Innovation in family and non-family SMEs: an exploratory analysis

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Innovation initiatives are known to enhance long-term performance of a business. However, those are high-risk endeavours because they involve large, upfront and mostly irreversible expenses whereas, success of innovations is not guaranteed. Family managements generally avoid excessive risks and for small and medium enterprises (SMEs) financial prudence is of utmost importance. Though SMEs play a significant role in most economies, the authors point out that in the SME context, differences in innovation activities and R&D investments between family and non-family businesses have not been studied.

In this study, the authors surveyed 2087 SMEs across 20 industry groups in Germany to examine how the innovation process differed in family and non-family firms. Their analysis led to some interesting findings that are presented in this summary.

Innovation in Family Firms

Like most of their strategic behaviour, family firms' decisions with respect to innovation are governed by their unique combination of economic and non-economic goals. Research on innovation in family firms has been inconsistent. On one hand, some studies suggest that family firms are not innovative. For instance, family firms have been found to invest less in innovation compared to their non-family peers. Innovation expense is a sunk cost with uncertain payoffs. Family managements' risk aversion to financial losses may be limiting their innovation expenditure. Besides, innovation failure is also likely to erode socioemotional wealth, which the owner families want to avoid. Family involvement is also known to have a negative relationship with patent citations. This indicates that owner families do not wish to take large risks involved in radical innovations. Ownership structures of family firms are also known to be inhibitors of innovation.

On the other hand, many studies suggest a positive link between family involvement and innovation outcomes. They argue that the unique characteristics and resources of family firms give them an edge in fostering innovation compared to non-family firms. Long-term orientation, stewardship behaviour and tacit knowledge of family firms have been found to be some of the underlying factors that make family firms more innovative.

Measuring Innovation Activities in SMEs

The authors studied the probability of SMEs investing in innovation and measured their innovation intensity by calculating innovation expenditure per employee. They measured product and process innovation outputs of SMEs. Family ownership, firm size and age were some of the other crucial measures that were considered in the study. Based on these measures further statistical analysis was conducted to understand the distinctions between innovation in family and non-family SMEs.

Key Findings

Some of the key findings of the study were the following -

1. ***Low Innovation Intensity*** - Family SMEs were more prevalent in industrial sectors that had relatively lower innovation intensities (such as food and tobacco) compared to non-family SMEs active in sectors that had higher innovation intensities (such as telecommunications). This suggests that family managements are more comfortable in sectors that grow with incremental innovations compared to those that grow with radical innovations.

2. ***Higher Investment in Innovation*** - Family SMEs were found to have a larger probability of investing in innovations compared to non-family SMEs. This points to the family managements' desire to retain competitive edge through constant innovation, even though most of those are incremental in nature. This investment ensures family SMEs' long-term sustenance.

3. ***Larger SMEs are more Innovative*** - Innovative SMEs were found to be larger in size in both family and non-family categories. Their large scale of operation gives bigger SMEs the advantage of larger capital resources needed to fund innovations.

4. ***Younger SMEs Innovate More*** - Innovative SMEs were found to be younger in age. This may be because younger firms are often driven by entrepreneurial zeal and passion to do something new or different.

5. ***Family SMEs good at Process Innovation*** - Family ownership was found to have a significant positive effect on process innovation output of the SMEs. Family managements thus had a positive impact on innovating business processes. However, process innovation was found to decrease with firm age. This may be explained by a tendency of organisational inertia that older firms often suffer.

6. ***Lower Labour Productivity*** - Family SMEs were found to have lower labour productivity than non-family SMEs. This may be due to the fact that family managements often lack systems and processes for monitoring productivity.

However, on most of the other parameters that authors studied, family SMEs were found to have an edge over their non-family counterparts in managing innovation.

Practical Implications

Family firms need to constantly innovate in order to have a competitive advantage. Instead of risky, radical innovations, family firms can opt for regular, incremental innovations as their pathway to success and long-term sustenance. These may include developing innovative production or delivery processes. Family firms must regularly invest in innovation, with clear objectives and targeted productivity levels. It is most important that family firms do not slip into inertia. They must keep their entrepreneurial spirit alive, while always exploring new ways of doing things.

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