germany, Cadbury in the UK and Peugeot in France.

Despite the importance of FBs as a mode for organising production in many countries around the world, the survival of individual FBs is always uncertain even if, as an institution, the FB will likely remain for a long time an important feature of numerous industrial and emerging economies.

This issue of longevity of FBs is particularly interesting to examine as one of the key characteristics exhibited by many FBs is their desire to transmit control across family generations.

In this regard, it is interesting to note that one UK study (Bournemouth University Business School 1999) found that only 30% of UK FBs successfully pass into the hands of the second generation of the founding family. This figure declines markedly over subsequent generations, with only 13% of UK FBs passing successfully to the fourth generation.

Leenders and Waarts (2001) reach a similar conclusion for Europe as a whole. They find that only a third of first generation FBs successfully passes down to the second generation. The average life of the FBs appears to be relatively short with two-thirds of FBs either collapsing or being sold-off under the helm of the first generation.

Key characteristics of family businesses

The nature and structure of ownership and management in FBs differentiate them significantly from non-family businesses (NFBs). For example, a manager of an NFB with no close link or direct family relationship with the owner(s) is likely to behave very differently from a manager of an FB who is often related in some way to the owners.

These characteristics are said to make FBs special economic entities, with advantages and disadvantages over competing NFBs that are likely to affect economic performance in different ways.

In this chapter we provide an overview of the theoretical literature on FBs that focuses on the special characteristics of FBs, which might affect economic performance. Four key factors are usually identified in the literature as being critical for FBs performance. These are ownership and control, management strategies and style, long-term view, and human resources. We will review each in turn.

Ownership and control

The separation of ownership and management is often said to be a fundamental characteristic of the modern capitalist corporation. This separation problem, first described by Berle and Means (1932), leaves managers of such a firm in effective control of the firm's operations. A number of students of this issue believe that this may impair the firm's performance, as managers might pursue their own interests to the detriment of shareholders' interest.

The nature and extent of this conflict, also known as the principal-agent problem or agency problem, depends on the extent to which shareholders (principals) can control managers' performance (agents) and on the differing objectives and incentives of managers and shareholders.

Consequently, the economic performance of the firms is expected to differ depending on the presence and extent of the separation of ownership from control. In a situation where property is concentrated in the hands of one family that usually also manages the company, the agency problem is to a large extent mitigated. In contrast, in situations where ownership is dispersed and diluted, the manager-shareholder divergence in interests may be greater.

Authors that support this line of reasoning argue that owner-controlled FBs are more likely to outperform management-controlled NFBs (see Daily and Dollinger, 1992). This is because owners of FBs are more likely to maximise firm value, enabling them to personally realise any financial and economic gains. In contrast, professional managers of NFBs may not pursue profit maximisation and growth-orientated strategies because they prefer to maximise their own benefits (e.g., realise financial gains for themselves directly) by pursuing other activities such as the maximisation of short-run sales revenues.

That being said, not everybody shares this perspective of an inherent conflict of interest between managers and owners in NFBs because they believe that managers are effectively constrained from taking actions that are not in the best interests of shareholders, via several disciplining mechanisms.

For example, Fama (1980) argues that competition in the managerial labour market will limit managerial discretion. In essence, managers will be willing to perform according to shareholders' interests to be able to gain access to the best jobs. In this context, bankruptcy works as the ultimate threat because of the loss of reputation for the manager.

Also, many argue that strong competition in product markets effectively limits managers' power to pursue their own interests at the expense of shareholders' interests because it makes it easier to verify the performance of managers – there are greater opportunities for performance comparisons across firms, and there is a higher probability of bankruptcy if managers pursue self-interested activities.

Other authors argue that executive compensation packages linking management's income to the firm's performance will align the interests of managers and shareholders so that there should be no difference in the level of performance of firms as a result of differing ownership-control structures. The current debate on the appropriateness of stock option plans and other performance related incentives could be seen as casting some doubts about the validity of this argument. However, often it is the inappropriate application of the general principle rather than the principle itself that has led to results that are nowadays questioned.

Finally, capital markets support and encourage takeovers of those companies that underperform and the replacement of poorly performing managers with more efficient managers. This market for corporate control will act as an additional external deterrent that will ensure managers do not diverge too much from shareholders' interests.

Nevertheless, management selection and replacement, enforcement of incentive contracts, and takeovers themselves, involve transaction costs (often referred to as agency costs) that do not exist or are minimal in an FB, where the principal and agent are the same person. Therefore, even if shareholders and managers' interests can be properly aligned through a range of internal and external mechanisms, FBs would still enjoy a cost advantage over NFBs.

The above discussion also suggests that the precise nature of the relationship between firm performance and various control mechanisms that one would expect to observe is not clear. Since alternative control mechanisms exist, greater reliance on one does not necessarily imply a better firm performance. In cases where one specific mechanism is used less intensively, there may be greater reliance on others, resulting in equally good performance.

Management strategies and style

FBs may also pursue a unique set of management strategies and adopt different management styles that facilitate the development of more efficient approaches to business management and problem-solving, such as flat management, customer service, leaner structures, quicker decision processes and the commitment of qualified personnel.

Arguments in support of this view generally fall under one of the following two broad categories: a) commitment, loyalty and trust of managers and customers and b) centralisation of the decision process. This is said to allow FBs to achieve natural performance efficiencies that many publicly quoted companies struggle to implement through painful restructuring and reorganisation (Deutsche Bank Institut für Familienunternehmen, 2001).

Commitment and loyalty of managers and customers highlights the relationship dynamics within FBs. The unique family oriented atmosphere in the working environment may inspire greater employee loyalty, motivation and trust (Ward, 1988; Tagiuri and Davis, 1996). This trust is also shared by clients and other external stakeholders who regard family management as reliable and honest (Ward and Aronoff, 1991; Allouche and Amman, 1999).

Indeed, the reputation of FBs and their relationships with suppliers, customers and other external stakeholders may be stronger and more value-orientated than at NFBs (Lyman, 1991). Overall, FBs are said to exhibit a greater commitment to their mission, possess a greater capacity for self-analysis, and suffer less from managerial politics (Moscetello, 1990).

In combination, these factors are conducive to fostering a level of commitment and loyalty among managers and customers alike that is unmatched at NFBs.

The centralisation of the decision process is another example of the special nature of strategy and management style of FBs. With decisional control resting largely in the hands of top family members, the FB benefits from lower decision-making costs and enhanced flexibility (Goffee and Scase, 1985; Hall, 1988; Tagiuri and Davis, 1996; Poza, Alfred and Maheshwari, 1997).

In addition, decisions are taken through efficient, informal channels. FBs thus benefit from a less cumbersome organisational structure with lower monitoring and control costs (Daily & Dollinger, 1992).

Finally, centralised decision-making is said to be even more efficient through the use of ‘family language’, which enables more effective communication and greater privacy (Tagiuri and Davis, 1996).

The inherent privacy of centralised family decision-making can give FBs another strategic advantage because their competitors do not have access to information about their operations or financial condition (Johnson, 1990).

A separate, but strongly related, issue is the one of business innovation. Two conflicting schools of thought concerning innovation within FBs exist.

The first highlights the potential transmission of innovative skills across the generational divide in FBs, and the role of the family unit as a successful model of interactive innovation (Litz, 2000). Under these conditions, the family unit, and particularly a family-based management structure, may be better able to innovate than comparable NFBs.

The other perspective puts forward a different argument pointing to lower innovation in FBs which is linked to generational succession. In this case, FBs cling to the products, strategies or management styles of previous generations that had been successful. This prevents adaptation to new market challenges and opportunities, and management is largely paralysed by the backward-looking orientation of the family. Colli (2002) compares innovation in two models of family firms, the ‘dynastic model’ and the ‘open family firm model’. In the dynastic model, the overwhelming focus on family leadership succession is said to undermine innovation, with the family counting on the competitive advantage gained during the start-up period. In contrast, the ‘open family firm’ – noted for the presence of outsiders in key positions – is consequently said to be more dynamic and innovative in response to changes in the market place.

Long-term view

Another important characteristic of FBs may be the use of longer-term time-horizons in their strategic decisions regarding growth targets, investment projects and other strategic issues.

Businesses owned and controlled by families are often said to adopt a more long-term perspective than NFBs and it is often argued that this characteristic enhances company performance. Intuitively, this claim is supported by the many special characteristics of FBs such as the inseparability of family and business objectives and the freedom of FBs from the constraints of shortsighted managers and quarterly financial performance targets. It is frequently argued that these conditions allow FBs to take a more rational approach to business planning and to make longer-term investments than those of NFBs. Finally, the stability of family leadership and the low managerial turnover at FBs may foster relationships with clients and markets that last longer over time than is possible at NFBs. Under such conditions we might expect to find empirical evidence for the hypothesis that FBs outperform NFBs over longer time-horizons – say 15 years or more – while NFBs perform better in the shorter run.

As noted above, some observers are of the view that the inseparability of family and business objectives within FBs significantly lengthens the time-horizon considered when making important strategic choices (Arnoff and Ward, 1994). The objective of any family is usually to maximise the well-being of current and future generations, an aim reflected by the desire of many FB founders to secure positions of responsibility for their siblings in the managerial structure of the FB and, ultimately, to secure the transmission of family control across generations. Consequently, investment plans, growth targets and other key strategic decisions are usually taken with such an extended, trans-generational time frame in mind. This in turn may serve to create a more unified, determined and effective long-run strategy than that which exists at many large, publicly owned firms; resulting in superior long-run performance.

In contrast, the aims and objectives of non-family managers in large publicly owned companies are fulfilled over a much narrower time-horizon. Here, the objectives of managers and the owners are separable. Managers seek to maximise personal benefits over their expected period of employment rather than over a lifetime or across generations. Thus, they unavoidably adopt shorter time-horizons than at FBs. Even at larger FBs, with many non-family managers, founding family members usually maintain the prerogative to overrule decisions taken by non-family managers, thus ensuring that the long-term interests of the family and the business are safeguarded.

The relative freedom of FBs from the constraints of having to match quarterly market targets is another condition that allows FB to adopt a longer-term outlook. As the ownership of FBs is by its very nature concentrated in the hands of founding family members, FBs may not face the same pressures for increases in quarterly economic and financial performance measures as publicly owned NFBs. These face constant monitoring and pressures from block and institutional shareholders. It is therefore argued that strong family ownership engenders well-defined longer-term goals (Moscetello, 1990).

A related point is the claim that FBs exhibit greater stability than NFBs in the face of cyclical shocks. In particular, FBs may be less reactive to short-run economic downturns, aware of the cyclical nature of their businesses when making longer-term strategic decisions (Ward, 1997). For example, in contrast to publicly owned companies where investment in research and development is generally related to current cash-flow, FBs appear more prepared to continue investing in business-building projects during downturns (Baskin, 2001). In the face of such adverse cyclical demand shocks, FBs have the independence and long-term vision to maintain important investment projects while temporarily accepting tighter margins in the full knowledge that this strategy will produce superior returns in the longer term. In contrast, NFBs may be forced to cut costs to meet market pressures for short-run performance resulting in a sub-optimal long-run outcome.

Another factor that may be conducive to adopting a more long-term perspective in business practices is that FBs are claimed to exhibit a lower managerial turnover than NFBs. The stability of family managerial leadership and control stands in sharp contrast to the relatively high turnover of executives at publicly-owned NFBs, where managers are often punished for failing to meet the short-run performance targets dictated by markets. Baskin (2001) argues that this factor may serve to foster longer-run relationships of trust between FBs and clients/suppliers, thus improving long-run business performance. In contrast, at NFBs with shifting management personnel, longer-term client and market relationships may be weaker than at family firms with long-serving family executives and senior managers.

Finally, in relation to the time-horizon adopted in the investment decisions taken by FBs, it is often asserted that FBs have a greater capacity to invest in long-run return opportunities (Dreux, 1990). This has been termed ‘patient capital’, referring to a willingness to wait longer than most other investors for a return from capital invested (de Visscher, Arnoff and Ward, 1995). Patient capital is an intuitive outcome of the special FB factors discussed above, such as the inseparability of business and family and the autonomy of FBs from the constraints of both short-run market pressures and non-family managers. FBs are said to have a unique freedom to invest in a product, service or market that may not be profitable for up to 10 years, but extremely beneficial to the firm in the long run. This again suggests that, in any longer-term empirical comparison of performance, FBs are likely to outperform NFBs.

However, while freedom from both the constraints of markets and autonomous non-family managers facilitates the adoption of a longer-term strategy, some have argued that the aims, ambitions and resources of FB are not conducive to aggressive growth-orientated strategies. Most notably, FBs may be less willing to take on risk. Gallo, Tapies and Cappuyns (2000) argue that FBs do not pursue genuine long-term business policies because they are not committed to taking the risk of embarking on a path of development which will enable them to compete successfully in the medium and long-term future. Supporting this argument, Daily and Dollinger (1992) find that NFBs are more likely to take an aggressive approach to long-run growth than FBs. Furthermore, Hayward (1999) argues that, even if FBs wish to pursue such a strategy, the attainment of these objectives is constrained by the depth of the family’s own financial resources and management abilities. Therefore, despite being in a unique position to take on more risk over the longer-term and aim for superior returns on investments than NFBs, FBs may in the end place a greater emphasis on the less risky objectives of stability and control than on pursuing aggressive sales and company growth.

Finally, it has also been noted that FBs, despite using a longer-term planning horizon than NFBs, may spend a disproportionate amount of time and energy trying to secure long-run control over the business through placing siblings in key managerial positions and ultimately transmitting the business into the control of the next generation. Binder Hamlyn (1994) finds evidence to suggest that longer-term growth in FBs is often foregone in favour of retaining such control, and that NFBs in the UK are more likely to expect to increase their market share compared with FBs. Other research (Reynolds, 1995) has noted that owners of FBs may be averse to significant additional growth because this may entail an erosion of family ownership and managerial control over the business.

Human resources

Another key characteristic of FBs is that family members are generally represented in senior management and new recruitment. Although this might be a potential benefit for the FBs in terms of lower recruitment and human resources costs (Levering and Moskowitz, 1993), the reality is that for many FBs this is potentially damaging as these managers may not always possess the appropriate skills nor be the best possible candidates for the position.

In short, a characteristic of FBs is that they are not solely profit maximisers, but that they also pursue other important objectives such as maintaining or enhancing the lifestyle of the owners, and providing employment for family members in the management team (Westhead and Cowling, 1997).

As a result, in some FBs there is a potential conflict between financial and non-financial objectives. The pursuit of such non-financial objectives (family issues) may potentially impede the performance of the company.

Another important factor to note is that, in the case of FBs, staff performance is not necessarily viewed as being linked to, or assessed on the basis of, individual work achievement but is often related to the performance of the firm as a whole. This might promote more flexible work practices among the employees of FBs (Goffee and Scase, 1985), or result in higher employee wages (Donckels and Frohlich, 1991) with a resulting increase in firm performance.

Finally, it is important to note that FBs are prone to potential conflicts among family members that go beyond managerial disputes and can potentially harm a firm’s performance. Moreover, as already noted by many authors, FBs face the specific problems of organising a proper succession and transmission of the company to the next generation. Reflecting the critical importance of these two issues for the well-being of FBs, studies and guidance on family conflicts and succession form the bulk of the literature on FBs.

Summary of the review of the theoretical literature

At this stage, it is useful to take stock, in summary form, of the key characteristics of FBs discussed in this chapter and to review their potential implications for the performance of FBs relative to that of NFBs. We start by highlighting those characteristics that might be performance enhancing and then we list those that might be performance limiting.

Performance-enhancing characteristics of FBs

- Agency cost efficiencies: FBs benefit from lower agency costs because ownership and management in FBs are inseparable. Consequently the interests and incentives of managers and executives are wholly aligned with those of the firm. In contrast, the separation of ownership and control in NFBs potentially creates a divergence of interests between shareholders and managers. It must be noted, however, that these agency costs are somewhat mitigated by dynamic forces in the labour market for managers, the implications of bankruptcy for managerial reputation and the market for corporate control (take-overs).
- Leadership efficiencies: FBs benefit from centralised family decision-making and a unified management style. There is considerable potential for interactive family innovation.
- Stakeholder efficiencies: the family-orientated environment of FBs increases trust, loyalty and motivation by managers, employees and customers alike.
- Increased time-horizons: FBs generally take a longer-term view than NFBs when taking investment, growth and other strategic decisions.

Performance-limiting characteristics of FBs

- Non-profit maximising objectives: FBs may adopt a lower risk approach to debt leverage and company growth than NFBs
- Different goal prioritisation: FBs often place a greater emphasis on non-pecuniary goals such as stability and the succession of siblings.
- Less efficient management: the desire to secure family control and succession of the business often leads to the presence of younger family members in senior positions in FBs. This may produce a sub-optimal outcome compared to the market-determined appointment of executives at NFBs.
- Weak innovation and adaptation to new circumstances: family and non-family managers of FBs may be constrained by pressures to pursue traditionally successful business practices.

The performance of family businesses

The literature reviewed in the previous chapter has clearly shown that the performance of FBs may often be affected by considerations other than profit maximisation.

Any assessment of the performance of various types of firms depends to a great extent on the performance variables one retains to assess performance. For example, an evaluation of corporate performance related to financial measures is likely to show better results for NFBs. In part, this is because the compensation of NFB managers in agency contracts is often contractually linked to performance based on verifiable measures, such as value of company's stock or rate of return on equity. In contrast, it is likely that the compensation of executives related to founding family are less linked to such performance-based compensations.

However, when looking at other measures such as turnover or profit growth it is less clear that differences between FBs and NFBs performance should be observed. The results will depend on the positive and negatives impacts of other characteristics of FBs such as trustworthiness and commitment, maximisation of family well-being or problems in succession, etc.

Research on the economic performance of FBs has developed along three main different lines.

One strand of research simply quantifies the statistical performance differences between FBs and NFBs based on a variety of measures such as average sales, number of employees, profit margins, growth rate of sales without looking into possible causes of such differences.

A second strand of research focuses on the principal-agent problem. In this case, it is believed that shareholder control and ownership should reduce manager discretion and result in a higher level of performance. However, there is no consensus on how to define ownership and control of the firm. Moreover, not all of the studies are directly linked to FBs. A large volume of this research focuses simply on the degree of shareholder concentration and shareholder control that may be exercised by various groups such as managers, institutional investors, financial institutions, etc. The impact of family control is only occasionally studied in this literature. However, we believe that some of the implications from this literature are highly relevant to any assessment of the performance of FBs because of the close relationship between ownership and definitions of FBs.

Finally, a third strand of the literature focuses on specific characteristics of FBs – such as reputation, quality and efficient recruitment – and how they impact on different measures of economic performance.

We review the empirical evidence from each of these lines of research in this chapter. First we review the studies comparing the performance of FBs and NFBs statistically. Next we review briefly the empirical literature on ownership structure and economic performance. Finally we review the empirical literature addressing specific aspects of FBs and their potential impact on performance.

Statistical comparison of the performance of family businesses and non-family businesses

A limited body of literature has evaluated the differences between FBs and NFBs based only on a statistical comparison of various performance indicators. While some studies focus primarily on economic performance (financial performance, sales, etc), others have focused on different business dimensions such as employment and training, innovation and development and the degree of internationalisation. Each of these aspects of the performance of FBs is reviewed separately.

Economic performance

The results of studies that compare the economic performance of FBs and NFBs have shown a diverse range of results. For some authors (Binder Hamlyn, 1994) it is clear that NFBs outperform FBs in sales turnover and productivity.

However, others report higher performance by FBs based on several measures (Daily and Dollinger, 1992; Neubauer and Lank, 1998; Ganderrio, 2002; Anderson and Reeb, 2002).

Finally, some studies conclude that the differences between FBs and NFBs are not significant with regards to turnover and profitability (Westhead and Cowling, 1997) or other performance criteria such as growth in sales (Stoy Centre for Family Business, 1997).

Among the studies that find evidence of a better performance by NFBs is the study by Binder Hamlyn (1994). The authors examined the growth in sales revenue, productivity and profitability of 667 private unquoted companies in UK with sales revenues between £2.5 and £25 million, between 1988 and 1993.

The study found that NFBs outperformed FBs in growth in sales revenue and productivity, but no difference was found in terms of profitability. The results show that[1]:

- Average sales growth in NFBs was four times higher than in FBs.
- FBs reported a fall of 3.8 per cent in productivity (defined as total sales revenue divided by number of employees) while NFBs recorded a real increase of 8.1 per cent.
- Finally, no marked differences were recorded between FBs and NFBs with regard to a qualitative measure of profitability over the period 1988 to 1993.

In contrast, a study conducted in the US draws opposite conclusions when looking at similar performance variables. Research by Daily and Dollinger (1992) on 186 small manufacturing businesses in Indiana (US) found that:

- Between 1986 and 1988, FBs outperformed NFBs in sales turnover and profit growth.

However, it is worth noting that the sample was constituted of companies with fewer than 500 employees and sales of less than 30 million dollars per year.

Several studies reported in Neubauer and Lank (1998) also point to better performance by FBs when compared to NFBs using a wide range of indicators:

[1] As reported in Westhead and Cowling (1997)

- Leach and Leahy (1991) examined 325 very large UK industrial firms in the 1980s. They found that greater ownership control had a significant positive effect on performance. Businesses with greater ownership control tended to have higher valuation ratios, greater profit margins, higher returns on shareholders capital, higher growth rates of sales and higher growth rates of net assets.
- Over the period of 31 December 1989 to 6 May 1996, the Societé de Bourse Française (SBF) 250 stock index increased by 8.8 % on average, whereas the ODDO Family Business Index – comprising 76 FBs included in the SBF 250 - increased by 73.3% (ODDO Génération, 1996).

A recent study (Ganderrio, 2002), using data from Statistics Sweden for the period 1985-1994, compares the performance of FBs and NFBs using various ratios of financial performance.

His results support the hypothesis of a better financial performance by FBs over the longer run:

- FBs have a significantly higher level of Return on Equity (ROE). It is argued that this stems from the lower equity to asset ratios, or alternatively the higher debt/equity ratios seen in FBs.
- FBs appear to be as strong as NFBs in carrying out normal business operations. FBs and NFBs exhibit similar results for variables such as gross profit margin and interest costs.
- FBs post a much lower equity to asset ratio than NFBs. This can be explained by the fact that NFBs have much easier access to the stock market.

For Anderson and Reeb (2002), founding family ownership is an efficient organisational structure producing higher profits and higher market valuation than comparable NFBs. Using data from 403 S&P 500 firms for the period of 1992 through 1999, profitability (Return on Assets - ROA) and market measures (Tobin's Q[2]) of firm performance are used in a time-series cross-sectional comparison of FBs and NFBs.

The results from the multivariate analysis suggest family ownership does represent an efficient organisational structure.

- Family ownership is prevalent (over 32% of firms in the S&P 500) and substantial (18% of firms' equity owned on average).
- FBs are more profitable and more valuable than NFBs (Tobin's Q is 11.6% larger than non-family firms).
- The relationship between founding family holdings and firm performance is non-linear: the firms' performance first increases and then decreases with the level of family ownership, using both accounting and market-based measures. At very high levels of family ownership the performance is marginally worse than for NFBs.
- Firm performance is better if a family member is CEO than if an outsider holds the position. A firm's return on assets is better by 3.7% and 1.1% respectively when the firm's founder or a descendent of the founder serves as CEO.

These findings are inconsistent with the argument that family ownership is inherently less efficient. In their conclusions, the authors contrast their findings with those of Faccio, Larry

[2] Tobin's Q is equal to the market value of a firm's assets divided by the replacement value of the firm's assets.

and Young (2001) who suggest that family ownership in East Asia has severely hampered performance. They point to differing rules governing the treatment of minority shareholders, greater disclosure of firm data and the prevalence of cross-shareholding networks in Asia as factors that may be contributing to differences in the impact of family ownership in the US and East Asia.

In addition to the previous studies, a few studies exist that have reported no significant differences between FBs and NFBs. For example, the Stoy Centre for Family Business (1997) conducted research based on information supplied by 427 companies, all of which were unquoted and at least ten years old. The survey found that:

- FBs were much more likely to be older than NFBs.
- There are no statistically significant differences in the performance of FBs and NFBs. The conclusion was based on an analysis of nine performance criteria, including the percentage growth in both sales and employment.

The first result is striking because research conducted elsewhere suggests that FBs are less likely to survive then NFBs: Alcorn (1982) states that the life expectancy of FBs is 24 years, whereas Gallo, Cappuyns and Estape (1995) observe that FBs have difficulties in sustaining growth.

Westhead and Cowling (1997) criticise the studies exploring the performance of FBs and NFBs because they do not control in their statistical comparisons for the potentially distorting influence of demographic differences between FBs and NFBs. The two authors explore the contrasts between independent, unquoted FBs and NFBs in the UK by using a matched pairs methodology.

The data was obtained from questionnaires sent to a stratified random sample of independent unquoted companies. The definition of a family company is one in which 'more than 50 percent of voting shares are owned by a single family group related by blood or marriage and the company is perceived by the respondent to be a family business'. The methodology is based on hypothesis contrasts on matched pairs[3]. The matching procedure simultaneously controlled for the potentially distorting influence of age of the company, location and main industrial activity.

The matched comparison revealed no statistically significant contrasts between unquoted FBs and NFBs with regard to a variety of performance indicators, in particular:

- No statistically significant difference between gross sales revenue sizes were observed.
- FBs recorded higher levels of absolute gross sales revenue growth although the differences were not statistically significant.

[3] Westhead and Cowling obtained 427 valid questionnaires from a sample of 887 unquoted companies. Two matched pairs of sub-samples of family and non-family companies were obtained from randomly sampling the 427 questionnaire returns. In the matching procedure they controlled simultaneously for four variables: age of the company since it received its first order, location of the company in a rural area, location of the company by standard region type and the main industrial activity of the company. After the matching procedure, the 427 companies were reduced to two matched sub-samples each containing 73 companies. It is believed that if demographic differences between the two groups of companies are not taken into account this could potentially bias any univariate comparison of performance and ambitions of family and non-family companies.

- Although NFBs recorded higher levels of productivity (gross sales revenue in 1994 divided by the number of people employed at the end of 1994), the difference with FBs was not statistically significant.
- With regards to profitability, equal proportions of FBs and NFBs reported they were profitable for the financial year ending in 1994.

The authors conclude that, based on the results of the matched-sample analysis, it would be unwise to conclude that independent FBs outperform comparable NFBs.

Gallo, Tapies and Cappuyns (2000) aim to identify major differences between Spanish FBs and NFBs using a different set of economic performance variables. The study classifies a firm as FB or NFB on the basis of the own judgement of the person answering the questionnaire.

Using a sample of over 300 Spanish firms the study finds that:

- On average, turnover is substantially lower in FBs than in NFBs.
- Although NFBs report higher return on owners equity (ROE), the difference does not appear to be statistically significant between FBs and NFBs.

The authors explain the results by noting that aversion to risk and fear of losing control of the business lead many FBs to limit their growth potential by not adopting generally accepted financial management policies.

In addition, the authors found that personal preferences concerning growth, risk and ownership control are specific factors affecting FBs. In particular:

- Some of the FBs grow more slowly, or do not want to grow as much as they could if they used all the available resources.
- FBs devote a smaller proportion of sales revenue to their own long-term development.
- FBs also show some degree of resistance to risk.
- FBs rely more on temporary personnel and they have considerably lower level of debt when compared to NFBs.

Finally the authors find evidence that FBs are concerned about loss of control of the company, show lower equity capital and refuse to accept partners such as financial institutions or stock market investors unrelated to the family.

These findings are corroborated by Maherault (1998). In a study on a sample of French FBs, the author found that FBs preferred to forego development rather than lose their independence.

Employment and training

A significant body of research exists that addresses employment issues of FBs. Some studies find evidence that FBs show higher employment creation than NFBs (Backes-Gellner, 2001), whereas others find no statistical evidence of any differences (Westhead and Cowling, 1997).

With regard to issues such as training, employee participation, or profit sharing, the findings seem to suggest that they are all lower in FBs (Backes-Gellner, 2001; Hirigoyen and Poulain-Rehm, 2000).

With regards to employment creation, the recent study by Backes-Gellner (2001) of the *Institut für Mittelstandforschung* focusing on the state of industrial FBs in Germany in 2001 found that:

- German industrial FBs increased employment by 7.3% from 1998 to 2001 while management-led companies reduced employment by 5% over the same period.

In contrast, Binder Hamlyn (1994) found that:

- NFBs in the UK recorded higher average absolute employment growth.

In their paper, Westhead and Cowling (1997) compare the employment performance of independent unquoted FBs and NFBs in the UK. They report that:

- No statistically significant difference was found between the number of people employed in both groups of companies.
- The differences in employment size between FBs and NFBs were not statistically significant.
- Employment growth was not statistically significantly different between the two groups.

It appears that the training performance of FBs is slightly worse than that of management-led companies. According to Backes-Gellner (2001):

- While 62% of German industrial FBs supported training outside the firm, 73% of management-led companies did so;
- Similarly, 64% of FBs funded some form of in-house training, while 71% of management companies did so.

Another measure of interest is that of employee participation. The Backes-Gellner (2001) study found that German industrial FBs have fewer employee participatory schemes than management-led companies:

- 58% of FBs had some form of employee participation while 66% of management-led companies did;
- 36% of FBs employed quality circles while 42% of management-led companies did so;
- In only 27% of FBs did employees sit on the supervisory board while the figure stood at 44% for management-led companies.

The findings of Backes-Gellner (2001) about employee financial participation is consistent with the literature that argues that it is more desirable to provide financial incentives in NFBs than in FBs.

- Only 15% of German industrial FBs have some form of profit-sharing scheme while 21% of management-led companies do so;
- 1% of these FBs offer some form of equity participation while 5% of management-led companies do so;
- No German industrial FBs offer stock options while 6% of FBs do so.

The study by Hirigoyen and Poulain-Rehm (2000) investigates whether listed family firms present particularities with regard to stock options policy in France. Their research is based on a survey of 61 firms (24 family-controlled and 37 non-family-controlled firms).

According to the legal records, 366 quoted French companies asked shareholders to approve a stock-option plan over the period 1989-1996.

The share of FBs among all the firms having implemented a stock option plan is 36.1%, about the same as their share of total listed companies (36.4%). Thus, there do not appear to be significant differences between FBs and NFBs in terms of the provision of stock options.

Within the group of listed companies with stock option plans, there are few differences in terms of stock option granting policies. The only notable difference is observed at the level of eligible employees.

While both types of firms tend to restrict the availability of stock options to their more senior management and top management, listed FBs tend to include a somewhat smaller proportion of their top and senior management in the population eligible for stock options. For example, more than 40% of top management is eligible for stock options in 67% of FBs and in 86.5% of NFBs.

In contrast, FBs tend to make stock options available to a larger proportion of their middle management and non-management employees than NFBs. For example, 16.2% of quoted FBs offered stock options to more than 40% of their non-management employees while only 11.1% of quoted NFBs did so.

Employee groups eligible for stock options in France (percentage of firms)				
	Family firms		Non-family firms	
	Less than 40% of group	More than 40% of group	Less than 40% of group	More than 40% of group
Top management	33.3%	66.70%	13.5%	86.5%
Non-executive directors	90.5%	9.5%	89.2%	10.8%
Managers of subsidiaries	52.2%	47.8%	38.2%	61.8%
Senior management	54.2%	45.8%	45.9%	54.1%
Middle management	79.2%	20.8%	87.5%	12.5%
Employees in non-management positions	83.8%	16.2%	88.9%	11.1%

Source: Hirigoyen and Poulain-Rehm (2000)

Finally, with regards to the length of employment, the Stoy Centre for Family Business (1997) research revealed that, in FBs, managers from within the owning family were generally employed in that position for significantly longer than those from outside.

Innovation and development
Backes-Gellner (2001) shows that with regards to innovation, FBs perform much worse than management-led companies.

- Only 50% of German industrial FBs planned in 2001 to introduce a new product over the next two years while 77% of management-led companies planned to do so.
- In contrast 23% of FBs did not plan to introduce a new product over the next two years while only 10% management-led companies were in the same situation.

Research and development is mostly undertaken by large FBs with more than 200 employees according to Backes-Gellner (2001).

56% of these large FBs undertook R&D on an on-going basis while this figure drops to 33% for FBs with 100 to 199 employees and to 25% or less for smaller-size FBs.

Ellington and Deane (1996) analyse the adoption of quality practices in manufacturing family-owned businesses in the US. The results of the study report that:

- Overall, family-owned firms are found to be non-adopters of total quality management (TQM) practices.
- However, highest FB performance levels are associated with a more complete quality management practices adoption pattern.

Degree of internationalisation
Finally, some studies examine the internationalisation of FBs and NFBs and its implications for economic success. The studies focus on firms' exports (Backes-Gellner, 2001; Donckels and Aerts, 1998; Binder Hamlyn, 1994; Westhead and Cowling, 1997).

In a study by Donckels an Aerts (1998), European family and non-family SMEs were compared across eight countries. The results provide evidence[4] that FBs:

- are not internationally focused;
- import and export less;
- generate less turnover from exports;
- take and give fewer licenses to foreign companies;
- do not have production plants overseas;
- do not have a branch approach.

The authors state that, if such internationalisation is essential to the success of firms of any size, then FBs give cause for concern.

Binder Hamlyn (1994) find results along the same lines:

- NFBs were markedly more likely to have looked overseas for market opportunities than FBs.

[4] As reported in Neubauer and Alden (1998)

However, Westhead and Cowling (1997) in a matched-sample comparisons study find that:

- There is no statistical evidence of differences on propensity to export sales outside the UK between FBs and NFBs.

Cooperation with other firms

In an increasingly complex business world, co-operation between different firms is often viewed nowadays as a key success condition. In this regard, it is interesting to note that Backes-Gellner (2001) found that German industrial FBs often cooperate with other firms, albeit somewhat less frequently than management-led companies.

- 64% of FBs in the survey cooperated in one form or another with other companies while 78% of management-led companies did so.

Ownership structure and economic performance

It is generally believed that strong shareholder control and ownership reduces manager discretion by eliminating, or at least mitigating, the principal-agent problem faced typically by NFBs.

The empirical literature seems to corroborate the hypothesis that strong shareholder control provides better return on the original investment, and suggests that a better managed capital structure and more efficient allocation of the owner's resources can be found in those firms where shareholders can impose some form of control over the managers[5].

However, the best mechanism for imposing this control is not clear. For some authors, it is the owner who can exert best control and hence firms tightly controlled by the owners should yield better results on investment (Monsen, Chiu and Cooley, 1964; Thomsen and Pedersen, 1998). This type of ownership is often related to the definition of FBs, where one owner or family members have control of an important share of the company.

For others, control can be exerted directly by shareholders (often via financial institutions) in combination with the disciplining forces of other external factors such as product market competition and financial market pressures (Nickell, Nicolitsas and Dryden, 1997). However, for some authors, too much monitoring in founding family controlled business can damage performance (Randoy and Goel, 2002).

Other studies focus on the control mechanisms available when the companies are quoted on the stock markets (Agrawal and Knowber, 1996; A. T. Kearney, 2001a, 2001b).

Finally, it is not clear in these studies how one should evaluate the performance of firms. Some authors have used productivity growth performance indicators whereas others use indicators of financial performance such as Tobin's Q.

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[5] See http://www.encycogov.com/A5OwnershipStructures/OwPerfStudies/Table_Ow_AB.asp for an updated survey on empirical studies on ownership structure and performance. Also see Short (1994) for an excellent review.

In a sample of twelve industries over a twelve-year period (1952-1963) selected from Fortune's list of 500 largest industrial firms by sales in 1963, Monsen, Chiu and Cooley (1964) study the differences between owner- and manager-controlled firms. Firms were classified as owner controlled if they fulfilled the following criteria:

1. One party owning 10% or more of the voting stock is represented on the board or in the management or is otherwise known to control;
2. One party owns 20% or more of the voting stock.

A firm was defined as management controlled if:

1. No single block greater than 5% of the voting stock exists;
2. There is no evidence of recent control.

Note that the definition of owner-controlled firms used in this study is similar to the definitions often proposed in the FB literature, although the share of ownership is smaller in this case.

The main results of Monsen, Chiu and Cooley (1964) support the argument that the presence of a powerful owner group does produce an appreciable increase in management's attention to owner interests:

- Owner-controlled firms significantly outperform manager-controlled firms. They achieved returns on owners' equity (ROE) that are 75% higher on average than in manager-controlled firms.
- With regard to other performance indicators (sales to total assets, net income to total assets, net income to sales, debt ratio) the study finds no significant differences between owner- and manager-controlled businesses.

In another study, Thomsen and Pedersen (1998) examine the impact of share ownership and identity of the largest owner on market-to-book values, asset returns and sales growth. They obtain similar results.

Thomsen and Pedersen study the relationship between ownership structures and performance of large non-financial companies in each of 12 European countries – Austria, Belgium, Denmark, Finland, France, Germany, Great Britain, Italy, the Netherlands, Norway, Spain and Sweden – over the period 1991-1996. Because of data problems, the actual sample used in the empirical work is limited to 435 companies.

The main conclusions of the research are that:

- There is evidence of a bell-shaped (first increasing and then decreasing) effect of ownership share on asset returns and market-to-book values, but no effect on sales growth.
- A particularly favourable effect of ownership share on market-to-book value was found if the largest owner was an institutional investor (a non-bank financial institution)
- Institutional ownership was generally associated with high market-to-book values, while a negative premium was found for companies in which the largest owner is a family, another company or government.

Sales growth was higher when the largest owner was a family, suggesting that families put greater emphasis on growth objectives than on profits.

Nickell, Nicolitsas and Dryden (1997) investigate the contribution of external factors to improved productivity performance in companies. In addition to shareholder control, they also analyse product market competition and financial market pressure.

In line with the studies that highlight the importance of proper incentives for addressing the agency problem, the authors argue that one way to reduce managerial discretion is the presence of a major shareholder who can exercise control over managers. However, the authors make the distinction between the case where the major shareholder is an outsider, whose main concern is with the performance of the company, and the case where the major shareholder is an insider such as one of the managers or a member of the chief executive's family.

It is argued that external control will result in a reduction of managerial discretion, while control by insider shareholding provides incentives for both better performance and the pursuit of other interests and objectives.

The data is based on the published accounts of approximately 125 UK manufacturing companies over the period 1982-1994. The authors estimate a model of company productivity with a specific variable for cases where there is a dominant shareholder (defined as a case where the shareholder has a 90 or 95 percent probability of wining a shareholders' vote).

The key empirical results of note are the following:

- If the dominant shareholder is an external financial institution, this has a positive impact on productivity growth.
- If the dominant shareholders are internal they have no effect on the firm's productivity growth.
- If the dominant shareholder is an external shareholder, but a non-financial company, this has a negative effect on productivity growth.

On the basis of this evidence, it would appear that external control by financial institutions imposes managerial discipline and hence generates higher productivity growth. Control by internal shareholders, such as families or non-financial companies, does not yield higher productivity growth.

After reporting these results the authors warn about the likelihood of having found reverse causality. In the longer run it might be possible that high productivity growth leads to market dominance, which leads to high rents which, in turn, may attract a dominant shareholder. In this case it is not shareholder control that has an effect on the firm's performance. Rather, it is the high productivity growth and high rents that make concentrated ownership more attractive.

Agrawal and Knoeber (1996) look for empirical evidence on the use of mechanisms to control for agency problems and their relationship with firm performance.

Drawing on the agency theory, the authors propose several mechanisms for imposing the right incentives on managers in a principal-agent situation. These are: managerial shareholdings, concentration of shareholdings, outsider representation on corporate boards, use of debt financing to induce monitoring by lenders, competition in the managerial labour market, and the threat of displacement by corporate control.

The sample is constituted by the largest US firms on the basis of sales, total assets, market value of equity, or profits, in 1987 as published by Forbes magazine. The empirical approach relates the firm's performance, as measured by Tobin's Q, to the control mechanisms.

The authors first relate firm performance to each control mechanism individually, and find that:

- Fewer outside directors, less corporate debt, and a less active market for corporate control all lead to improved firm performance.

These results would suggest that the above mechanisms have not been used optimally to maximise firm performance. Reducing outsider representation on the board, debt financing and corporate control activity could increase firm performance.

However, the authors warn that the relationship could be the reverse of what is implicitly assumed (the reverse causality problem mentioned in Nickell, Nicolitsas and Dryden, 1997). Better firm performance may lead to, rather than be the result of, fewer outside directors, less debt, and fewer takeovers. To address this issue, the study estimates a system where firm performance and control mechanisms are treated as related variables. The results show that:

- When allowing for interdependence between control mechanisms and firm's performance all control mechanisms lose statistical significance, with the exception of the coefficient for outsiders on the board, which is still negatively related to firm's performance (fewer outside directors implies a better performance).
- The results of both models do not vary after the inclusion of industry effects.

The evidence of the interdependence model suggests that, with the exception of board composition, control mechanisms are being chosen optimally. The findings follow the argument of Demsetz and Lehn (1985) that a firm's ownership structure is being cooperatively decided by shareholders to lead to firm value maximisation. If the control mechanisms are being chosen optimally, any cross-sectional variation in their use reflects only differences in the industry or its operating environment.

The negative effect of outside directors is not very clear to the authors, but they suggest that firms tend to have too many outside directors. One possible explanation for this is that outsiders are added to boards for political reasons, to include politicians, environmental activists or consumer representatives, which will reduce firm's performance.

For A. T. Kearney (2001a, 2001b), quoted companies can be closely monitored and controlled by institutional investors and the latter are less hesitant to force change in case of unsatisfactory performance. According to the study, the reason for any difference in performance of quoted and non-quoted companies is related to the effects of disciplinary mechanisms in the context of the principal-agent problem.

Moreover, in the absence of a liquid and transparent ownership market, it is difficult for investors in non-quoted companies to exercise the ultimate sanction of selling a nonperforming stock. In addition, investors in non-quoted companies are often less informed about company developments as the reporting requirements are lighter and few, if any, market analysts cover non-quoted companies.

In a comparison of the financial performance of 5000 listed and non-listed companies in Germany, A. T. Kearney (2001a and 2001b) found that, over the period 1990 to 1998 and for the economy as a whole:

- The rate of return on invested capital (ROIC) of companies quoted on stock markets was 98.1% percent higher than the ROIC of non-quoted companies.
- The rate of return on equity (ROE) of quoted companies was 75.5% higher.

An examination at industry level of the difference in financial performance of quoted and non-quoted companies yields similar results. Quoted companies vastly outperform non-quoted companies in terms of financial performance.

- Out of the 27 industries, there were only 8 industries[6] in which non-quoted industries posted a better performance.

According to the study, the economic impact of this difference in financial performance is substantial. It is estimated that, if the non-quoted companies performed as well as the quoted companies, German GDP would be DM 300 billion (8%) higher.

So far we have reported studies showing that a higher degree of control should have an overall positive, or at least neutral, effect on firm's performance. However, some authors warn that too much control can damage firm's performance, especially the type of control often found in family-controlled firms.

For Randoy and Goel (2002), ownership structures prescribed by agency theory, such as board and inside ownership as well as block ownership and foreign institutional ownership, appear to hinder performance in founding family controlled firms.

Randoy and Goel examine the effect of founding family control (FFC) – as CEO or chair of the board – on the relationship between ownership structure and firm performance (measured in terms of profitability and Tobin's Q). They argue that the agency theory prescriptions – for example stronger corporate governance monitoring through block holder ownership – are redundant in FFC firms. Three forms of ownerships structure are considered: board and insider ownership, block-holder ownership and foreign institutional ownership.

The study of 68 small and medium-sized Norwegian firms uses information on profitability, market value, founding family CEO/Chair, board and inside ownership, block-holder ownership and foreign ownership. The authors then test the hypothesis that the performance of FFC firms is hindered by the presence of the type of ownership structures listed above. The main results are the following:

- In line with agency theory predictions, non-FFC firms benefit from board and insider ownership, outsider block-holder ownership and foreign institutional ownership

[6] Industrial machinery, textile mill products, communication, electronics and other equipment, wholesale trade of non-durable goods, miscellaneous manufacturing and rubber and miscellaneous plastics products

- In contrast, the performance of FFC firms is damaged by 'too much monitoring' from the above factors.

Their results highlight the need for taking into account the impact of alternative governance mechanisms when studying the impact of family ownership/control on performance.

The results support the view that various control mechanisms may have different impacts in different types of firms. In non-FFC firms, the costs of corporate governance controls are outweighed by the benefit of reducing high agency costs. However, in FFC firm's agency costs are either non-existent or minimal. The separation of ownership and control – the key condition giving rise to agency costs – is not applicable. As a consequence, there are no significant benefits to be gained from such ownership structures, only costs. Consequently, the performance of FFC firms is negatively related to corporate governance ownership structures prescribed by agency theory.

Other explanatory factors

A number of studies exist that analyse other dimensions of FBs such as quality or client service (Backes-Gellner, 2001), the personality of the founder (Ashley-Cotleur, King and Brazeal, 2000), or the negative impact of nepotism (Perez-Gonzales 2002) and their influence on the overall performance of the firm. In the study of A. T. Kearney (2001a, 2001b) it is argued that FBs may attach greater importance than NFBs to the employee's well-being. The study also notes that some FBs may pursue financial strategies, such as zero debt or other objectives, which are not necessarily conducive to profit maximisation.

Among the work that focuses on quality and client service it is worth noticing the study by Backes-Gellner (2001).

In the study of German industrial family businesses, survey respondents were asked to define their performance relative to the industry's overall performance. The table below shows that, according to expectations, the key perceived strengths of FBs are quality, client service and advice, proximity to the clients, price quality ratio, and environmentally friendly products and production.

Share of German industrial FBs judging their performance as better than the industry average (in % of total survey respondents)

Performance factor	
Quality	84%
Client service and advice	76%
Proximity to clients	76%
Quality-price ratio	71%
Environmentally-friendly products/production	56%
Introduction of new processes	55%
Market position	50%
Level of own capital	45%
Liquidity	42%

Source: Backes-Gellner (2001)

In contrast, the key perceived weaknesses are at the level of own capital and liquidity. Moreover, there are very few differences between medium and large FBs with regards to the first four factors. However, large FBs perform significantly better than smaller FBs with regard to the other performance factors.

Ashley-Cotleur, King and Brazeal (2000) highlight the personality of the founder, his ability to foster supplier and customer relationships and their link with success in the first family generation.

The leadership role and difficulties within the family in the second generation may place strains on employees, customers and supplier relations, especially if the second-generation owner pursues his own agenda and/or fails to honour special customer arrangements.

Moreover, the loss of long-term employees (through a weakened bond with their new company head) may lead to customer dissatisfaction and reduced loyalty. Thus, revenues and profits suffer, possibly leading to failure of the firm.

Perez-Gonzalez (2002) presents evidence of the negative impact of nepotism upon US firm performance in 1994. The firms in the sample are non-financial non-utility publicly traded corporations with sales of at least $5 million that were founded before 1964. Firms that promoted family CEOs who had not attended well-known educational institutions were found to suffer the most pronounced downturns in performance.

In addition, the author presents an overview of employment and industry characteristics in which family CEOs are most prevalent. In particular, the study finds that:

- Family heirs are promoted to CEO, on average, 7.7 years earlier than unrelated managers.
- The average ownership stake of heirs is 13.1% while the unrelated CEOs' stake is 3.3% of the outstanding equity.
- Firms that promote external CEOs are larger in sales and assets, and have lower returns on assets.
- Firm that stay under family control have lower R&D spending relative to firms who recruit CEOs externally, indicating that inherited control is less likely in technology-intensive industries.

According to the study by Westhead and Cowling (1997), FBs may pursue objectives other than pure profit maximisation. Information was obtained from a questionnaire survey. FB responses suggest that lifestyle of the owners, and employment for family members were prime objectives.

- FB respondents reported such key objectives as 'to maintain/enhance the lifestyle of the owners' and 'to provide employment for family members of the management team'.
- Moreover, the reported evidence suggests FBs and NFBs have very similar growth ambitions as stressed by the importance attached to sales growth as well as to the desire to increase net profits.
- However, there were no statistical differences in the responses for the questions linked to the desire to 'ensure the survival of the business', 'ensure that our employees have secure jobs in the business', or 'to enhance the reputation and status of the business in the local community'.

- No statistical differences were found with regard to desired increases in net profits from operations, sales levels, or increasing employment sizes.

Summary of the review of the empirical literature

The results of the empirical studies that compare the economic performance of FBs and NFBs statistically have shown a wide range of contradictory results.

For some authors (Binder Hamlyn, 1994) it is clear that NFBs outperform FBs in sales turnover and productivity.

However, opposite results have also been reported by others with regards to sales turnover and profit growth (Daily and Dollinger, 1992; Neubauer and Lank, 1998; Ganderrio, 2002; Anderson and Reeb, 2002).

Finally, some investigations conclude that the differences between FBs and NFBs are not significant with regard to turnover and profitability (Westhead and Cowling, 1997) or other performance criteria such as growth in sales (Stoy Centre for Family Business, 1997).

The research that focuses on employment at FBs also yields contradictory results. Some find evidence that FBs either post higher employment creation than NFBs (Backes-Gellner, 2001) or lower (Binder Hamlyn, 1994). Others find no statistical evidence of such differences (Westhead and Cowling, 1997).

With regard to issues such as training, employee participation, or profit sharing, the findings seem to suggest that they are all lower in FBs (Backes-Gellner, 2001).

The bulk of literature that investigates the role of control mechanisms to reduce manager discretion seems to agree that stronger control is related to better performance. However there is no agreement on the form such control should take.

Studies relating control to shareholder ownership conclude that owner-controlled firms achieve higher return on owners' equity (Monsen, Chiu and Cooley, 1964) and higher sales (Thomsen and Pedersen, 1998). Where a distinction is made between various types of controlling agent, such as an external financial institution or an internal or external non-financial company dominant shareholder, a study (Nickell, Nicolitsas and Dryden, 1997) found that only external financial institution ownership would have a positive impact on productivity growth.

Authors that focus on external or market forces as a control mechanism find that the mechanisms available to listed companies are more effective for increasing the rate of return on invested capital or the rate of return on equity (A.T.Kearney, 2001a, 2001b). Other studies suggest that control mechanisms are already being chosen optimally and hence there is no scope to increase firm's performance. Firm's ownership structure is already beingdecided by shareholders in a way that maximises firm value (Demsetz and Lehn, 1985). Therefore, any cross-sectional variation in the use of control mechanisms reflects only differences in the industry or its operating environment (Agrawal and Knowber, 2002).

Finally, some authors warn of the damage that may arise when agency prescriptions (e.g. stronger monitoring) are imposed on family-controlled firms. In NFBs, the costs of corporate governance controls are outweighed by the benefit of reducing high agency costs. However, in FBs, where agency costs are either non-existent or minimal, there are no significant benefits to be had from such ownership structures, only costs. Therefore, the performance of family controlled firms is negatively related to corporate governance ownership structures prescribed by agency theory (Randoy and Goel, 2002).

Among a number of 'other arguments' put forward to explain a potentially better performance by FBs one can find the high importance attached by FBs to quality and client service. This would obviously impact positively on performance (Backes-Gellner, 2001). Others focus on the positive link between personality of the founder and customer satisfaction (Ashley-Cotleur, King and Brazeal, 2000).

However, some special characteristics of FBs such as family promotion or nepotism (Perez-Gonzales, 2000), lack of innovation, or a focus on non-profit maximising corporate goals such as corporate well-being or zero debt (A.T. Kearney, 2001a, 2001b) may undermine the performance of FBs relative to that of NFBs.

Outline for a comprehensive European study

The fact that the studies described in the previous chapter yield contradictory conclusions about the relative performance of family businesses may be due to differences in the definition of a family business, the sample of companies, the time-period covered, etc.

To establish a firmer basis for policy-making with regards to family businesses, it would be useful to undertake a broader, pan-European study of the performance of family businesses using a consistent definition across countries and covering a sufficiently large set of performance indicators over a sufficiently long period so that short-term and long-term financial and economic performance can be assessed separately. Also, it would be useful to investigate whether the performance of family businesses that are listed on stock exchanges differs from privately held family businesses.

In this chapter we sketch out the key elements that would need to be considered in undertaking such a study. We first address the issue of the identification of family businesses and collection of relevant data. Next, we focus on the issue of definition. Then we briefly review the set of performance indicators that would need to be considered in such a study. We also review an additional set of economic variables that would need to be considered and then discuss the recommended empirical model and the main hypotheses that would need to be tested.

Identification of family businesses and data collection

A pan-European study on this subject would need to start with a proper identification of all major family businesses in EU Member States. This could be done on the basis of various lists of major or top family businesses that are periodically published by business newspapers and magazines.

As a first step, economic as well as financial information on family businesses that are listed on stock exchanges and non-listed family business would need to be collected. Information on the former could be gathered from the statutory filings required by the stock exchange on which companies are listed; while the latter would need to be gathered from the information, if any, such companies are legally required to release. As a first step in this data-gathering process, it will be important to clarify the legal financial information publication requirements of the various national legislations.

It would also be very useful to complement this primary data collection process with a survey of family and non-family businesses to gather information on all aspects of business activities (such as training, innovation, etc.) that are not necessarily covered in the documents that companies are required to publish.

At a minimum, the database that will need to be constructed should contain consistent information on ownership and key performance indicators (see below) over a period of about 10 to 15 years to allow the study to distinguish between short-term and long-term performance.

A key issue that will need to be addressed at this stage is the one of definition of a family business. To be informative, such a definition would need to allow for various forms and degree of family ownership such as single family or multiple families, first generation versus later generations, full ownership or partial ownership ranging from less than majority of ownership to more than 50% ownership, etc; and various forms and intensities of family control such as sitting on the board only, to actively participating in the day-to-day management of the company.

In addition, in order to investigate how different stakeholder interests can affect economic performance, it would be useful to gather information on the other holders of open capital of family businesses. These could be retail investors, banks, other non-bank financial institutions or other companies (national and foreign).

Indicators of economic performance

As part of our literature review, we have seen that the concept of performance may be very different for family businesses and non-family businesses. Whereas it is likely that non-family businesses focus mainly on financially-related measures, family businesses may emphasise a set of different variables such as growth in sales, employee satisfaction, maintenance of trust in the company, etc.

Therefore, it would be useful to gather a wide range of quantitative and qualitative performance indicators, ranging from the traditional financial indicators, to economic activity indicators (sales, production, employment, investment, innovation), to more qualitative indicators related to employee and customer satisfaction, etc.

Additional explanatory variables

Besides the information on ownership, it would also be useful to gather information on the forces that tend to discipline managers in non-family businesses. If strong disciplining forces are at play, the performance of family businesses and non-family businesses may be very similar. This would be useful information for policy formulation in respect of the governance of both family and non-family businesses.

In this regard, it is useful to recall that a number of studies have highlighted the importance of product-market competition and debt pressures as control mechanisms. Other authors have suggested including a measure of the state of the labour market for managers, or indicators of the risk of displacement through corporate take-overs.

Finally, since the geographical area of interest would be the whole of the European Union, or the European Economic Area, the analysis would also need to account for nation specific effects, in addition to the usual industry effects.

Empirical model

Drawing on the findings of the literature reviewed in this report, it would be useful for the study to estimate statistically the relationship that may exist between the different performance indicators discussed above and the family ownership and control indicators, as well as the discipline/control mechanisms and other additional variables.

Such empirical work would need to distinguish between short-term and long-term performance. This would be particularly important with regard to financial performance as non-family businesses appear generally to perform better than family businesses, at least over the short-run.

The empirical work would also need to take account of any retro-effect whereby performance may itself affect the nature of company ownership and control in both family and non-family businesses.

Key hypotheses to test

The study would aim to test primarily whether the performance of family businesses differs statistically and economically from that of non-family businesses. This assessment would need to be undertaken for the full range of performance indicators discussed above.

A second hypothesis to test is whether the results vary with the length of the time period over which the performance comparison is undertaken.

A third hypothesis to test would be whether any estimated performance difference varies with the level and nature of family control and whether the characteristics of the additional shareholders in family businesses with open capital have an effect.

A fourth hypothesis to test would be whether the level and nature of family ownership are themselves influenced by the firm's performance.

A fifth and final key hypothesis to test would be whether the performance of non-family businesses differs statistically from that of family businesses when managers in the former are subjected to strong external disciplining forces.

The completion of such a pan-European study would provide for the first time a comprehensive empirical overview of the relative strengths and weaknesses of family businesses in Europe and would provide valuable input into the growing debate on governance and relative merits of various forms of business structures.

Moreover, a recent study of Dutch family businesses (Leenders and Waarts, 2001) suggests that, within the family business population, there co-exist different types of family businesses with some exhibiting a stronger family orientation and some a stronger business orientation. Each orientation has strengths and weaknesses that would directly affect the performance of the family business. It might, therefore, be useful to considering adopting such a typology of family businesses in the proposed study.

Conclusions

Theory and practice indicate that, in family businesses, the interaction of the family, individual family members and the business itself constitutes a complex system with important implications for firm performance.

This report provides an overview of the theoretical approaches examining the main characteristics of FBs, and a review of the empirical evidence comparing the economic performance of FBs and NFBs.

A key fact to note is the lack of consensus on the definition of an FB, particularly on the degree of family ownership required for an FB to be classified as such.

The importance of the FB as an economic unit and the role played by FBs in the aggregate economy appears often to be less fully appreciated. From the evidence reported in this document it is clear that FBs continue to play an extremely significant role in many economies.

Family businesses and performance: the theory

At the present time, the discussion on the key characteristics of FBs and their effects on economic performance is still inconclusive.

The theoretical literature suggests that FBs benefit from a number of special characteristics that should be performance enhancing. These are: agency cost efficiencies; leadership and other efficiencies derived from the family-orientated environment (increased trust, loyalty and motivation by managers, employees and customers alike); the degree of 'freedom' in taking longer-term decisions on investment and growth.

On the other hand, FBs also suffer potentially from a number of performance-limiting characteristics such as the pursuit of non-profit maximising objectives and a greater emphasis on non-pecuniary goals, stability and succession; inefficient management; low innovation and slow adaptation to new circumstances, usually related to maintaining traditionally successful business practices.

Family businesses and performance: the empirical evidence

The key conclusion that can be drawn at present from the existing empirical literature on the performance of FBs is that, so far, there is no consensus on whether, overall, FBs perform better or more efficiently than NFBs.

The principal-agent problem and the widely held view that separation of ownership and management hinders economic performance, suggests that strong shareholder control and ownership lead to better economic performance. However, there is some lack of consensus in the literature on how this control should be exercised. Many studies suggest that it should be based, at least in part, on shareholder ownership. This argument would give a strategic advantage to FBs, where the problem of separation between ownership and management is small or non-existent. This conclusion must be qualified as some authors also warn that, while strong control appears desirable, excessive control or very high levels of family ownership may damage firm performance. Thus, the issue is to find the appropriate level of control which limits managerial discretion without impairing economic and financial performance.

There is some empirical evidence to suggest that FBs of a more family-orientated environment have differences in goal prioritisation.

- Although it is generally agreed that FBs tend to put greater emphasis on quality and client service than their NFB counterparts, the studies reach different conclusions regarding employment creation. On the other hand, some evidence is provided on the fact that FBs are less orientated to exports or looking for overseas markets, but there is no complete agreement in all the studies that the differences are statistically significant.
- With regards to the economic performance of FBs, there is no consensus whether FBs perform better in terms of turnover, profitability, or return on equity. However, innovation and development, and R&D spending seem to be lower in FBs than in NFBs.
- Recruitment and provision of employment for family members seems to be a key objective for FBs, and this has been proved to be damaging to firm performance and R&D spending. Attention to the employees' well-being also seems to be an important business objective of FBs.

Overall, the empirical studies of the relationship between firm performance and the various characteristics of FBs and NFBs are inconclusive. This may reflect the fact that the various studies rely on different definitions of an FB and use different samples of firms in different countries and different industries over different periods. Therefore, to properly inform the on-going debate on governance and the relative merits of various forms of business organisations, it would be necessary to undertake further work. Such additional research would study family businesses in Europe in a consistent framework and over a sufficiently long time-period to be able to test whether FBs outperform NFBs over the short run and/or the long run on the basis of a wide range of financial and non-financial performance indicators.

Glossary

FB – Family business
FFC – Founding family control
Fortune's list of 500 – Annual list of the 500 largest US corporations
NFB – Non-family business
R&D – Research and development
ROA – Return on assets
ROE – Return on equity
S&P 500 – Standard & Poor's 500 (US equity index)
SBF – Societé de bourse française
Tobin's Q – A financial performance indicator that divides the market value of a firm's assets by the replacement value of the firm's assets

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