A reflection about Responsible Ownership in family SMEs

Cristina Aragón Amonarriz
Deusto Business School
University of Deusto
Mundaiz, 50
20012 San Sebastián (Spain)
Tel: 34 43 32 66 00; Fax: 34 43 27 39 32
cristina.aragon@deusto.es

Cristina Iturrioz Landart
Deusto Business School
University of Deusto
Mundaiz, 50
20012 San Sebastián (Spain)
Tel: 34 43 32 66 00; Fax: 34 43 27 39 32
cristina.iturrioz@deusto.es

A reflection about Responsible Ownership in family SMEs

Introduction

The responsible ownership (RO) term originally was associated to large firms (Demb & Neubauer 1992; Demb & Richey 1994) where ownership is often so fragmented that individual shareholders have difficulty to exercise control over the board and/or the firm management (Maher & Anderson 2002). In the last decade, this concept has been applied to closely held large firms, where ownership is concentrated in the hands of few owners, as happens in the majority of family firms (Aronoff & Ward 2002; Lambrecht & Uhlaner 2005; Brundin *et al.* 2008; Berent-Braun & Uhlaner 2012a; among others). However, few are the development of RO in small and medium family firms (FSMEs). These firms are the predominant form of enterprise in all developed economies; in fact, more than 90% of businesses have fewer than 50 workers and approximately two thirds, at least, of such firms are family businesses (Neubauer & Lank 1999). The direct relations between the family and the firm allow the owners to set up the parameters within which their business has to be run (Lambrecht & Uhlaner 2005). In fact, the particular nature of family firms allows that "due to their ownership, family members enjoy certain control rights over the firm's assets and use these rights to exert influence over decision-making processes in an organization" (Carney 2005: 251); aspect that it is particularly intensified in FSMEs. The relevance of this kind of firms and their specific governance and organizational context in FSMEs require a development of the concept of RO and its operationalization.

Following Lambrecht and Uhlaner (2005: 8), RO is considered "an active and long-term commitment to the family, the business and the community, and balancing these commitments with each other". RO and corporate governance are closely related, but they are not the same thing. Whereas corporate governance is defined as the internal and external

mechanisms to influence the behaviour of management of firms toward the interests of stakeholders (Maher & Andersson 2002); RO is a construct that goes a bit further and, in the case of family firms, pursues the balance among the family, the business and the society. Following Uhlaner *et al*. (2007a: 278) "serves the collective good of the ownership group as well as the firm". Therefore, corporate governance can be considered in FSMEs as one of the very central elements of RO, but not the only one.

This paper aims to develop the RO concept applying it to the particular nature of the FSMEs. Firstly, in FSMEs, family is a specific and relevant stakeholder whose duties and rights have to be balanced along with the interests of other stakeholders in order to allow the continuity of the firm (Sorenson *et al.* 2009). Secondly, the family has a relevant influence on the firm, not only due to its main ownership rate, but also due to its influence on the firm culture and involvement of family members with or without formal contract with the firm (Chrisman *et al.* 2012). And, thirdly, in FSMEs owner-manager overlaps extensively or even completely. The family member or group, based on asymmetric information, governs directly the firm usually without any other formal mechanisms (Huse 1993; Mustakallio *et al*. 2002). As a consequence, the owner commitment to those stakeholders is necessary to guarantee the balance among the different systems, the family, the firm and the society.

Therefore, in FSMEs, the maintenance of the required balance among different stakeholders' interests has to be based on the owners' commitment to the firm and its stakeholders, and on the explicit behaviours associated to this commitment in order to make it credible to the stakeholders.

In this study, we adapt the RO concept (Uhlaner *et al.* 2007a) to FSMEs and propose a new construct called responsible family ownership (RFO). RFO considers, both, the commitment of the family to the stakeholders in the long term; and the explicit behaviours associated to RO in FSMEs. Thus, this study contributes to the RO literature by providing a new construct,

the RFO, which is a key driver in order to balance family and firms systems and thus to promote healthy FSMEs.

In the following sections, we first present a review of the literature of RO and evidence the need of a more accurate concept to assess it in FSMEs and second, we develop the RFO construct, focusing on the theoretical development of its different dimensions. Finally, the main conclusions are presented.

From Responsible Ownership to Responsible family ownership: a review

After the work about the *effective shareholders* in family firms (Aronoff & Ward 2002), different authors have developed the concept of RO in closely held firms in the last decade. In particular, Aminoff *et al.* (2004: 17) define RO as a position, a role and task which includes risks, duties and worries. These authors present RO as the result of "balancing the rights and privileges of ownership such as wealth, power, joy, source of motivation, and other rewards, with associated duties and risks of ownership including the proper concern for welfare of the firm and accountability for the firm success".

Lambrecht & Uhlaner (2005: 8) focus on the commitment required to balance rights and duties in the long term. They define RO as "an active and long-term commitment to the family, the business and the community, and balancing these commitments with each other". In this sense, Brundin *et al.* (2008: 16) define responsibility by the family firms as "emotions such as being protective, caring, nurturing, and being prepared to make sacrifices and to channel one's full energy and time into the family business".

Based on these previous conceptual advances, some other authors have tried to identify particular behaviours linked to this RO concept. Hamilton & Godfrey (2007:9) identify some good owners' practices such as the development a shared vision for their future together or the ability to design a workable decision-making process for the group of owners. At the same time, Uhlaner *et al.* (2007b: 278) define the concept of RO behaviours (ROB) as "acts that serve the collective good of owners and the firm".

Due to the lack of direct measurement of owner attitudes or behaviours, a common shortcoming in corporate governance research (Huse 2005; Uhlaner *et al.* 2007), some empirical studies have been recently developed applying these concepts to the context of family firms. Firstly, Berent-Braun & Uhlaner (2012b: 23) analyse the impact of RO behaviour in the financial performance of the family owned large firms. In this paper, the authors identify four types of RO behaviours: professionalism, active governance, owners as a resource and the fulfilment of basic ownership duties.

Secondly, the same authors focus on the study of the family governance practices in large firms, and identify different practices related with family constitution, family code of conduct, clear selection and accountability criteria, family council, formal family communication mechanisms and family reunions (Berent-Braun & Uhlaner 2012a).

But, what about FSMEs? Family firm is conceived as a dominant, controlling coalition that shapes the vision of a firm across generations (Habbershon & Williams 1999). This definition of family firm, as others, possesses three core elements: overlapping of ownership and control; family involvement in management; and the expectation or realization of family succession. All these three characteristics are particularly intense in FSMEs (Carney 2005). The relevant and specific role of the owner and the family in these firms require a responsible attitude by family owners and a specific development of the concept of RO is missing.

Three are the main reasons supporting this specificity. Firstly, in FSMEs, family is a specific stakeholder with a relevant influence on the firm. The asymmetry between the family and other stakeholders highlights the relevance of balancing family and firm systems to assure the continuity of the firm (Sorenson *et al.* 2009). However, in FSMEs additional conflicts of interest and asymmetric information problems may arise, not between managers and owners (Huse 1993; Uhlaner *et al.* 2007b), but among the family and other stakeholders, since this kind of ownership structure can "adopt policies that benefit the family at the expense of the other stakeholders" (Won 2011: 287), expropriating value from other shareholders to increase the wealth of the controlling owners (Chang 2003; Won 2011). The owner-manager can prioritise the interests of the firm over the family members' interest or *viceversa*. In both cases, both systems are unbalanced.

Secondly, ownership is central in determining the influence of a family on a business (Astrachan *et al.* 2002; Sundaramurthy & Kreiner 2008). The family is not only interested on the continuity of the firm itself, but on the continuity of the firm in the hands of the family (Sirmon & Hitt, 2003), and without any doubt, this implies a series of responsibilities in form of owner family's duties and rights towards the firm. These duties and rights of the owner family affect the family understood in a wide sense. It affects family owners but also other family members with direct or indirect influence on the FSMEs, even if they are not current owners or managers.

Thirdly, in FSMEs owner-manager overlaps extensively or even completely. As a consequence, direct and informal governance, based on asymmetric information, is developed by the family. In FSMEs, the family member or group governs directly the firm and often rely on informal social controls usually without any other formal mechanisms (Huse 1993; Mustakallio *et al.* 2002; Uhlaner *et al.* 2007a). In this case, the monitoring system, oriented to assure that the manager does not act as a free-rider, becomes unnecessary. For example, these

firms may not need a board of directors (Filatochev 2006; Minichilli *et al.* 2009; Berent-Braun & Uhlaner 2012b).

From the previous review, we conclude that, firstly, there is a lack of studies on RO in the specific context of FSMEs. Secondly, the development of the RO concept for FSMEs deserves a specific development different to large firms, since the lack of formal governance mechanisms is replaced by the owners' commitment to stakeholders and their responsible behaviours. And finally, given the critical role that the concept of RO has on the healthy evolution and development of FSMEs, a development of the RO construct to asses the particular specificity of RO in FSMEs is needed.

The RFO construct: family commitment and responsible behaviours

RFO stresses on the particular responsibility of the family, as the main owner of the firm, to balance both, internal and external stakeholders' interests and family's interest. The assumptions considered in the definition proposed by Lambrecht & Uhlaner (2005: 8), where RO is considered as "an active and long-term commitment to the family, the business and the community, and balancing these commitments with each other" are extended in RFO. As a result, in this paper, RFO is understood as "an active and long-term commitment of the family owners with the other stakeholders of the family firm, included non-owner family members and other non-family owners, that implies to balance the rights and privileges of family ownership with associated duties and risks of ownership including the proper concern for welfare of the firm and the firm success". The advantages of the specific term RFO are that it recognises the relevance of the specific stakeholder of FSMEs, the family, and therefore it focuses not only on corporate governance but also on the family governance.

The presented definition includes, according to the relational governance model presented by Uhlaner *et al.* (2007b: 277), two components: owner commitment and specific behaviours, or ways of acting. In the case of FSMEs, it would be family owners' commitment and family ownership behaviour.

Family owners' commitment

RO is supported by family's strong attitudes. The Family Business Network listed ten attitudes that showed responsible behaviour, such as the preservation of the history or the clear definitions of family and clear roles of family members, although few families achieve to process all of them (Hamilton & Godfrey 2007). In this sense, owner commitment has been accepted as the main attitude related with RO (Aminoff *et al.* 2004; Fitgerald *et al.* 2005; Uhlaner *et al*. 2007b). Owner commitment is "the degree to which owners as a group feel emotional attachments, involvement and identification to the firm they own" (Vilaseca 2002; Uhlaner *et al.* 2007b).

In the specific case of family firms, this commitment is based on the vision of firm continuity, one of family firms' intrinsic characteristics (Sirmon & Hitt 2003). This broad vision comprehends the requirements of the stakeholders of the company, avoiding to focusing only on the family interests, as a basic condition to develop wide stakeholder commitment. In this sense, some family owners consider that the function of their firms is to provide goods and services that lead to the maximisation of profit within the 'rules of the game'. This vision is consistent with the neoclassical approaches (Friedman 1962, 1970) based on the premise of the maximisation of the efficient use of resources. By contrast, other owners attempt to meet societal expectations in terms of protecting the environment, developing the community, conserving resources, and philanthropy. This broader perspective is consistent with stakeholders' theory (Freeman 1984) and is directed towards building sustainable social

relationships (Quazi & O'Brien 2000). In this sense, having sustainable social relationships implies attending to the demands of "[...] any group or individual that may affect or be affected by the achievement of business objectives" (Freeman 1984: 25). In this manner, a family company ensures its long-term interests by building a link to society (Quazi & O'Brien 2000), and the vision of a firm entails that companies contribute to the welfare of society because it has responsibilities that extend beyond the maximisation of short-term profit.

Family ownership behaviour

In order to become real, this commitment has to be proved by actions. Supporting commitment asks family owners to model certain behaviours. On the contrary, the lack of behaviours showing or the existence of behaviours denying these attitudes becomes RO unbelievable. Therefore, behaviours are also, in the extent, required to develop RO (Hamilton & Godfrey 2007). Literature has focused on RO behaviours that are defined as “owner behaviours that serve the collective good of the ownership group as well as the firm” (Lambrecht & Uhlaner 2005; Uhlaner *et al.* 2007a). In this sense, higher commitment will derive in higher responsible behaviour it is inferred by Uhlaner *et al.* (2007b: 234) when they state that “owners with stronger commitment are likely in turn to behave more responsibly toward the firm”.

Berent-Braun and Uhlaner (2012b: 23) identify four types of ownership behaviours: professionalism, active governance, owners as a resource and the fulfilment of basic ownership duties. Regarding professionalism and following these authors, family owners act professionally when they become involved with internal affairs within the firm only if it is agreed that doing so is part of their responsibility, but it can also be related to inconsistent demands, interference or meddling demands that are a well-recognized problem in the family business literature (Aronoff & Ward 2002; Eddleston & Kellermanns 2007). In this sense,

family ownership is frequently described as in need of professionalization (Brundin *et al.* 2008). Two main streams of issues have been studied regarding professionalism in family firms. On the one hand, the human resources policy in the family firm, leaders selection and equality practices among non-family and family employees (as e.g. promoting family members, even if they are not the most adequate to the position in the firm) are particularly relevant in the family context and they are related with the clear selection and accountability criteria (Berent-Braun & Uhlaner, 2012a). On the other hand, the organizational and financial practices in the family firm assuring the required delegation level and financial resources for the firm competitiveness (Gallo & Amat 2003). The risk is to make relevant decisions following family needs or preferences or financing personal expenses or investments directly from the firm and not general norms of company management. In this context, the concentration of power and responsibility in the same hands makes more difficult to separate both systems, generating problems due to this confusion. Thus the RFO has to focus specifically on avoiding this confusion and keep both systems separate as one of its main purposes.

Second, active governance refers to the monitoring of management by owners. In the case of FSMEs, the firm is directly governed by a family member or group, and thus the monitoring system, oriented to assure that the manager does not act as a free-rider, becomes unnecessary (Filatochev 2006; Minichilli *et al.* 2009; Berent-Braun & Uhlaner 2012b). Third, owners as a resource is understood in family firms as the owners' abilities to provide specific resources to create a competitive advantage (Berent-Braun and Uhlaner 2012b). Owners with a wide conception of the family firm consider, as the purpose of the firm, the satisfaction of its stakeholders in the long term. As stated in the previous section, this approach is supported on the family ownership commitment to stakeholders.

Fourth, owners' basic duties are associated with activities such as attendance at shareholder meetings concerning e.g. business succession planning, the review of annual reports... In the case of FSMEs, considering the lack of formal governance mechanisms, the succession of the owners and the managers in the firm is one of the main basic duties of the ownership. In fact, early family business research family (Morck, *et al.* 1988; Fukuyama 1995; Morck & Yeung 2003) often view nepotism, preservation of the status quo, and expropriation of nonfamily shareholders as main rationales for succession within the family (Zellweger *et al.* 2012). In fact, delaying the succession process is one of the one of the most frequently perceived irresponsibility in family firms (Gallo 1998).

Table 1. The RFO construct based on Responsible Ownership Behaviours

Responsible Ownership Behaviours in large family firms (Berent-Braun and Uhlaner, 2012b)	**Responsible Family Ownership in FSMEs**
Professionalism: the extent that owners fulfil the roles and commitments in relationship to the owners and to the firm. The involvement with firm internal affairs only if it is part of their responsibility.	Professionalism in leader selection and human resources management
	Professionalism in organization and financial practices
Active governance: monitoring of management by owners	Family ownership commitment to stakeholders
Owners as a resource: creating a competitive advantage by the owners' abilities to provide specific resources, related to their contribution to the firm's social capital	
Fulfilment of basic ownership duties: attending at shareholder meetings in order to develop different topics such as business succession planning.	Planning the firm succession

Source: Own elaboration based on Berent-Braun and Uhlaner (2012b)

Conclusions

The objective of this work was the development of the RO concept, in order to make it applicable not only to large and publicly held firms but also to FSMEs, a very relevant

category of the firms in all economies. Based on the literature, the need for the theoretical development of new construct called RFO has been argued.

The paper contributes to the debate on RFO in FSMEs by developing an insightful and inspiring new construct adapted to the particular governance system and stakeholders asymmetry in FSMEs. The RFO construct presents interesting insights about the responsible issues relevant to FSMEs, in particular, regarding family influence. This may be especially noteworthy in FSMEs where family power can prime without considering firm competitiveness and damage organization's survival.

Further empirical research may be undertaken in order to develop a measurement scale of this RFO construct and test the validity of the scale in different FSMEs contexts. Moreover, RFO construct impacts on managers' behaviours and it could be probably related to social responsibility in FSMEs. Relationship between RFO and social responsible enterprises need to be developed and tested, too. Finally, taking into account that "ethics refers to the rules or principles that define right and wrong" (Sims, 1994: p. 5) understanding the relationship between owner ethical behaviour and RFO and their implications in FSMEs competitiveness and sustainability can also be a future area of research.

References

Aminoff, P., Blom, A., Pärssinen, K., Helkama, J., Koiranen, M., Nyman, K. and Paasikivi, K. 2004, *On the characteristics and duties involved in responsible ownership*. Helsinki, Family Business Network Finland.

Aronoff, C.E. and Ward, J.L. 2002. *Family Business Ownership: How to Be an Effective Shareholder*. Family Enterprise Publishers, Marietta, GA.

Astrachan, J.H., Klein, S.B., and Smyrnios, K.X. 2002. 'The F-PEC scale of family influence: A proposal for solving the family business definition problem.' *Family Business Review*, 15, 45–58.

Berent-Braun, M.M. and Uhlaner, L.M. 2012a.'Family Governance Practices and Teambuilding: Paradox of the Enterprising Family.' *Small Business Economics Journal* 38:1, 103-119.

Berent-Braum, M.M. and Uhlaner, L.M. 2012b. 'Responsible ownership behaviors and financial performance in family owned businesses.' *Journal of Small Business and Enterprise Development*, 19 (1), 20-38.

Brundin, E., Samuelsson, E.F. and Melin, L. 2008. The family ownership logic: Core Characteristics of family-controlled businesses, CeFEO Working Paper 2008:1.

Carney. M. 2005. 'Corporate Governance and Competitive Advantage in Family- Controlled Firms.' *Entrepreneurship Theory and Practice*, May, 249-265.

Chang, S. J. 2003.'Ownership structure, expropriation and performance of group-affiliated companies in Korea.' *Academy of Management Journal*, 46, 238–253.

Chrisman, J.J., Chua, J.H, Pearson A.W. and Barnett, T. 2012. 'Family Involvement, Family Influence, and Family-Centered Non-Economic Goals in Small Firms.' *Entrepreneurship Theory and Practice*, March, 267-293.

Demb, A. and Neubauer, F.F. 1992. 'The corporate board: confronting the paradoxes.' *Long Range Planning'* 25:3, 9-20.

Demb, A. and Richey, B. 'Defining responsible ownership: cross-national perspective.' *European Management Journal*, 12: 3, 287-96.

Eddleston, K.A. and Kellermanns, F.W. 2007. 'Destructive and productive family relationships: a stewardship theory perspective.' *Journal of Business Venturing*, 22:4, 545-65.

Filatotchev, I. 2006. 'Effects of executive characteristics and venture capital investment on board composition and share ownership in IPO firms.' *British Journal of Management*, 17: 1, 75-92.

Fitzgerald, M., Haynes, G., Schrank, H. and Danes, S. 2005. 'For-Profit Family Businesses as Socially Responsible Organizations: Evidence from the U.S. National Family Business Survey' Paper presented at the FBN-IFERA World Academic Research Forum, EHSAL Brussels.

Freeman, R.E. 1984. *Strategic Management. A Stakeholder Approach.* Pitman/Ballinger, Harper Collins, Boston.

Friedman, M. 1962. *Capitalism and Freedom*. University of Chicago Press. Chicago.

Friedman, M. 1970. *The social responsibility of business is to increase its profits*. New York Times Magazine.

Fukuyama, F. 1995. *Trust.* New York, NY: Free Press.

Gallo, M. Á. 1998. *La sucesión en la Empresa Familiar*. Servicio de Estudios "La Caixa".

Gallo, M.A. and Amat, J. 2003. *Claves del éxito y la duración de las empresas familiares*, Instituto de la Empresa Familiar.

Habbershon, T. and Williams, M.L. 1999. A resource based framework for assessing the strategic advantages of family firms. *Family Business Review*, 12, 1–25.

Hamilton, S. and Goodfrey, J. 2007. 'Preparing the next generation for the responsibilities of ownership.' *Journal of Wealth Management,* 10: 3, pp. 8-16.

Huse, M. 2005. 'Accountability and Creating Accountability: A Framework for Exploring Behavioural Perspectives of Corporate Governance.' *British Journal of Management* 16, S65–S79.

Huse, M. 1993. 'Relational Norms As a Supplement to Neo- Classical Understanding of Directorates: An Empirical Study of Boards of Directors.' *Journal of Socio-Economics*, 22:3, 219–240

Lambrecht, J. and Uhlaner, L.M. 2005. *Responsible Ownership of the Family Business: State-of-the-art*, The Family Business Network International, EHSAL, Brussels.

Maher, M. and Andersson, T. 2002. 'Corporate governance: effects on firm performance and economic growth', In McCahery, J., Moerland, P., Raaijmakers, T. & Renneboog, L. (Eds), Corporate Governance Regimes: 386-418, Oxford University Press, Oxford.

Minichilli, A., Zattoni, A. and Zona, F. 2009. 'Making boards effective: an empirical examination of board task performance.' *British Journal of Management,* 20: 1, 55-74.

Morck, R., Shleifer, A., and Vishny, R. W. 1988. 'Management ownership and market evaluation: An empirical analysis.' *Journal of Financial Economics*, 20, 293-315.

Morck, R., and Yeung, B. 2003. 'Agency problems in large family business groups.' *Entrepreneurship Theory and Practice*, 27, 367-382.

Mustakallio, M., Autio, E. and Zahra, S.A. 2002. 'Relational and Contractual Governance in Family Firms: Effects on Strategic Decision Making' *Family Business Review* 15:3, 205–222.

Neubauer, F., Lank, A. 1999. *La Empresa Familiar. Cómo Dirigirla para que Perdure*. Ediciones Deusto, Barcelona.

Quazi, A. M. and O'Brien, D. 2000. 'An Empirical Test of a Cross-national Model of Corporate Social Responsibility.' *Journal of Business Ethics*, 25, 33-51.

Sims, R.R. 1994. *Ethics and organizational decision-making: A call for renewal*. Westport, CT: Quorum Books.

Sirmon, D.G. and Hitt, M.A. 2003. Managing Resources: Linking Unique Resources, Management, and Wealth Creation in Family Firms, *Entrepreneurship: Theory and Practice*, 27, 339–358.

Sorenson, R.L., Goodpaster, K.E., Hedberg. P.R. and Yu, A. 2009. 'The Family Point of View, Family Social Capital, and Firm Performance: An Exploratory Test.' *Family Business Review*, 22, 239-253.

Sundaramurthy, C. and Kreiner, G.E. 2008. 'Governing by Managing Identity Boundaries: The Case of Family Businesses.' *Entrepreneurship Theory and Practice*, May, pp.415-436.

Uhlaner, L.M., Wright, M. and Huse, M. 2007a. 'Private firms and corporate governance: an integrated economic and management perspective.' *Small Business Economics*, 29:3, 225-241.

Uhlaner, L.M., Floren, R.H. and Geerlings, J.R. 2007b. 'Ownership commitment and relational governance in the privately-held firm: an empirical study.' *Small Business Economics*, 29- 3, 275-93.

Vilaseca, A. 2002. 'The Shareholder Role in the Family Business: Conflict of Interests and Objectives Between Nonemployed Shareholders and Top Management Team' *Family Business Review*, 15:4, 299–320.

Won Y.O., Young K.C., Martynov, A. 2011. 'The Effect of Ownership Structure on Corporate Social Responsibility: Empirical Evidence from Korea.' *Journal of Business Ethics*, 104:283–297

Zellweger, T.M., Nason, R.S. and Nordqvist, M. 2012. 'From Longevity of Firms to Transgenerational Entrepreneurship of Families: Introducing Family Entrepreneurial Orientation.' *Family Business Review*, 25(2) 136–155