Family Firm Heterogeneity and Governance: A Configuration Approach

– *Mattias Nordqvist, Pramodita Sharma, and Francesco Chirico*

Family firms vary in terms of family involvement in ownership and management of business. Though literature recognizes family firm heterogeneity, it is not clear about what governance mechanism are most suitable to attain the objectives of different types of family firms. In this paper, the authors identify from extant literature, nine types of family firms based on varying levels of family involvement in firm ownership and management. The authors also list the kind of governance mechanism(s) that are likely to be most effective in each of those cases.

Evolution of Family Firm Governance

Family firms are known to have distinct governance mechanism due to family involvement in management, ownership and control of business. Agency theory dominates the thinking on family firm governance but only examines it from the perspective of incentive structures. Another view that emerges in literature looks at governance from its three constituent perspectives i.e.,: 1) norms of legitimacy that guide resource allocation and accountability 2) norms of authority that minimize conflict and make decision - making efficient, and 3) incentive system that minimizes agency costs.

However, family firms are heterogeneous on account of level of family involvement in ownership and management. The nature of family involvement is likely to change overtime, thereby changing the firm's authority structure, legitimacy norms and incentive structures.

The governance bodies in family business range from family meetings (at the informal end) to Board of Directors (at the formal end). The authors posit that the extent and nature of family involvement determines as to which governance body(ies) is/ are appropriate for the family business. Hence, family firms need to evolve their governance mechanisms in tune with the changes in family's involvement in business.

Configuration of Family Involvement and Governance Mechanisms

Family ownership may change overtime from a controlling-owner firm to a sibling partnership, to a cousin consortium. In terms of family involvement in management, firms may vary from being family operated to family supervised to family investor firms.

Taking into account three levels of family involvement in ownership (i.e., controlling owners, sibling partnership and cousin consortium) and in management (family operator, family supervisor and family investor firms), the authors identify nine configurations and suggest governance mechanism that might be most appropriate in each context. These are as following:-

1. ***Controlling Owner-Family Operator Firms:*** In these firms owner-manager makes strategic decisions. Governance bodies effective in these firms include - Advisory Board and Family Meetings.

2. ***Sibling Partners-Family Operator Firms:*** These firms are managed by sibling owner-managers. Board of Directors/ Advisory Board, Shareholders' Assembly and Family Meetings are the key governance structures in these cases.

3. ***Cousin Consortium-Family Operator Firms:*** These firms are operated by cousin owner-managers. The governance structures in these setups include - Board of Directors, Shareholders' Assembly and Family Council.

4. ***Controlling Owner-Family Supervisor Firms:*** These firms are led by a family owner - CEO. Board of Directors, Top Management Team and Family Meetings are the key governance bodies in these firms.

5. ***Sibling Partners-Family Supervisor Firms:*** These firms involve a large number of family and non-family members. Governance bodies in these businesses include - Board of Directors (with External Members), Top Management Team, Shareholders' Assembly and Family Meetings (with a Facilitator).

6. ***Cousin Consortium-Family Supervisor Firms:*** These firms involve a large number of family members and require extensive information disclosures. Board of Directors (with External Members), Top Management Team, Shareholders Assembly, and Family Council are the key governance structures in these businesses.

7. ***Controlling Owner-Family Investor Firms:*** In these firms ownership and control is clearly demarcated. Governance bodies in these firms include - Advisory Board and Family Meetings.

8. ***Sibling Partners-Family Investor Firms:*** Non-family managers dominate the top management of these firms. Board of Directors/ Advisory Board, Shareholders' Assembly and Family Meetings are the main governance structures in this case.

9. ***Cousin Consortium-Family Investor Firms:*** These firms have increased diversity among family owners. The governance structures in these setups include - Board of Directors, Shareholders' Assembly and Family Council.

Practical Implications

Family involvement varies across family firms. It also varies in the same firm over time. Therefore, it is important for family businesses to transform their governance structure to that is appropriate to their specific context. This will ensure good alignment in their norms of legitimacy, authority and incentives structures, hereby leading to effective governance.

In order to maintain the effectiveness of the governance mechanism it is vital that family firm managements anticipate forthcoming changes in family ownership and involvement in business management. Following this, family businesses must take timely action towards designing appropriate governance structures for both the business and family (which is often the ignored part). These measures will maintain the continuity of effective overall governance.

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