

# Family-Enterprise Management

## A model and empirical test

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### Abstract

This research contributes to family business literature by empirically demonstrating the concept of *Family-Enterprise Management*. Considering family enterprise as an autonomous area, mature research field requires holistic models which integrate the existing knowledge to identify clearly the internal behaviour of the firm and its relationship with how far the agreed aims are achieved. The representative sample of 732 Spanish family enterprises enabled to find empirical support to the concept. Our model represents the first step in the development of a theory of family enterprise management. Understanding the family-business relationship in the decisions linked to the strategic process, board of directors, human resources and succession is an important requisite to be able to achieve the family and business goals, providing the distinctive characteristics for defining and understanding the behaviour of these companies.

### Introduction

What makes the family enterprise different? This question has been posed and widely debated in the specialized literature to determine the differences and basic characteristics of these enterprises. The extensive literature on this subject demonstrates that family enterprise is not a single research topic.

A literature review attempts to reflect the nature of these firms, identifies three fundamental elements in the study of family enterprise: the family-business relationship, the management and governance mechanisms (to explain the behaviour), and the organizational success. What is missing in the studies carried out up to the present on the behaviour of the family enterprise is a holistic view, integrating different areas of research (strategic process decisions, the board of directors, human resources and succession) which have been fragmented, and analysing the relationship to business and family performance. Our research try to find answer to the following questions: What are the management and governance mechanisms of family enterprise?; how are these management and governance mechanisms integrated?; what is the relationship between integrated management and governance and business and family results?

Answering the questions, we will be able to separate and identify, within a theoretical research framework, the set of variables which are considered as potentially critical factors which make the family enterprise unique and able to find a competitive advantage difficult to immitate. Our general hipotesis is that the management and governance mechanisms of the family enterprise and their orientation (business or

family-oriented) provide the distinctive characteristics for defining and understanding the behaviour of these companies. The adaptation of the mechanisms to the goals set (for both family and business) determines their effectiveness. In the present study, we try to find a common view of management in family enterprises, what we call *Family-Enterprise Management*, after finding different approaches by a classification of family enterprises (Basco & Pérez Rodríguez, 2009).

The model will allow us to: 1) integrate the two systems into a single one, the real family enterprise, 2) understand the family-business relationship, 3) understand how this relationship is achieved from decisions linked to strategic process, board of directors, human resources and succession, and 4) understand the importance of decisions and the family-business relationship for achieving their aims. The main contribution of this paper is to conceptually and empirically determine the elements that are relevant in family-enterprise management. We can conclude that decisions in four areas and their family and business orientation are significant elements in the concept of management and this combination explain the performance from the family and business approach.

### **Discussion and hypothesis**

Understanding of the family enterprise has evolved over time on three axes: 1) the family-business relationship, 2) management and control mechanisms used in the different systems, and 3) organizational success. Using these three axes attempts have been made to ascertain whether family enterprises behave differently from non-family ones, investigate the differences between different family enterprises and analyse the effect that these behavioural differences have on the organizational success of family enterprises.

The triangulation of the three axes leads to a highlighting of two relationships in the literature on the subject: 1) the appearance of the family-business relationship as a behavioural determinant of family enterprise (Borch & Huse, 1993; De Kok, Uhlander & Thurik, 2006; Eddleston & Kellermanns, 2007; Fiegener, Brown, Dreux & Dennis, 2000; Gallo & Vilaseca, 1998; He, 2008; Jaskiewicz & Klein, 2007; León-Guerrero, McCann & Haley, 1998; Mustakallio, Autio & Zahra, 2002); and 2) the appearance of the family-business relationship and its relationship with the success of the organization (Gómez-Mejía, Núñez & Gutiérrez, 2001; McConaughy & Phillips, 1999; Westhead & Howorth, 2006). From these two basic relationships, some studies analyse the relationship between the behaviour of the family enterprise and the success of the organization (Chrisman *et al.*, 2004 and 2007; Daily & Dalton, 1993; Lee, 2006; Schulze, Lubatkin, Dino & Buchholtz, 2001; Tower, Gudmundson, Schierstedt & Hartman, 2007).

The construction of our framework take into account two problems that emerge from literature review. The first one, as noted Dyer (2006) and Jorissen *et al.* (2005), the field of family business faces the difficult of drawing conclusions on the differences and unique characteristics of family enterprise because the variety of definitions of family firms and the different methodologies employed. With this problems it seems imposible to create or build knowledge. The second problem is that the study of the family business behavior has been fragmented and it has been scarcely related to financial and non-financial results at the same level of analysis.

Facing with these problems our framework try to understand holistically the behavior of family business by using the family-business relationship and to explain the family and business results.

The family relationships support different behaviour which combines two tendencies: business-oriented and family-oriented. We have demonstrated that the behaviour of the family enterprise is linked to the framework of management and governance decisions and the underlying nature of their philosophy (Basco & Pérez Rodríguez, 2009). For us, the interpretation of the family–business relationship is the quest for integration of the decisions of each area studied (strategic process, board of directors, human resources, and succession).

The mechanisms used by family enterprises are not good or bad in themselves. It is their adaptation to the goals set (for both family and business) and to what extent these are achieved which determines their effectiveness. We conceptualize the family social system and the business system as being integrated. So, governance and management address the whole family enterprise as an integrated system. Therefore it is possible to forecast that there exists a particular way of acting which can be defined as *Family-Enterprise Management* or “the combination of management and governance decisions, depending on the family or business orientation shown, based on the family-business relationship to reach family and business goals”.

*Hypothesis 1: In each activity area of the family enterprise (strategic process, board of directors, human resources, succession), there is a covariation model of the family and/or business orientation type which is used for different decisions*

*Hypothesis 2: The business and family orientation of management and governance decisions (hypothesis 1), integrated in a second order factor, are positively related to both family and business results*

### **Procedures for collecting data**

There is no directory of family enterprises in Spain. So, we built a database of family enterprises that met one of two essential requirements: There are family members on the board or in management posts, and/or the capital is divided among family members. The choice of enterprise size ranged from 50 to 500 employees.

The criteria mentioned above were applied to two databases: SABI (Sistema de Análisis de Balances Ibéricos) and DUN (Dun & Bradstreet). From an original database of 16,000 Spanish enterprises that fell within the size parameters set, 4,450 enterprises met our criteria. The sample is representative with a 3.38% sampling error. In sum, 728 companies answered a telephone survey between July and October 2004, with a minimum two calls made and a maximum of four or five calls made, depending on how difficult it was to interview and question the appropriate post holders (i.e., managing director, CEO or director). A chi-square and student analysis confirmed that there were no significant differences between the sample and the population in relation to the legal format, the sector of economic activity, the location of the enterprise, and the number of employees.

An exhaustive analysis of the literature identified the most significant areas to be included in the design of the survey questionnaire. The composition and structure, as characteristics of the whole system, were used to identify the family and business orientation in management and governance, thus defining the internal activity of the family enterprise. The system aim allowed the integration of a set of business and family goals in accordance with the design of the study. More information about the questionnaire can be found in Basco and Pérez Rodríguez (2009). The questionnaire validation process was strengthened by the critical analysis of academic experts (professors who belong to the network of family business chairs throughout Spain that the Spanish Family Enterprise Institute coordinates) and family enterprise experts (those managing directors, CEOs, and directors who helped during the pretest).

Before testing the hypothesis, a factorial analysis was used to construct the dimensions of each study area, identifying the business–family relationship. A separate principal components analysis was used to define factors for each area. Items that loaded on a factor at approximately .50 or above were subjected to a reliability analysis. The reliability analyses in all the dimensions have a value higher than .60, thus indicating the internal reliability of the constructs. The Family Tendency factor indicates that the family philosophy predominates sui generis. The Business Tendency factor indicates that the traditional business philosophy prevails.

Table 1 summarizes the meaning of each factor. More information about the items in Basco and Pérez Rodríguez (2009). The analysis confirms emphases on both family and business, thereby suggesting varying amounts of overlap in the systems of the family enterprise. The factorial analysis allows us to identify the first order factors of the proposed model. The created dimensions reflect the family–business relationship.

**Table 1: Interpreting the factors**

<b>Area</b>	<b>Factor</b>	<b>Reliability</b>	<b>Interpretation</b>
<i>Strategic Process</i>	Factor: Family tendency	.888	Reflects the functions related with the incorporation of the family in the strategic development.
	Factor: Business tendency	.835	Reflects the functions in a posture independent of the family in strategic development.
<i>Board of Directors</i>	Factor: Family tendency	.805	Reflects the functions centred on family questions.
	Factor: Business tendency	.852	Reflects general functions of the board of directors: control, acquisition of strategic resources, and advisory services.
<i>Human Resources</i>	Factor: Family tendency	.619	Reflects the use of practices based on trusted links generated by the family relationship.
	Factor: Business tendency	.647	Reflects the use of practices in formal relationships where market philosophy predominates.

<i>Succession</i>	Factor: Family tendency	.854	Reflects the development and training of the successor from an internal viewpoint to boost the skills and capabilities of the future leader.
	Factor: Business tendency	.834	Reflects the development of the successor from a viewpoint based on experience and his capacity to demonstrate his skills as future leader.

To measure performance, we used a multidimensional approach developed by Hienerth and Kessler (2006) as a proposal for the family enterprise environment. So, 14 items were used for business performance, from the work of Gupta and Govindarajan (1984), and 13 for family performance, based on Sorenson (1999 and 2000). More information about the items in Basco and Pérez Rodríguez (2009). Business and family performance were calculated as weighted averages of the score for each item, given the importance of the goal and the level of satisfaction with each goal.

### Results

To contrast the hypotheses of the proposed model AMOS 7.0 for Windows was used as the basis for a study of structural equations. Structural equation models allow a series of multiple dependency relationships to be considered simultaneously, to represent non-observed concepts.

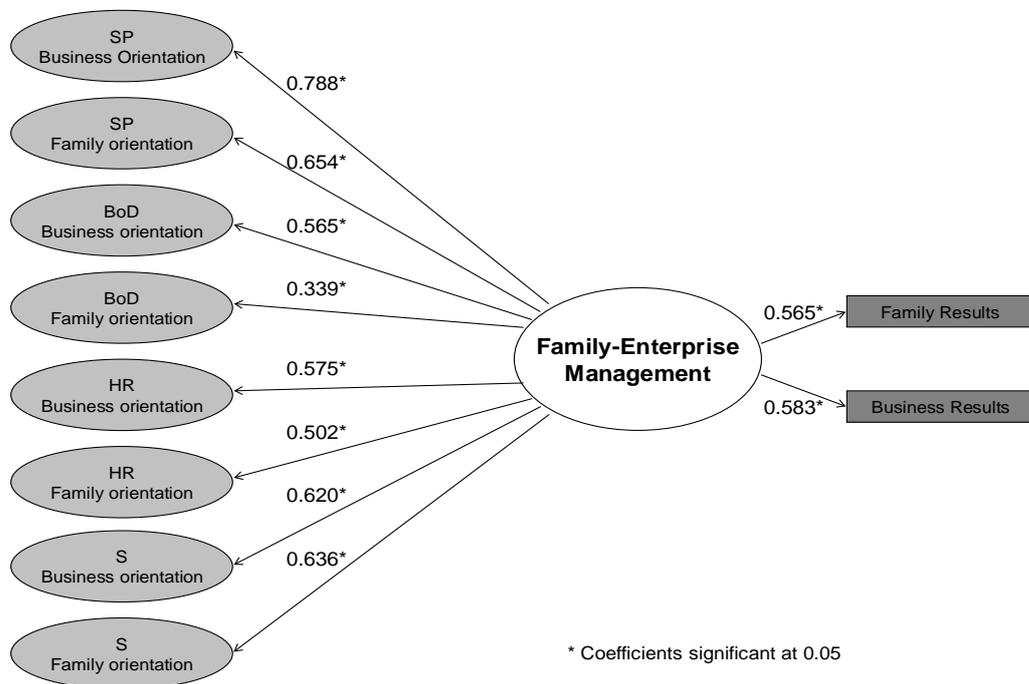
The structural equations model uses two levels: 1) a measurement model (confirmatory factor analysis), and 2) a structural model (simultaneous linear regression). The measurement model is used to analyse the relationships between the dimensions (non-observed latent variables – first order factors) and their corresponding indicators (observed, i.e. measured, in our research are each management and governance decisions-practices). The structural model analyses the relationships between the constructs (second order factor) and the latent variables (drawn up from observable indicators) and relationships between construct and performance measures.

The sequence diagram identifies the relationships between the dimensions (first order constructs) and the second order constructs (see Figure 1). The arrows indicate the specific relationships between each one. In the first order factorial analysis each observable variable was assigned to its corresponding dimension (only one parameter between the variables and the dimensions is set to the value 1). In the second order factor the co-variation between the dimensions (first order factors) was analyzed. All the coefficients related to the second order factor (*Family-Enterprise Management*) were estimated freely except the relationship set with value 1 (to identify the model the indications of Rindskopf and Rose, 1988, were used).

Once the model was defined the variable distribution characteristics (kurtosis and multi-collinearity) were evaluated. We considered the recommendations outlined by Byrne (2009). The normality and kurtosis distribution analysis run with the SPSS and Amos program did not show any observed indicator which is significantly abnormal or has very marked kurtosis.

For the first order factors the measurement model has to be considered. This is applied through the confirmatory factorial analysis (CFA), as an *a priori* requisite to measure the relationships (Wisner, 2003). This means that the measurement model specifies the measurement of the first order factors with the indicators, establishing the reliability and variance extracted. The CFA confirmed the composition of the scales identified in the previous factor analysis. Cronbach's coefficient in all cases was over 0,7, the criterion usually considered to identify strict internal consistency, and in all cases, the composite reliability coefficient was above the minimum level of 0,6 recommended by Bagozzi and Yi (1988). The results of the CFA are shown in Table 2. The different adjustment measures allow the corroboration of the goodness of fit of the factors analysed for each of the areas of management and governance.

**Figure 1: Construct-level structural equation model (standardized version)**



**Table 2: Evaluation indices: Confirming factorial analysis**

Areas	Dimensions	Absolute fit measurements				Measurement model	
	First order factors	GFI	RMSEA	AGFI	Chi-Norm.	Reliability	Significance
Strategic Process	SP-Business	0.944	0.65	0.919	4.11	0.893	> 0.05
	SP-Family					0.933	
Board of Directors	BoD-Business	0.954	0.081	0.917	5.8	0.854	> 0.05
	BoD-Family					0.871	
Human Resources	HR-Business	0.982	0.065	0.957	4.05	0.736	> 0.05
	HR-Family					0.730	
Succession	S-Business	0.961	0.048	0.943	2.66	0.889	> 0.05
	S-Family					0.903	

The measurement model also analyzes the content, convergent and discriminant validity (Fornell and Larcker, 1981). Since the scales were built on the basis of the previous literature and therefore included items used in scales that had already been validated for measuring similar concepts and the questionnaire was considered by academics and family enterprises experts. The convergent validity of the measurements is represented by the high factorial weights and the significance of these, as well as by the high variance measurements explained for each dimension. Finally, discriminant validity measures the degree to which the specified latent factors differ even though they are correlated. The discriminant validity was evaluated, demonstrating that correlations between the dimensions are not as high as their reliability coefficient.

Before evaluating the model, the error estimates were determined, i.e. the estimated coefficients were identified (for both the measurement and the structural model) which might have exceeded the acceptable limits. The most common error estimates are: 1) negative error variances, 2) standardized coefficients which are greater than or near 1, and 3) very high standard errors related to any estimated coefficient. Once it had been verified that there were no error estimates, adjustment analyses were carried out.

The aim of a global fit assesment is to determine the degree to which the model as a whole is consistent with the collated empirical data. Except for the  $\chi^2$  test, which did not reach the desirable significant level (P-value equal to or over 0,05) – as expected because of he sensitivity of this test to the number of cases in the sample. Diamantopoulos and Siguaw (2000) recommended using several measures. The other indices were satisfactory since they exceeded the optimal values recommended.

Table 3 shows the goodness of fit indices mentioned which allow the validity of the proposed model of the *Family-Enterprise Management* concept to be accepted and its relationship with family and business results.

**Table 3: Evaluation indices**

	<b>CFI</b>	<b>GFI</b>	<b>RMSEA</b>	<b>Chi-Norm.</b>
General Model	0.904	0.87	0.043	2.30

All the coefficients of the proposed relationships are significant at 95% confidence level. This means that the conclusion is that not only the statistical adjustment of the model is correct but also that the relationships between the construct (*Family-Enterprise Management*) and first order factors (management and governance decision dimensions) and business and family results variables support the theoretical framework from which they were established.

The standardized total coefficients (Figure 1) show the strength of the relationships proposed in the model (in all cases they are higher than 0.5). In the proposed relationships statistically significant values are identified for P ( $P < 0.05$ ).

The first hypothesis was formulated considering the *Family-Enterprise Management* concept as a second order factor. The standardized effects of the relationships between the second order factor and the first order factors, which differentiate the types of management and governance decisions by their orientation, are high and reach significant P values. The results allow the first working hypothesis to be accepted.

The concept of *Family-Enterprise Management* conceived as a latent model allows the importance to be inferred of all dimensions by family or business orientation. High standardized effects can be seen between the *Family-Enterprise Management* construct and the following factors: the business and family succession process, the business and family strategic process, the decisions of the business board of directors and the business and family human resources decisions. At the same time a slightly lower standardized effect can be seen with the board of directors factor which considers family decisions.

The low levels for the family board of directors dimensions can be justified from agency theory. The ownership and management of the enterprise are integrated in one person or a group of persons with family links, and so need fewer control mechanisms. For the group of small and medium enterprises studied, it may be that the board of directors is in fact redundant for the exercise of some functions. Although the family board directors was found to be less important, it does contribute to building a concept of Family-Enterprise Management.

In the second working hypothesis, the relationship between the *Family-Enterprise Management* construct and the business and family results shows high values for the standardized parameters (Table 4) with statistically significant relationships. This confirms the second hypothesis. The concept of *Family-Enterprise Management* centres on the consideration of family and business aspects in management and governance decisions to explain the business and family results. The causal relationship between the *Family-Enterprise Management* construct and results measurements is positive and significant and the relationships explain 0.30% and 0.33% of the variance in business and family results respectively (R-squared).

**Table 4: Standardized total effects of the structural equations**

	<i>Family-Enterprise Management</i>
Family_Efficiency	.619
Business_Efficiency	.713
PE-Business	.739
PE-Family	.655
BoD-Business	.601
BoD-Family	.401
HR-Business	.578
HR-Family	.564
S-Family	.609
S-Business	.637

## Conclusions

This study may shed light on the way the family business is governed and managed, and contribute to the debate about the behaviour and performance. This study adopts a

holistic and systematic approach to analysing family management, taking into consideration various decisions-practices and orientation and relating them to outcomes.

Our model represents the first step to build a theory to explain the behavior of the family business. Because of this our research has some academic and practical implications.

### **International and managerial implications**

The model has a practical application in that it can help family and non-family participants in enterprise development to reflect on the way in which, explicitly or implicitly, they use management and governance mechanisms to lead the family enterprise towards its financial and non-financial goals. They should be interpreted the decisions in the context in which they develop, recognising the importance of family elements within their overall enterprise. Owners, managers and practitioners should recognize where and how the family-business relationship affects the existence of the family business which seems to be important: in the management behaviour and in the aims of the family business. The model that has been presented can help participants to recognize what kind of business they run. They need to analyze their family enterprise, and what type of decisions they use in their course of actions.

In closing, our model can help unveil the unobservable aspect of the family business. If the participants could understand their decisions, their orientation and the aims or goals, they have an opportunity to be consistent. The consistency could explain why family business succeeds or fails and it is the best way to build a bridge from the present to the future: what kind of business do I run? – what kind of business do I want to run?

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