A new variable to consider for family firms

Around the globe, family firms tend to be more conservative and take a longer view. New research by IESE's Pascual Berrone and co-authors puts this behavior and strategy in context.

August 9, 2016

Family firms tend to approach business differently. Compared to non-family firms, they tend to be more risk-averse and more focused on long-term value creation, thinking about their next generation and beyond.
But where do family firms thrive? In what kinds of cultural contexts? How different are family business strategies, compared to non-family firms' approaches? To get at the answers to all these questions, Professor **Pascual Berrone** and four co-authors invent a new variable: the family-legitimizing environment (FLE) index.

Presented as "Family-Controlled Firms Around the World: The Family-Legitimizing Environment as a Key Determinant of Prevalence, Strategy and Profitability," this research was awarded the Best International Paper Award from the Organization and Management Theory (OMT) Division of the Academy of Management for 2016.

Analyzing family-controlled firms in 83 countries, the co-authors find that cultural context — i.e., certain family values, as measured by their FLE index — has a significant impact on family firms' prevalence, strategies and performance.

Family-legitimizing environments

What makes a national culture family-legitimizing? The co-authors draw from many academic disciplines — from anthropology to psychology — to measure the strength of countries' pro-family values. Specifically, the FLE index tallies up scores for five cultural dimensions:

1. "**Intergenerational survival-oriented culture,**" which captures an understanding

between generations to promote the longevity of family endeavors.
2. "**Continuity-oriented culture**," with reverence for and attachment to the past.
3. "**Network-based relations**," which looks at the strength of community ties.
4. "**In-group solidarity**," which is when trust tends to run freely in a closely knit group, with outsiders kept at arm's length.
5. "**Patriarchal domination**," in which work tends to be separated along gender lines, with a traditional head of family holding power.

Where are the world's highest FLE scores found? Of the 83 countries measured, the strongest FLE scores belong to: Nigeria (1.00), United Arab Emirates (.98), Bangladesh (.94), Tanzania (.94) and Mozambique (.92). Meanwhile, the lowest are found in New Zealand (0.00), Denmark (.03), Sweden (.04), Norway (.10) and Finland (.17). In very broad strokes, most western, developed nations tend to have lower FLEs.

But how do the world's biggest economies stack up? Interestingly, half of the world's top 10 economies, as measured by GDP, have low FLEs, and half score high. On the lower end, we see the world's top economic powerhouse, the United States (.33), and also Germany (.27), the United Kingdom (.28), France (.27), and Canada (.28). Meanwhile, on the higher end of the FLE scale, we see China (.60), Japan (.63), India (.78), Brazil (.74) and Italy (.62).

Three takeaways

So what can we do with the FLE scores? The authors offer three statistically significant takeaways:

1. **Popularity:** Stronger FLEs are associated with a greater prevalence of family control among all publicly listed firms. For example, in high-FLE India, more than half of all publicly run companies are family controlled.
2. **Strategy:** Stronger FLEs are accompanied by a greater deviation between the strategies of family and non-family firms. In other words, the family firms in a low FLE country like Germany are managed more like professional, non-family-run firms. To contrast, family firms in Brazil may have a different managerial style, as is supported by its family-values-focused culture.
3. **Performance:** The stronger the FLE in a country, the stronger the relationship between family control and firm performance in that context. In fact, family businesses tend to do better than non-family ones where there are high FLEs.

FLEs offer leeway to strategize?

Ownership and governance structures are not built on a whim. Instead, they tend to be based on local social, cultural, and economic expectations. And so perhaps it's not surprising that the co-authors were able to show that family-controlled firms were more prevalent in countries where the culture and attitudes are in alignment with family firm-style values.

In strong FLEs, like Japan and Italy, family firms tend to be more free to make strategic choices that differ significantly from those of other publicly traded companies. For example, they might prioritize their business reputation over financial gain; adopt a parental, altruistic leadership style; or choose strategies that shy away from risks in favor of firm longevity. In these environments, family firms are less likely to use debt to finance activities than non-family-controlled firms. They also tend to spend less on R&D and avoid risk.

How FLEs affect performance

It might be surprising to hear that family firms outperform non-family ones in countries that score high on the FLE index. In particular, the research highlighted that the following cultural traits were strong drivers of this tendency: a strong respect for tradition, robust kinship and "in-group" ties.

Indeed, family firms grow and thrive in strong FLEs largely due to relationships. In these places, it is easier for family firms to receive political endorsements, develop relational contracts and social capital, and build long-lasting relationships with banks, suppliers and clients. As previous research suggests, communicating with this broad range of external stakeholders helps family businesses identify market opportunities, start new businesses and generally foster growth.

Many cultural studies of organizations point to contrasting patterns of behavior along predictable categories: Eastern vs. Western; emerging vs. mature, etc. However, if family businesses enjoy significant performance advantages in countries as diverse as Japan and Italy, then we need to look beyond obvious classifications. By homing in on family-legitimizing environments, the authors offer a new framework for understanding why and where family firms may thrive.

Methodology, very briefly

This is actually a study of studies. More specifically, the researchers analyze 484 carefully selected, previously published, relevant studies about publicly listed, family-controlled firms. The 484 studies meeting all criteria span 83 countries and a time period ranging from 1953 to 2011. The co-authors use academically rigorous, meta-analytic techniques and censored regression to coherently combine the results of the hundreds of studies and test their three main conclusions.

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