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Is the family business a safer type of governance in time of crisis?

Abstract

Family-owned businesses account for half of the capitalization of the Paris Stock Exchange and more generally 80% of businesses, all sizes considered. Their shares often remain stronger and perform better than those with anonymous shareholders. A performance that apparently continues in times of crisis even though funds in family-owned firms show in 2008, a decline from a performance standpoint, they are more resistant. The stakes are high: family-owned businesses represent a significant percentage of country GNPs and even more so as a percentage of the number of firms. Why and how family-owned capitalism seems to suffer less from the crisis? The aim of this paper is to show why and how, family-owned firms are more resilient to crises than others.

The search for financial independence makes them less vulnerable to a liquidity contraction in financial markets. The reasoning in terms of a heritage which must be bequeathed to future generations implies a longer-term decision horizon that does not systematically favour a quick return on investment. Family-owned firms seem to have found a way of reconciliation between tradition and modernity and provide a strong governance model in complex and changing environments.

Keywords: family-owned businesses, crisis, social responsibility, governance, long-term decision.
JEL Classification: M14, D92, H12.

Introduction

Family-owned businesses account for half of the capitalization on the Paris Stock Exchange and more comprehensively 80% of the structures of all sizes. Their stocks often stay stronger and more performing than those with anonymous shareholders. Thus, the OSE (family-owned companies Oddo) index recorded a performance of 10.3% over the year 2008 against 9% for the DJ Euro Stoxx. The performance remains apparently stable in a period of crisis. Even the performance of the funds in family business, dropped in 2008, shows more strength. The stake in substantial family businesses account for a sizeable percentage of the domestic GNP (from 30 to 65% according to countries) and a still higher percentage of the member of firms (Beckhard and Dyer, 1983; Shanker and Astrachan, 1996): 90% in the United States according to Ibrahim and Ellis (1994), 60% in France, 93% in Italy (Gallo, 1994). They also generate 50% to 75% of the total employment figure one may wonder whether the crisis brings back family capitalism into fashion.

It is true that family businesses are, by nature, distant from the sectors which are severely hit by crises such as: finance, energy and also raw materials. The causes of their higher resistance should still be accounted for, of one wants, to make out a model of capitalism that is more resistant to financial crises. The purpose of this paper is to show why and how family businesses resist financial crises better than the others. The better results of family businesses have their source in the particular features, which are nowadays considered an endogenous in the case of this better resistance. This paper will try to bring out these characteristics.

1. Family-owned businesses, the rate of indebtedness and performance

A lot of literature has dealt with the definition of family businesses. There are almost as many definitions as authors. As far as we are concerned, we shall agree with Croutsch and Granidis (2008) to adopt a definition proposed in 1986 by Stern, who described the family business as being controlled by the members of one or two families. This definition is quite wide since neither any seniority nor any minimum percentage of capital holding by the family are required.

The quantitative analysis of family businesses' economic weight as well as the assessment of superiority in terms of results has been shown by numerous authors (Allouche and Amann, 1995; Galve and Sala, 1993; Gallo, 1994; Gluek and Meson, 1980; Ibrahim and Ellis, 1994; Lank, 1994; Leach, 1990; Martinez, 1994; Owens, 1994; Reidel, 1994; Ward, 1987; Guèye, Leleux and Schwass, 2002).

J. Allouche and B. Amann (1995) showed the superiority of family businesses over non-family businesses in terms of economic performance over the 1989-1992 period in relation with a sampling of 47 firms. They highlighted the following points:

- the average return of family businesses in higher than that of non-family businesses;
- the net capital yield ratio, which proves the ability of firms to pay shareholders, is positive;
- the net profitability ratio leads to similar conclusions;
- the gearing is markedly lower;
- the general liquid assets ratio is higher;

- the economic profitability is higher;
- the self financing capacity is higher.

The higher profitability of family assets was confirmed by a later study conducted over a wider sampling and a decade (Gueye, Leleux and Schwass, 2002).

The financial data enable family businesses to tackle a shrinking market under better circumstances, on the one hand, but also, and more particularly, a lack of liquid assets within financial bodies. Markedly lower gearing confirms the family businesses' wish to take fewer risks concerning its capacity to transform current assets into liquid assets, in order to meet usual contingencies and make them less dependent on the banking system.

2. A basis of values promoting the notion of trust

The greatest differentiation between family structures and non-family structures lies in the capacity of the family business and of its management to direct their activity through founding values. "The culture effect" is based on the capacity for a firm to create wealth in connection with its founding values. Concerning "the culture effect" Ronald S. Burt (1999) showed that the stronger a firm's culture is the higher the return of its investments. A study conducted by J. Kotter and J. Heskett (1992) showed the limits between the economic and financial performance (measured by the growth of the net results, the average return of the invested capital and the average yearly increase of the share price, based on 207 US companies) and the in-house culture of a vast sampling of firms selected from a wide range of industrial activities.

According to Schein (1985), culture is the whole of fundamental assumptions sufficiently confirmed in action so that it is possible to consider them a valid and, consequently, to teach them, any new member of the group, introducing then as the most appropriate way to be able to think and sense the issues of collective action. On the bases of the values, established by the founder, a specific firm culture, which the family will transmit through the generations, is created. More specifically the culture of the family business is a combination of three different cultures, whose convergence ensures permanence: the culture of the management, the culture of the Board of Directors and last the culture of the family itself (Dyer, 1986). Those three cultural systems should be managed simultaneously.

To a large extent, a family business draws an advantage from the consideration of human factors. Those factors are particularly useful. The employees' attitude toward their work is more important than the changes in their working conditions (Gillespie, 1991). The family business can then rely on the family or more generally on a staff whose human aspect is considered in the organization. In times of crisis the human dimension of a family business becomes a valuable asset. Over 70% of those polled by PriceWaterHouse Coopers[1] among 1454 family business managers declared that human resources constituted their first priority investment.

A recent study by PriceWaterCoppers highlighted the priorities of the family businesses' managers: among investments human resources come first, the workers' training and development are "the issues that governments should tackle first and foremost" according to those firm heads. Average salaries are lower in family businesses in compensation for high-rise of the value of work. That is the reason why they are less affected by the famous "turnover". The stability of the persons concerned and the qualities, which inspire them, make it possible to build up confidence toward the family business stakeholders. Allouche and Amann (1998) proposed that notion of trust as a factor, explaining the good results of family businesses. We may question ourselves about the stability of that trust in times of crisis.

"Thus the explanation of the superiority of family businesses must lie in the expression of confidence in three dimensions: (1) personal trust; (2) intra-confidence; and (3) inter-confidence".

The notion of "personal trust" mobilized by Williamson (1993) described the confident relationship between managers. Concerning family businesses, it described the connection between the managers of the family business, whether they belonged to the family or not once these "outsiders" subscribed to family values. Intra-confidence is the cone existing between the managers and the employees of the structure, family businesses give more stability just as in a family, according to the principle that "one must feel well at home" (PriceWaterHouseCoopers study).

The trust between the organization and its environment may be called inter-confidence. In that case too, the family business constantly calls up its limits with external parties concerned and its commitment in the economic web, which feeds it, a contextual setting, which brings an unquestionable asset in times of crisis.

3. An efficient mode of governance

With Lannoo (1994) definition as a basis, we can define governance as the system by which companies are managed and controlled. It can be reduced to an elementary structure of rights and control operated by the owners, to control and reward the peo-

[1] http://www.pwc.fr/enquete_sur_les_entreprises_familiales_2007_08.html.

ple in charge so that they should serve the shareholders' interests the best they can.

Whereas the theory of ownership rights (Fischer, Alchian, Demsetz, 1972) stressed the advantages of the divide between the functions of manager and owner. Recent developments, based in the theory of the agency (Jensen, Meckling, 1976; Fama, Jensen, 1983), have studied how far the interaction between the family and the firm permitted to solve or not the agency problems, reported in a non-family business. Vilaseca (2002), Chrisman et al. (2004), George et al. (2005), Zahra (2005), and Bartholomeusz and Tanewski (2006) have studied the relationships between shareholders and manager within public companies and more particularly listed firms. Let us notice that in the case of a family business, the manager/owner has both functions, which should reduce the problems of incomplete information.

The theory about corporate governance, drawn from the works of Berle and Means (1932), assessed the disparities between controlling shareholders and the others. There was also the necessity to change the managed firm into a governed firm. Pound (1995) described the features of the two paradigms (managed firm/governed firm) and resumed the assessments of the steps to take in order to complete the decision process and enable shareholders, and directions to influence the managers' actions, concerning family businesses. Numerous studies have shown that they did not resort much to pavement of dividends, which also distinguishes them specifically from the usual governance conflict. The low level of the payment in dividend, consequently, a strong feature of permanent family businesses and that situation can also be accounted for by the absence of information asymmetry between managers and investors since they are both, managers and owners (Spence, 1974; Myers, Majluf, 1984).

As emphasized by Mignon (2000) concerning this state of fact about the sampling of the Henokians[1] firms studied.

"In this respect, it may be noticed that there are several ways of paying a shareholder: by giving him dividends but above all, by letting him make a capital gain on the sale of the securities he has held. The latter way is not the one preferred by the firms of our sampling since they are unlisted firms, consequently, with no liquid assets. Besides, the minority sometimes find themselves in a situation in which the taxes paid exceed the dividends they have received. This situation which is unbearable for any shareholder, giving priority to the yield of his portfolio and a sentimental attachment of the family to the capital represented by the firm".

One of the main features of the family business is the part, it represents in the family's capital. The family will then act like a non-diversified shareholder but controlling the firm and, consequently, not much inclined to investments in risky plans so that the capital should not be staked too dangerously. This becomes an asset in times of crisis.

In fact, a family business presents an obvious specificity in its structure which is the coexistence of 3 types of actors: family, management and shareholders with the bodies representing the tree groups. The overlaps shareholders/family and management/family have been widely written about. Whatever, legal standpoint is adopted, a family business consequently shows that fundamental characteristic which in the interaction between the life of the business and the lives of one or several families, the firm depends on the family and the family depends on the firm (Gélinier and Gaultier, 1974). As a consequence, it presents the particular feature of being at the intersection of two systems, the former of which works with an emotional logic (the family) and the latter with a rational logic (the firm). So, it is governed by a compromise of the values, standards and objectives of the two systems.

Although, there is no real specific structure of family businesses, they, however, share certain features directly derived from their culture and history. According to Neubauer (1994) the active role of the board is one of the major determining factors of survival in family businesses. However, most family businesses ignore or underrate the importance of the board, whose only role is often to ratify decision which have already been made. Too many family businesses choose the members of the board only among the members of the family.

The coexistence family business may give rise to many problems as conflicts often have their origins in family issues. However, this coexistence can contribute to the success and performance of the family business through its stable direction (Danco, 1982), its capacity to put up with hard times, its sense of tradition, even of personal involvement (Donckels, 1989). Though these family conflicts and inter- or intra-family rivalries sometimes make the firm more difficult to manage, it should be noticed that the dependence of the business in relation to family hazards is not a permanent feature and should be put into perspective along with the firm's development stage (Hirigoyen, 1985). Finally, a conflict is not negative in itself. In fact, the firm, which experi-

[1] Henokians companies have been permanent family businesses for over two centuries.

ences no conflict, certainly misses part of its ability to innovate, to adapt and to change (Lank, 1997).

4. A much more distant horizon of strategy and investment

A few authors put weight on the distinction between non-family businesses and family businesses by showing the latter as self-contained (Donckels and Frolhich, 1991) or introverted (Cohen and Lindberg, 1974) in which the "family" subsystem is dominant and determines the other three subsystems: management, firm and share capital. Besides, these firms are supposed to have managers who named rather be "one-man bands" or "organizers". On the contrary for Mouliné (2000), it seems that the family business cannot be comprehended as a self-contained system for it appears to be permanently connected with its economic, technical, political and socio-cultural environment. It participates in social actuality while being partly determined by this actuality which is defined through its institutions, standards, values, culture and practices (Martinet, 1985). Besides for Hirigoyen (1985), it is possible to specify that the pursuit of profitability by managers-owners may decline as the firm grows and that beyond a certain size. Managers-owners' attitude may tend to get closer to salaried managers.

Family businesses are reputed for aiming at the best financial independence. However, they remain dependent on their historic fund-providers who generally belong to the family. This financing policy largely limited by the financing capacity may sometimes exclude development strategies which can sometimes appear as indispensable to the survival of their entity, but is favourable, when there is a crisis of current assets on financial markets. However, this financing policy is often accompanied by a detrimental confusion between family capital and firm capital.

The family nature of the capital permits to think that a family business has investment capacities with long-term views, whereas, the decisions of expansion, refocusing or restructuring, are often motivated by "growth opportunities which may yield a return higher than the capital cost" (Hoarau, 1998) in listed firms managed for their value. The long-term permits higher risk-taking according to the portfolio theory and, consequently, those actors become less prejudiced against risks.

According to the study "Survey of Consumer Finances, 1995" published in 2000 family business owners are more inclined than non-owners to run financial risks in their portfolio management and actually run more risks but with a more distant horizon.

Time is an essential component of firm management and more widely of all the financial theory. According to the principle of "the short-sightedness of markets", they have just a short-term vision and are unable to see beyond the profit of next three months. It seems that the strategic horizon of a family firm is distinctly more distant than the one of non-family markets and firms. Time and the attitudes towards time in a family business are essentially tackled though the study of their permanence. Mignon (2000) wondered if the pursuit of business permanence was not an alternative scheme in the pursuit of value by the financial market, she did emphasize the fact that the opposition of the two management processes should be moderated. A scheme of the creation the short-term share value must not be opposed to a model of a permanent family business. The financial experts of share value infer that the interests of the parties concerned (the "stake holders") are convergent over a long period (Copeland, 1995; Stern, Castillo, 1998). Then the question is "to know if a firm's final purpose is to survive over several centuries or to make its shareholders wealthier" (Albouy, 1999, p. 90).

All permanence is perceived as a permanence of power with a very strong adaptability. Family business presents two types of permanence: a permanent power and permanent planning or activity (Mignon, 2000). Not only does a business react to its environment but it also "pro-acts"; its capacity for evolution is emphasized. Mignon (2000) showed that real data fluctuated between those two extremes. Adaptation and selection are not antinomic; change and continuity are two opposite tensions and a source of evolution (Tushman et al., 1986). Again according to Mignon (2000) the capacity for adaptation to the market, to the customers' needs, to the technologies of production, and the permanence pursuit of the customer's satisfaction appear as the two most often mentioned criteria of permanence with ability of pro-action. These qualities emphasize strong energy with family business, a guarantee of its survival.

De Geus (1997), Collins and Porras (1994) have highlighted that long-term successful firms are those which are able to "preserve their essence and stimulate their progress". Family businesses justification often lies in their own permanence. However, this notion is often implicit in other discussed issues (entrepreneurial attitude and attitude toward time more particularly). Thus, as the factor of permanence mentioned firm is adaptation (Mignon, 2000), there is no doubt that the attitude to innovation is pointed out in that case. Mignon wrote: "If continuity relies on men's values and loyalty, the references to the needs for change have the following aspects: innovation, diversification, importance of the willingness to pro-act, appropriateness of the requirements adaptation".

Hanna and Chen (1997) studied the relationship between risk, planning horizon and wealth. They deduced that even investors with a very low personal risk tolerance manage their portfolio very aggressively and consequently with great risk if the planning horizon exceeds twenty years. That conclusion permits to put into perspective the standard notion of less risk-taking by family businesses.

The great categories of specific risks, they are confronted with concern:

1. The continuity and permanence of the family core (absence of heirs, family conflicts and the issue of nepotism).
2. The continuity and permanence of the transmitted values.
3. Stability to expend and change along with the times.

One of the paradoxes generated by the notion of permanence is also that of the necessity to change while remaining stable, and that of the necessity to yield, to the pressures of the environment, and at the same time to be able to transform it. Is a family business competent to manage those paradoxes?

The vision and the strategic intention are the characteristics of the strategic management of a family business.

According to Ward and Carlock (2001), a family business's success goes in fact through an increasingly significant combination between family and business (shared power and ownership). Ward and Carlock encouraged family businesses to use standard management tools. The planning of a family business must strike a balance between the requirements and opportunities of the market and the family's wishes and needs. Ward and Carlock (2001) described three generic choices of the mainstream in the family business:

- Business first: any decision should be taken first and foremost with what is best for the business in mind (more particularly recruitment);
- Family first: in this respect the feeling is that the family's happiness and the sense of belonging come first;
- Family enterprise approach: in this respect the idea is that any decision must strike a balance between business and family.

In all scenarios the options, concerning the strategy of a family business, will take place at the intersection of its internal skills, of the environment and of the family commitment. It is one of the assets in the family business to be able to create and increase its social capital.

A family business advances more by more or less separate steps in the definition of its strategy. In its connection with time, it is consequently rather extreme: according to Catry and Buff (1996) it has a very short-term approach in its action with the founder's vision as a long-term consistency element. The difference between the evolution of any firm and a permanent firm lies in the quality of the procedures screening the strategic initiatives. Permanent businesses, because of their seniority, present the particular feature of the obligation to compromise with the legacy of their past culture and know-how coming from material and immaterial investments. Consequently, one may think that the apathy of these firms will lead them to make choices in the continuity of attitudes securing permanence and, consequently, not to select rash or even erroneous initiatives. The competitive advantage spreads to the capacities of evolution (energy capacities) of the businesses and no longer to their adaptability to the environment at a given moment ("fit").

The building up of these assets requires twofold continuity:

- a continuity in time: a guiding principle in the course of time (that is the strategic vision or intention);
- a continuity in space between the different strategic assets of the business which are to combine into network: the different parts of the firm connected to each other within a framework coherent with the strategic vision of the firm (that is the strategic architecture).

A family business seems to have a noteworthy advantage on these two points. This fundamental aspect raises the issue of the firm's energy skills, of the accumulation of assets and of the organizational architecture which must make these two aspects easier by giving them concretes expression in the firm's organization.

Conclusion

A family business apparently bears natural variables enabling it to resist crises in a stronger manner. As they are boosted by values established in their family environment, their main objective is permanence through times, such is the case at Hermès, where the mandate to managers is "to be present there in fifty years". The pursuit of financial independence makes it less vulnerable to a reduction of liquid assets on financial markets. The reasoning, in terms of patrimony to be bequeathed to future generation, implies a longer time decision horizon which does not systematically boost a rapid return on investment, while preserving short-time realness of adaptation to its environment. It is definitely a type of natural lasting development: "to meet present demands without jeopardizing the capacity of future generations to meet their own needs". It is a fact that family businesses have apparently found a way of reconciling tradition and modernity in order to present in this manner a solid mode of governance in complex and changing environments.

A family business can be considered as long-lived insofar as it gives priority to the "income" generated by its capital stock rather than reduce it. Family businesses show a socially responsible development of their natural capital.

Gladwin (2000) proposed a model of sustainable development based on the assumption that the natural and social capital supplemented the industrial capital instead of replacing it. Every type of capital should remain intact because the productivity of one of them depends on the availability of the others. This model leaves out the traditional neoclassical assumption of the almost absolute substitution of the different types of capital (ecological and social).

The ecological capital represents the resources, processes, functions and biological, cyclic and renewable services. The material capital represents the geological or non-renewable resources like ores and fossil fuels. The human capital represents knowledge, expertise, healthcare, feeding, security and innovation among people. The social capital refers to society, social cohesion, respect for truth, reciprocity standards, fairness and to all that facilitates co-operation is everybody's interest. "Really efficient firms are those which are aware of what they do, why they exist and which have a strong culture and the sense of their history" (Mintzberg, 1993). A family business holds assets which are propitious for efficiency and survival in times of crisis.

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