

FAMILY FIRMS – how social and business networks influence the choice of board members

Abstract

Family firms are characterized by concentrated ownership, with one or a number of family members in control of the majority of shares, and family members often take leading roles in managing the firm. Decision making is thereby not only influenced by economic conditions but also by family-oriented considerations. There is furthermore often limited contact with external sources of competence, as family members often occupy the leading positions and rely on family members also for the positions in the board of directors. Previous research on the board composition of family firms has mainly focused the context of publicly traded family businesses. There is a lack of studies examining how family firms identify the chosen members of the board. It has been indicated that nonfamily board members primarily are included as a result of pressures from nonfamily stakeholders, like investors and banks, but there is a lack of empirical studies addressing this issue. Addressing this gap, this paper reports on a qualitative study of four family firms in a Swedish region characterized by sparsely populated areas and small cities.

Introduction

The family firm, a universally fundamental form of business organization, is of major importance to economic development and growth, locally as well as nationally (Adjei et al., 2018), extensively contributing also to international trade (De Massis et al., 2018). Family firms are characterized by concentrated ownership, with one or a number of family members in control of the majority of shares, and family members often take leading roles in managing the firm (Fama and Jensen, 1983). The family ownership often results in emotional attachment to the firm (firm-specific human capital (Gedajlovic and Carney, 2010)) and a long-term orientation (De Massis et al., 2018). Decision making is thereby not only influenced by economic conditions but also by family-oriented considerations. There is furthermore often limited contact with external sources of competence as family members often occupy the leading positions (Boellis et al., 2016; Kano and Verbeke, 2018) and often rely on family members also for the positions in the board of directors (Bammens et al., 2011).

Family firms relying on restricted, family focused, networks for their decision making, run a risk of network closure, resulting in lock-in effects and inertia (Boschma, 2005). In contrast, relationships with actors external to the core of family members may bridge structural holes (Burt, 1992, 2004) and thereby increase the likelihood of accessing novel knowledge and information. Previous research on the board composition of family firms has mainly focused the context of publicly traded family businesses (Bammens et al., 2011) and the consequences of various constellations. The findings regarding the impact of nonfamily members in the board of directors on firm growth and firm internationalization have however been contradicting (Bammens et al., 2011; Fernández and Nieto, 2006; Zahra, 2003). Such inconsistencies may originate in differences between family firms, since the family firm concept has not been consistently defined in previous studies (Arregle et al., 2012).

There is furthermore a lack of studies examining how family firms identify the chosen members of the board. It has been indicated that nonfamily board members primarily are included as a result of pressures from nonfamily stakeholders, like investors and banks (Bammens et al., 2011), but there is a lack of empirical studies addressing this issue (Carney et al., 2014).

Quantitative methods dominate family firm research (Hair and Sarstedt, 2014) and there has been repeated calls for further case studies able to deepen the present knowledge on various topics (e.g. De Massis and Kotlar, 2014). Adhering these calls, this paper reports on a qualitative case study of five Swedish family owned SMEs acting on international markets, focusing on their choice of board members. The firms are located in rural areas or small cities in a sparsely populated part of Sweden, within a 4-5 hours' drive from the capital Stockholm. This paper contributes to our understanding of family firm management by examining how social and business networks of family firms influence the choice of members of their board of directors. It thereby broadens and refines our understanding of family firm governance and the factors contributing to firm growth.

Theoretical frame of reference

The family firm

Family firms have been characterized on the basis of personalism (combined ownership and control, which implies decision making with accountability only to family members); parsimony (careful resource deployment as the family owns the resources and thereby puts their own property at risk); and particularism (the option to give priority to nonfinancial, family-related outcomes, such as family control) (Carney, 2005). It has also been recognized that owner families tend to assemble boards of directors that do not threaten their discretion over decision making (Bammens et al., 2011), which may result in a high proportion of family members in the board of directors. The effects of various types of board compositions have been studied from different perspectives and in relation to various outcomes, such as firm growth and internationalization (Arregle et al., 2012; Bammens et al., 2011). There is however a strong predominance of quantitative studies and a lack of studies addressing how the owner family identifies individuals to be included in the board of directors (Carney et al., 2014). The choice of board members may be influenced by nonfamily stakeholders (Johannisson and Huse, 2000), but is likely also often strongly affected by the individuals included in the owner family's network of relationships. In other words, by the number and types of individuals included within the network horizon (Snehota, 1990).

The board of directors is of interest as board members may represent a pathway to new knowledge and information, critical to innovation and competitive advantage. In a closed network (Burt, 2001), such as a family, each actor is connected to most other actors within the network. As a consequence, there is a lot of trust due to shared norms and social control, but access to new information within this closed network is limited (Coleman, 1990). Research on social networks and business networks have shown that network closure may result in lock-in effects and opportunity costs due to the lack of novel information and new, creative ideas (Boschma, 2005; Grabher, 2004; Granovetter, 1985). In contrast, bridges to other networks, for instance represented by external members of the board of directors,

may add value by facilitating access to various types of resources, such as information, knowledge and referrals. It has for instance been observed that team compositions including individuals with personal networks spanning beyond the team to different parts of a company are more likely to be successful (Rosenthal, 1997). The number and variety of firms included within a focal firm's network horizon (Henders, 1992) is therefore of importance, as is the firms and individuals within that horizon considered relevant for action (Snehota, 1990). These aspects will be affected by emergent social and business networks, but also organised networking initiatives, like regional strategic networks (Eklinder-Frick and Åge, 2017; Lundberg, 2011) may make a difference.

Method

A qualitative case-study method (Yin, 2013) was chosen to create greater understanding of how small and medium-sized family firms identify external members of their boards of directors. Four firms located in a region characterized by sparsely populated areas and small cities are part of the study. Three interviews were carried out at the firms' premises during January and February 2019. The final interview was made using Skype for practical reasons. Before the interviews, the firms' web pages, newspaper articles and public records were searched for background information, for instance regarding the composition of the board of directors. For the data analysis and the data reduction process (Coffey and Atkinson, 1996; Miles and Huberman, 1994), the constant comparison method was applied.

Case presentations

Case 1: the food producer

Case 1 is a third-generation family firm located in a village of less than 1 000 inhabitants, 42 kilometres from a city of less than 100 000 inhabitants. The present owner acts as CEO and the board includes only the CEO and her husband. After one year at the university, studying business administration, she started working in the firm under the guidance of her father and grand-father, both former CEOs. She has no siblings but her father still fills the role of an adviser from time to time. She recognizes the risk of myopia from being so dependent on family members for the firm management and often "feels very alone", lacking someone outside the family to discuss with. She has proactively tried to interact with other firms in the nearby area by taking active part in a small regional strategic network that arranges various kinds of events intended to facilitate firm interaction and offer opportunities for knowledge development, such as seminars, after work and study visits. The other network members are however very small firms or self-employed individuals. They rarely participate in the offered activities, and she questions their ability to really contribute to developing her firm.

Case 2: the equipment producer I

Case 2 is located at the outskirts of a city of less than 20 000 inhabitants. The CEO is a representative of the third generation, a sibling works in the administrative department and a third sibling is a passive owner. After a year in the USA as an exchange student, a degree in business administration at university level and after working for some years with other companies, he accepted a position in the marketing department and 7 years later became the CEO. He had, however, joined the board of directors some years before starting working

in the company. He has “always taken an interest in the firm. Dad has talked about interesting matters and we have discussed a lot at home. ... I’ve always had an interest, so when there was an opening at the marketing department, I took the chance.” They still do many business trips together, “he is more like a friend, we have a nice dialog and make decisions together”.

The present board of directors includes the father and former CEO (the chairman of the board), the uncle (and part-owner) of the present CEO, the sibling who works in the firm but also two nonfamily members. One of them is an old friend of the family who used to run a large firm. The other is a personal friend of the CEO from the university years, who now runs a national unit of a large multinational company and therefore knows a lot about running sub units. The CEO “appreciates the opportunity to get some input from external actors but also the need to motivate why various measures are taken – or not”. There was for many years another chairman, a CEO of a larger local firm with “much experience of international business and cultural differences”. He is an old friend of the family and could provide advice when they were planning to enter the US market.

There are however also other channels for various kinds of input from external actors, as the firm is part of three strategic regional networks. One group of firms coordinate various forms of contracts, such as transportation and electricity. A larger network (A: 19 members), supported by the municipality, cooperates on recruitment and some of them, using similar technology, also on R&D together with a leading Swedish university. The CEO finally takes part in a network for CEOs in the region.

Case 3: the wooden products producer

Case 3 is a second-generation family firm producing wooden products. It is located in a village of less than 1 000 inhabitants, 17 kilometres from a city of less than 10 000 inhabitants. The majority owner acts as CEO. Two other siblings are passive shareholders. The present CEO had that position for 8 years in the past, then left the firm for two years working for one of their major suppliers, a large multinational company in the area, before returning to the position of CEO.

This CEO is a rather passive member of a regional strategic network and does not interact much with other firm managers in the area. He feels that the firm acts in a rather special niche and that the network of suppliers and customers is sufficient. In his second period as CEO, he has however made important changes in the board of directors. In addition to a sibling (who is also a co-owner) there are now four external individuals. One of them he got to know a long time ago when she worked for one of their resellers. The second external member of the board is vice-president of a sub-division of the large multinational company the CEO previously worked for. The third member is one of their present resellers who “knows a lot about business” and the fourth member acts as the chairman of the board. The CEO got to know him privately to start with as they have a shared interest for a specific hobby and met through mutual friends.

Case 4: the equipment producer II

Case 4 is located in a village of less than 1 000 inhabitants, 17 kilometres from a city of 7 000 inhabitants. The present CEO represents the second generation, a sibling is production manager but the founder still owns the firm as is chairman of the board. The firm has 24

employees. The founder realized the benefits of local networking and of involving external actors on the board early on - both informally and formally. He was part of a group of local CEOs who met regularly to help each other out by discussing board-related issues regarding their firms. When the present CEO joined the firm in 2004 (becoming CEO in 2014), there were two external board members, both CEOs of local firms. One of them was a personal friend of her father while he had met the other person in a project run by a public support agency, providing small firms with board members.

In addition to the founder (chairman of the board) the board now consists of another local CEO who “knows a lot about branding”. The founder (who did not know him from before) proactively contacted him, inviting him to join the board. The other external member is the CEO of a firm in another city. The present CEO met him in a regional strategic network (B) that they both participate in; a regional strategic network that cooperates on recruitment and, a smaller group, on R&D together with a university. She appreciates him as a person and he is able to ask relevant questions, not hesitating to query their work, as his firm has gone through a similar development as they are facing and therefore understands their challenges.

Discussion

Kin, and especially the closest relatives, are easily accessible and likely willing to join the board of directors. but may be too personally involved in the business to be able to offer objective advice. A CEO receiving advice from a senior family member may also experience a certain pressure to comply with that opinion, especially if the person giving the advice is the original founder or a previous CEO, and still a member of the board of directors. Furthermore, if the CEO is taking advice from senior members of the family, like a parent, their views may already have been “streamlined” during the upbringing, as a family that interacts a lot can become a closed system (Burt, 2001; Grabher, 2004) where you often know the opinion and expectations of the other party beforehand. If CEOs thus mainly rely on a core network consisting of family members, they run a risk of not receiving the appropriate support in opportunity recognition, the evaluation of various alternatives and in making critical decisions. Non-family relationships would then be more likely to provide novel information as they bridge structural holes (Burt, 2004), and such individuals may also possess needed expert competences in certain areas.

In order to escape the closed family network structure, CEOs can aim to include external individuals in the decision-making process by offering positions on the board of directors or discuss on more informal occasions. For case 1, however, this step felt so far-fetched and out of reach that it had not even been discussed. Representing a small, low-tech firm and without any formal education herself, she might find it hard to approach managers of larger firms even if several are within reach in the neighbouring city. In her own view, it is a form of “incompetence”, but it is maybe also a case of insecurity and a lack of arenas for interaction.

The CEOs of case 1 and 3 share the feeling of running a firm that is rather unique in the area and in questioning if the other firm managers really could be of any help in improving the business. But the CEO of case 3 has worked in another company for two years in a managerial position, which gave him many new important insights that have affected the

composition of the board of directors. He saw the value of an open, forward-looking discussion and noticed that complementary competencies can make a huge difference in all types of decisions, from strategic topics to streamlining the business for greater efficiency and efficacy. As a result, he added three business contacts and one personal friend to the board and, in his opinion, this has meant a great difference.

Like case 3, also case 2 and 4 illustrate the importance of personal relationships when small and medium-sized family firms look for board members. Notably, however, case 4 also shows that regional networks may provide platforms for interaction that can broaden the network horizon and make other firms and individuals being considered relevant for inclusion in a board of directors.

Conclusions

The present study illustrates the importance of the personal networks for the choice of external members of the boards of directors in small and medium-sized family firms. Notably, however, it also illustrates that the arenas for interaction offered by regional strategic networks may broaden the network horizon as well as the firms and individuals network context considered relevant when choosing a board of directors. This may be of great importance as CEOs of family firms that only share their ideas and thoughts within a closed network of family and close friends run a risk of facing the downside of network closure in the form of limited access to information and novel knowledge.

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