

Family Governance and Firm Performance: Agency, Stewardship, and Capabilities

Danny Miller, Isabelle Le Breton-Miller

After decades of being viewed as obsolete and problem ridden, recent research has begun to show that major, publicly traded family-controlled businesses (FCBs) actually outperform other types of businesses. This article examines the nature of such family businesses in an attempt to explain why some seem to do so well and others so poorly. It begins with four fundamental governance choices that distinguish among different kinds of family businesses: level and mode of family ownership, family leadership, the broader involvement of multiple family members, and the planned or actual participation of later generations. Using precepts from agency and stewardship theory, it relates these dimensions to the nature of the resource-allocation decisions made by the business and capability development, which in turn have implications for financial performance. Propositions are drawn about the drivers that make some family businesses great competitors—while leaving others at a disadvantage.

The literature has been highly critical of family-controlled business (FCB) as an organizational form. FCBs, often rightly, are viewed as suffering from a dearth of professional management (Chandler, 1990), destructive nepotism (Schulze, Lubatkin, & Dino, 2001; Schulze, Lubatkin, Dino, & Buchholtz, 2003), and exploitation of minority shareholders (Morck & Yeung, 2003). Executive succession is another major problem as it may be determined by family whims rather than competence (Le Breton-Miller, Miller, & Steier, 2004). FCBs are also said to be plagued by inadequate access to capital due to the ever-increasing needs of a growing family (Chandler, 1990) and because of skepticism by financial markets (Claessens, Djankov, Fan, & Lang, 2002).

Although there is truth to such criticisms, recent systematic comparisons of FCBs and non-FCBs reveal that the former outperform along a great many dimensions (Allouche & Amann, 1997; Anderson & Reeb, 2003; McConaughy, Matthews,

& Fialco, 2001; Miller, Le Breton-Miller, Lester, & Cannella, 2005; Simon, 1996; Villalonga & Amit, in press).

This article aims to tease out some of the drivers that make some major family businesses great competitors—while leaving others at a disadvantage. The focus here will be on four core governance dimensions: level and mode of family ownership, family leadership, the broader involvement of multiple family members, and the planned or actual participation of later generations. Precepts and research in the areas of agency and stewardship theory suggest that each of these dimensions leads to different choices and firm capabilities that can have both positive and negative implications for firm financial performance. We shall generate propositions about those outcomes, and about the moderating conditions that determine their ultimate impact. In this way we extend the work of Williamson (1999), Makadok (2003), and Hoopes and Miller (in press) by con-



necting the literatures on governance and capabilities, but here via the paths of agency and stewardship.

Scope and Definitions

As the research to which we refer pertains mostly to *large and publicly traded family businesses*, these are the focus of this article. Such companies represent anywhere from 20–70% of the largest companies in the world, depending on country of origin (La Porta, Lopes-Silanes, & Shleifer, 1999). By a *family business* we mean one that is partly owned by one or more family members who together control at least 20% of the total votes outstanding (La Porta et al., 1999).

By *firm capabilities* we mean distinctive competencies that would be difficult for rivals to imitate within practical time and budget constraints, and that lead to superior returns due to their capacity to increase prices or reduce costs (Teece, Pisano, & Shuen, 1997). Typically, these capabilities are said to be valuable, rare, inimitable, and hard to copy or substitute (Barney, 1991). They include hard assets; talents in innovation, manufacture, or marketing; valuable relationships; and even advantages of corporate culture and organization (Barney & Hansen, 1994).

By *firm financial performance* we mean the financial returns generated by the firm—typically measured by the returns on the assets or equity of the business—that are available to *all* public shareholders of the firm, family and otherwise, either via dividends or stock market returns. Where expected performance outcomes vary from the above, we will refer to those specifically.

Agency, Stewardship, Capabilities, and Performance: A Framework

As noted, the two core domains we will draw on are agency theory and stewardship theory. The agency problem arises when a manager with superior information acts as agent for an owner, allowing that manager to exploit or expropriate

business resources that would otherwise provide returns to the owner—the so called free-rider problem. The problem stems from the information asymmetries between the parties and from their different incentives (Ang, Cole, & Lin, 2000; Demsetz, 1988; Fama & Jensen, 1983a, 1983b). Family businesses differ in the degree to which they have to bear these costs, depending on their governance choices. Agency costs between owners and managerial agents can be advantageously low if there is a close alignment or even identity between the interests of owners and managers (Fama & Jensen, 1983a, 1983b). Another type of agency cost, however, can be higher within FCBs—that between minority owners and the major family owners who serve as their potentially exploitative *de facto* agents (Morck & Yeung, 2003; Villalonga & Amit, in press).

Stewardship is another informative perspective from which to view the advantages and disadvantages of a family business. Stewardship theory posits that many leaders and executives aspire to higher purposes at their jobs—that they are not simply self-serving economic individuals, but often act with altruism for the benefit of the organization and its stakeholders (Davis, Schoorman, & Donaldson, 1997; Donaldson & Davis, 1991; Fox & Hamilton, 1994). The belief is that stewards are intrinsically motivated by higher-level needs to act for the collective good of their firms. They identify with the organization and embrace its objectives; they are committed to make it succeed, even at personal sacrifice (Davis, Schoorman, Mayer, & Tan, 2000). These attitudes, we believe, will be especially prevalent among family businesses in which leaders are either family members or emotionally linked to the family. Such executives often commit deeply to the mission of the business, treasure its employees and stakeholders, and feel motivated to do their best for the owning family and the organizational collective (Miller & Le Breton-Miller, 2005). This attitude in turn can engender far-sighted contributions that feed distinctive capabilities and produce superior financial returns. Not all kinds of FCBs are likely to breed such stewardship in owners or their agents,

however, and FCBs under some kinds of governance conditions are quite short-sighted.

We will discuss how our dimensions of governance can influence these agency and stewardship outcomes and, through them, the financial performance of the firm—either directly or by shaping the resource allocation decisions and distinctive core competencies of the firm. Figure 1 presents a visual representation of our framework and Table 1 and the Appendix summarize our propositions. Proposition set P1 and parts of P2 cover familiar ground to demonstrate how our organizing framework explains established findings. Proposition sets P2, P3, and P4 generate new conjectures from the framework. Where propositions have been developed elsewhere our arguments will be brief.

Degree of Family Ownership and Control

One issue that confronts most public family businesses is how much ownership and control to give to nonfamily members. This choice can influence the incentives and monitoring costs of owners, their strategic behavior, and financial performance of the firm.

Ownership Concentration and Performance—The Positives

Agency. Agency theorists argue that concentration reduces monitoring costs because large owners have the incentive and often the expertise to monitor their managers (Jensen & Meckling, 1976). Given significant shareholdings, family owners, too, will possess the incentive, power, and

information to control their managers, thereby reducing free-rider agency costs and boosting returns (see Anderson & Reeb, 2003; Morck, Shleifer, & Vishny, 1988).

Stewardship. According to stewardship proponents, managers and owners are driven by more than economic self-interest. Many wish to make a contribution to an organization’s mission, longevity, and stakeholders (Davis et al., 1997, 2000). Indeed, family owners often have a deep emotional investment in their companies (Bubolz, 2001) as their family’s fortune, personal satisfaction, and even public reputation are tied to the business (Ward, 2004). Therefore, they invest to strengthen the firm and its people (Hoopes & Miller, in press) (see our elaborations of Propositions 2-2 and 4-1).

Proposition 1-1. On average FCBs will outperform non-FCBs in financial returns due to lower free-rider agency costs and superior attitudes of stewardship.

The Downside of Too Much Family Ownership

Once a party, family or otherwise, has enough ownership for unchallenged control, it can begin to abuse its power by taking resources out of the business (Claessens et al., 2002). In this case, a major owner—a cohesive family coalition or its CEO representative—may serve as a poor de facto “agent” for the minority owners (Villalonga & Amit, in press). Thus some researchers have argued that family-dominated businesses are more apt to be characterized by extraordinary dividend payouts (DeAngelo & DeAngelo, 2000),

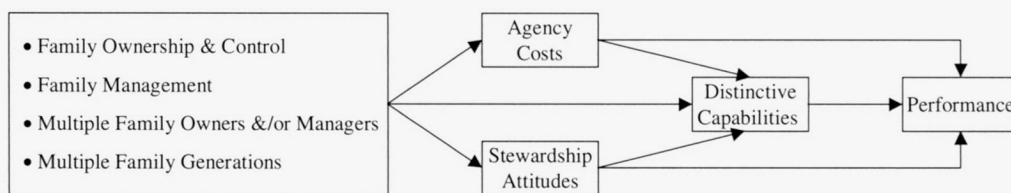


Figure 1 Relating Governance to Performance in FCBs.

Table 1 Agency and Stewardship Positives and Negatives of Governance Choices

Governance Choices	Agency Perspective	Stewardship Perspective
Family Ownership & Control		
P1-1: Concentration—moderate or complete family ownership*	Knowledge and incentive to monitor managers	Emotional investment in the company and its people
<i>P1-2: Concentration > 30%**</i>	<i>Power and incentive to exploit minority shareholders</i>	
P1-3: Presence of strong independent directors or blockholders	Knowledge and incentive to monitor managers; better protection of minority shareholders	Nonfamily director-owners who serve as informed stewards
<i>P1-4: Family control with little ownership, e.g., via super-shares or pyramiding</i>	<i>Power and incentive to exploit minority shareholders</i>	<i>Less personal attachment to the company; especially if pyramiding occurs</i>
Family CEO		
P2-1 & P2-2: Family CEO	Alignment of manager and owner interests; knowledge to monitor other managers and to run business	Long-term tenures, learning and farsighted investments; commitment to building capability
<i>P2-3 & P2-4: Family CEO with ownership control and no strong outsiders</i>	<i>Power to exploit minority shareholders inside the family or out</i>	<i>Discretion to engage in risky, unorthodox, or dangerous behavior</i>
Multiple Family Managers or Owners		
P3-1: Multiple family members on top management team	Broader knowledge and deeper monitoring capabilities	Broader, more multifaceted stewardship
<i>P3-2: Multiple family owners: highly diffuse ownership or contentious power blocs</i>	<i>Executive owner or agent able to exploit other owners</i>	<i>Owner factions elevate local interests and carry into the business</i>
Multiple Generations in the Business		
P4-1: Multiple generations—planned for	Incentive to monitor	Stewardship—conservative financing, invest in competencies, relationships, reputation, apprenticeships, and human resources
<i>P4-2: Multiple generations—actual</i>	<i>Potential conflict: strong family owners exploit weak family owners</i>	<i>Dilution of stewardship, succession problems, resource depletion</i>

*, ** Nonitalicized rows present performance positives; italicized rows present negatives.

entrenched managers (Gomez-Mejia, Nunez-Nickel, & Gutierrez, 2001), few new products (Ellington & Deane, 1996), little investment in new technologies (Chandler, 1990), and a redistribution of wealth from employees to the family (Burkart, Panunzi, & Shleifer, 2002). All these tendencies can ultimately reduce core competencies and financial returns of FCBs.

Proposition 1-2. Beyond a threshold level, there will be a negative relationship of family ownership with financial returns (thus overall an inverted U-shaped relationship).

A punitive ownership threshold level may be one that is impractical for outside interests to exceed. Morck et al. (1988) have found that after a concentration level of 30%, stock market valuations begin to fall.

The Presence of Significant Nonfamily Directors and Shareholders

Costs of family ownership may be reduced by independent directors and influential shareholders from outside the family (Anderson & Reeb,

2004). Such parties, if they are indeed independent, may contribute expertise and objectivity, provide alternative perspectives, and bring to bear critical information that a family might overlook. They can also serve as more objective monitors of family executives, help in locating and hiring better managers, improve resource-allocation decisions, and avoid expropriation of firm wealth by family members (Anderson & Reeb, 2004; Dalton, Daily, Ellstrand, & Johnson, 1998). Moreover, if these directors are significant shareholders, they have an added incentive to act as vigilant stewards over the resources of the company (Burkart, Gromb, & Panunzi, 1997; Buckart et al., 2002; Claessens et al., 2002; Finkelstein & Hambrick, 1996, p. 226). Thus, again from both an agency and stewardship perspective:

Proposition 1-3. Family ownership is less apt to be associated with poor financial returns when there are independent directors and significant nonfamily shareholders on the board.

Control With Little Ownership

Agency costs may increase as the interests of different classes of owners diverge. This can occur, for example, if there are special types of shares that provide control with little ownership (Bhattacharya & Ravikumar, 2001; Morck & Yeung, 2003). The temptation among those in control may be to run the business for personal gain, especially if they are able to keep a large percentage of their assets outside the business. The use of holding companies for “pyramiding” purposes is another way families can gain control and exploit minority shareholders with little ownership. In this case, there is too little alignment between the interests of the controlling owner and the other shareholders of the lower-tier firms.

Stewardship problems may arise as well. Pyramiding may put not only financial but psychological distance between an organization and its family owners. Thus the family may be more apt to favor nepotism, sweetheart contracts, and lavish expenditures that benefit themselves at the cost of other shareholders.

Proposition 1-4. The lower the ratio of family ownership to family control, the greater the incentive to exploit nonfamily shareholders and the weaker the attitude of stewardship, and thus the lower the financial returns to the lower-tier firm.

Family Management

Whereas all family businesses are partly owned by families, only some are led and managed by them. Typically, this management takes the form of a founder or family descendent who acts as the CEO. Family management, we will argue, can reduce agency costs and increase attitudes of stewardship, thereby extending investment time horizons and building firm capabilities. But left unchecked, family management can be dangerous, promoting leadership irresponsibility, expropriation from minority shareholders, hubris, and excessive risk taking—in short, the antithesis of good stewardship. Propositions 2-1 and 2-2 address the agency and stewardship benefits of having a family CEO. Propositions 2-3 and 2-4 discuss the respective downsides.

A key assumption of this section, to be relaxed in the next, is that the family CEO has discretion to make major decisions without undue interference from other family members or owners. To simplify our analysis, we focus on the CEO position. However, we expect similar arguments to apply to firms run by a hands-on family chairman.

Lower Free-Rider Agency Costs

Reductions in agency costs may be achieved by eliminating entirely the separation between owners and management—as when a major owner becomes the top manager. Subject to the qualifications above, and unlike nonfamily CEOs who are often driven by short-run motives, many owner-managers have the power, incentive, and knowledge to run the business well. The resulting reduction in free-rider agency costs is in and of itself associated with savings, and thus with surplus resources that can generate superior financial returns (Hoopes & Miller, in press; Jayaraman, Khorana, Nelling, & Covin, 2000).

Proposition 2-1. FCBs run by family top managers will have higher financial returns than non-FCBs or FCBs run by outsiders.

Stewardship Effects

Perhaps the most powerful benefit associated with owner management derives from the stewardship motivations of the leader. Leaders who are “insiders”—whose names are on the business and whose past, present, and future are tied to the reputation of their firm—may act as especially solicitous stewards (Bubolz, 2001; Miller & Le Breton-Miller, 2005). Their stewardship can manifest in lifelong commitment to the firm, assiduous management of organizational resources, and a host of competency creating investments (Davis et al., 1997).

Lengthy job tenures. The average CEO tenure at family-run businesses is said to range between 15 and 25 years, while that of the typical public, non-FCB leader has reduced to three to four years (Le Breton-Miller et al., 2004; Mass Mutual, 2003). Thus, family CEOs are usually quite secure in their jobs and operate with the expectation that they will be in office for a long time. This alone will cause some of them to be farsighted stewards of the business (Davis et al., 1997). Moreover, as noted, because the family name, fortune, and reputation are at stake, and because they are there for the long run, family CEOs may be more committed to the business and willing to do what is needed to make it strong (Donaldson & Davis, 1991). This may engender a number of strategic outcomes that bring superior returns.

Avoiding the quick fix. Managers who anticipate lengthy tenures shun quick-fix solutions. They are less apt than their shorter-term peers to make opportunistic, short-term decisions that may come back to haunt them later in their careers. They avoid potentially hazardous moves to boost revenues, such as acquisitions into areas beyond the firm’s expertise (Amihud & Lev, 1999; Fox & Hamilton, 1994). They also resist downsiz-

ing expedients that may reduce costs but destroy morale and erode the firm’s human capital and knowledge base (Lavery, 1996). Unlike many outsider CEOs, family leaders are usually secure enough in their positions to resist being goaded into risky short-term expedients to impress the board with quarterly numbers (Jacobs, 1991).

Farsighted investment. Long family-CEO tenures may also be associated with long investment time horizons and a willingness to commit resources toward the ultimate health of the business, even if this means sacrificing in the short run (Hoopes & Miller, in press; James, 1999; Lavery, 1996). To increase returns over a prospectively lengthy career, family CEOs may make quintessentially farsighted investments such as those in research and development, training, and state-of-the-art infrastructure. Indeed, some evidence reveals that FCBs do outspend non-FCB peers in R&D (Weber et al., 2003) and in capital investments in plant, equipment, and even information technology (Kang, 2000). There is also evidence that large FCBs pay out lower dividends and reinvest a higher percentage of profits (Anderson, Mansi, & Reeb, 2003; Daily & Dollinger, 1992; Gallo & Vilaseca, 1996). We expect that these findings will be especially strong in *owner-managed* family businesses.

On-the-job learning. Miller and Shamsie (2001) and Henderson, Miller, and Hambrick (in press) found that CEOs continue to learn on the job for many years, and that the financial performance of their firms only peaks after eight to ten years of tenure. This augurs well for the development of superior strategies and capabilities in FCBs whose family CEOs tend naturally to be at the job for a very long time. Firms with more frequent executive turnover will find such capabilities hard to match.

Core capability development. Due to these stewardship concerns, steep investments in the future, and refusal to be distracted by short-term expedients, family-managed FCBs will have a

better chance of developing distinctive core capabilities. Barney (1991), as noted, has argued that firms enjoy competitive advantage when they develop resources that are valuable, rare, inimitable, and for which there are no ready substitutes. According to Dierickx and Cool (1991) and Teece et al. (1997), such resources and capabilities result from the orchestrated long-run investments in core competencies that we have just described. This farsighted, focused investment approach builds on path dependencies that keep a firm's capabilities growing cumulatively, thereby making its learning trajectory especially tough for rivals to imitate (Miller, 2003). Fast-tenure executives will find such programmatic investments more difficult to make.

Proposition 2-2. Compared to their competitors, FCBs run by family CEOs are apt to manifest more beneficial stewardship behaviors: specifically, fewer shortsighted acquisition and downsizing decisions and more R&D, training, and capital expenditures, and thus more distinctive capabilities that produce higher long-term financial returns.

The Downside of Owner-CEO Control: "The Organization Is Mine."

Family owner-CEOs sometimes are given an inordinate amount of discretion at the job, especially where they personally have voting control of the company. Often, these CEOs cannot be controlled effectively by directors, and are free to follow their instincts and impulses—unchecked.

Agency issues of CEO control. Unfortunately, family CEOs with enough votes can abuse their power by extracting resources from the company or by hiring cronies or incompetent relatives (Faccio, Lang, & Young, 2001; Morck & Yeung, 2003; Schulze et al., 2001, 2003). In short, controlling CEOs can sometimes be poor de facto agents for other owners (Villalonga & Amit, in press).

Proposition 2-3. Family CEOs with voting control are more apt to exploit minority shareholders than are family CEOs who are subject to influence from

other family or nonfamily owners. This will manifest in lower financial returns.

Poor stewardship. Controlling owner-CEOs may view their firms as personal fiefs. They have the discretion to act—or to resist acting—without board or top team intervention, and that can lead to risky decisions or, in the cases of lengthy tenures, strategic stagnation (Finkelstein & Hambrick, 1996), both of which may be hazardous.

Proposition 2-4. Family CEOs with voting control are more apt to make hazardous decisions, for example, changing too rashly or too slowly.

Involvement of Multiple Family Owners and Managers

After the first two to three decades, most FCBs embrace multiple family members (Gersick, Davis, Hampton, & Lansberg, 1997). It is important to distinguish between two types of family involvement: service on the top management team and ownership. The first kind is more apt to produce superior financial performance than the second, although key conditioning factors apply.

Multiple Family Members on the Top Management Team

As the power and independence of owner-CEOs can lead to excess, an influential sounding board is vital (Wiersema & Bantel, 1992). The top team can serve as such a body, particularly if its managers are empowered to challenge the CEO. Family executives often do have that power in rare measure. Thus, top management teams (TMTs) with multiple family executives *potentially* have both agency and stewardship advantages.

Agency advantages. Multiple family executives bring to bear multifaceted expertise, and therefore broader knowledge, to monitor a variety of managerial and employee "agents." At Coors and Nordstrom, three or four brothers served on the top management team—some with excep-

tional skills in operations, others in finance or marketing. These executives had both the incentive and the knowledge to diligently oversee their managers in each of these parts of the business (Miller & Le Breton-Miller, 2005). When family members collectively have a *diversity* of experience, their monitoring contributions can be especially valuable (Finkelstein & Hambrick, 1996, pp. 154–156).

Multifaceted stewardship. Emotional and financial attachments to the business make many family executives devoted managers—deeply concerned about the future of their enterprise. The fact that there are several such executives on the job allows them to make responsible, farsighted decisions in *many* areas of the company, and to socialize others to do the same. Moreover, family executives with common interests, mutual trust, and job security are in an ideal position to present frankly their points of view to the leader, thereby countering excesses or blind spots (Lansberg, 1999). Their family status lets them be honest without fear of adverse consequences to their careers (Bubolz, 2001).

Proposition 3-1. The presence of multiple family members on the top management team will correlate positively with financial performance.

An important qualification here is that *family executives must get along*. Where there are rivalries, having multiple family managers will do more harm than good, especially given the difficulty of getting rid of incompetent owner-managers. Also, where the business lacks scale or resources, it may not be able to afford many family managers (Gersick et al., 1997). Another qualification is that there not be *too many* family members involved in the business, as that opens the door for conflict and can drain funds.

Multiple Family Owners: Intra-Family Ownership and Firm Financial Performance

Although, on balance, having multiple family executives is expected to have a positive impact on

the performance of a family business, there are particular distributions of ownership or voting power among family members that are likely to have a negative effect.

Agency lapses. Apportioning company ownership among family members poses a number of challenges. The most obvious is where a CEO has voting control and can exploit minority owners or behave recklessly. However, having ownership too broadly dispersed can cause similar problems—especially if the owners cannot agree. In that case, a CEO, owner or not, may be able to seize the balance of power and act in a self-serving manner (Miller et al., 2005; Morck & Yeung, 2003; Schulze et al., 2003). Here again, the agent is beyond the effective control of the owners.

Stewardship erosion. A similar but even more common ownership distribution problem occurs when there are several contentious family blockholders whose votes enable them to cancel one another's initiatives (Claessens et al., 2002; Ward, 2004). Such factionalism may parochialize owner interests. It may also give rise to factionalism among managers, making for an organization in which counterproductive power plays muddle policies and stymie effective action (Davis et al., 2000). Stewardship over the company is replaced by personal interests.

Proposition 3-2. Financial returns will be eroded by a distribution of ownership that gives de facto control to a CEO (e.g., due a highly diffuse distribution of shares) or by a balanced distribution of power among contentious blockholders.

Multiple Generations in the Family Business

As an FCB prepares to incorporate later generations, priorities and problems change (Gersick et al., 1997). The mere intention to include later generations may strengthen attitudes of stewardship that drive diligent management of finances, reputation, and alliances with resource providers. It

also may give rise to strategies for passing on tacit knowledge and building superior capabilities. Unfortunately, the actual *inclusion* of later generations in a family business is a challenge fraught with negatives. Succession problems arise, a plethora of family members may drain resources, and political skirmishes and agency problems become more likely.

Intention to Keep the Business in the Family

Where there is a clear intention on the part of owners to keep a business in the family, strategic decision making is more apt to reflect long-run stewardship and the incentive to monitor managers will be greater (i.e., Proposition 2-2 will be supported). The tendency will be to sacrifice for the business to benefit subsequent generations, and that can lead to the generous resource commitments, extended time horizons, distinctive capabilities, and superior financial returns we discussed above.

Proposition 4-1a. The stewardship outcomes of Proposition 2-2 will be especially strong in FCBs whose owners plan to keep the firm in the family over subsequent generations.

Prospective Stewardship: Investing for Later Generations

Businesses intending to accommodate future family generations are expected to exhibit a good deal of stewardship in how they manage capital and where they direct their attention. They are more apt to be financially cautious, invest more in building long term reputation, and build social capital in the form of enduring relationships with outsiders.

Financial conservatism. Concern for the long-term survival of the business may translate into more conservative financial strategies. This often takes the form of less debt, more liquidity, and sounder balance sheets (Anderson & Reeb, 2003;

Daily & Dollinger, 1992; Gallo & Vilaseca, 1996). Such policies will help the business survive until the new generation is ready to take over, and will leave successors with a healthier enterprise to run. Financial positions are expected to be especially strong just before the handoff to the next generation.

Reputation building. The current generation often tries to strengthen the organization for a family successor. It might, for example, build up the reputation of the business to give the new CEO a “head start.” This may be done via the long-term investments we mentioned—in innovation, R&D, quality, and branding. Other reputational investments might fund superior advertising and promotion, customer service, public relations, and community involvement (Ward, 2004). Estee Lauder, for example, has over the decades outspent its rivals in promotion by a factor of two. This has allowed family successors to inherit very strong brands (Miller & Le Breton-Miller, 2005).

Building social capital through relationships with outsiders. FCBs trying to smooth the way for later generations have a strong incentive to build social capital in the form of enduring associations with external parties that can supply critical resources to successors (Adler & Kwon, 2002; Gomez-Mejia et al., 2001). These associations can take the form of long-term alliances with partners, suppliers, and major customers (Palmer & Barber, 2001). Such concerned FCBs are also more apt to make the unusually generous investments that make those relationships attractive (Bubolz, 2001; Naphiet & Ghoshal, 1998), as well as to lure well-networked board members who can help later generations with their contacts (Anderson & Reeb, 2004). Reputational resources and enhanced organizational legitimacy may also be built by these companies by fostering good relationships with the community, for example, via charitable investments in civic and social institutions and exceptionally generous political contributions (Morck & Yeung, 2003).

Proposition 4-1b. A family's intention to pass the business to subsequent generations will be associated with conservative financial management; investment in reputation building; and enduring relationships with external providers of resources. These efforts in turn will be associated with superior long-run financial returns.

Preserving Tacit Knowledge Inside the Firm

Stewardship may take the form of preserving tacit knowledge. Tacit organizational knowledge is skill or know-how that resides in individuals and working groups and is not easily codified or communicated (Knott, Bryce, & Posen, 2003; Naphiet & Ghoshal, 1998). To preserve such knowledge and support a new generation of leaders, intentionally multigenerational FCBs are apt to invest more than other firms in executive apprenticeships, building a strong top team, and fostering a resilient corporate culture.

Executive apprenticeships. Intensive executive apprenticeship programs transfer knowledge across the generations of family executives. Firms such as Michelin and Motorola had multiple family members from different generations serving in an office of the CEO so that the younger generation could learn on the job by watching the veterans (Miller & Le Breton-Miller, 2005). This works especially well in an FCB because of the very long tenures and high trust environments existing in many family businesses. The older generation is often willing not only to share wisdom but to discuss their own mistakes (Bubolz, 2001). Such frankness would be quite rare in nonfamily businesses, where managers have careers to protect and are uncertain about their successors. Apprenticeship also may involve the older generation passing on its personal contacts to the younger, as did the Bechtels of the Bechtel Group via exclusive clubs such as the Bohemian Grove (Miller & Le Breton-Miller, 2005).

Building a supportive top team. Generationally attentive FCBs will be especially inter-

ested in preserving a stable and loyal top management team to help the new family leader take over. The old CEO, for example, may stay on as chairperson, making sure that when the new leader comes on board he or she will be supported by a number of capable veterans (Ward, 2004). Rarely would one expect many major changes in the top team in the years immediately preceding or following the succession, especially if the firm has been performing well (Finkelstein & Hambrick, 1996).

Building a strong corporate culture. Another way families help pass the baton is by fostering a strong, value-driven corporate culture (Barney & Hansen, 1994; Habbershon & Williams, 1999). This ensures that a loyal set of talented employees will be available to keep the firm strong. Veteran FCBs such as Hallmark, Timken, L.L. Bean, S.C. Johnson, W.L. Gore, and many others are known for their profound investments in employee training, minimum layoff policies, employee participation programs, painstaking staff selection, generous benefits, and minuscule turnover statistics (Miller & Le Breton-Miller, 2005). In fact, Allouche and Amann (1997) found that among major French companies, FCBs invested significantly more in training, benefits, and salaries than non-FCBs. Reid and Harris (2002) found the same for Irish FCBs.

These practices—unusual financial stewardship and superior investments in reputation, alliances, tacit knowledge transfer, and corporate culture—all may contribute to capabilities that rivals cannot match (Teece et al., 1997).

Proposition 4-1c. The intention to involve later family generations in the business will be associated with more intensive executive apprenticeships, longer tenures on the top management team, and more investment in corporate culture and human resources. All these actions or qualities will contribute to strategic capabilities and enhance financial performance.

Actual Involvement of Multiple Generations in the Business

The actual involvement of multiple generations of a family in a business may have some advantages. As we have seen, it can preserve tacit knowledge and family connections. However, there are many daunting challenges as the generations progress and the number of family members multiplies. These include conflicts among family factions, succession problems, and a drain on resources, which collectively might well outweigh any multi-generational advantage.

A Growing Cast of Family Members: Conflict and Resource Depletion

As an FCB enters second and later generations, the number of involved family members often grows—children, children's children, and a host of cousins and in-laws. Sometimes, there is harmony and the possibility of new talent coming into the business, but as relatives proliferate, so, too, does the potential for conflict among those running the business, among owners, and between the two groups (Gersick et al., 1997). Schulze et al. (2003) argue that these conflicts are especially apt to occur when the distribution of ownership is balanced between competing blocs, as often occurs as later generations enter the business. Again, agency issues arise if those in control or running the business exploit other family or nonfamily owners, thereby serving not as stewards of the business, but of their own nuclear family. Such exploitation may be more common where rival ownership blocs among family factions have different interests and roles (e.g., extracting dividends vs. growing the business), and where there has been a turbulent family history (Miller et al., 2005).

Another potential problem as generations progress is the growing demand for dividends from a greater number of family members who no longer directly work for the business. In modest-sized firms, this can represent an important drain of capital that hobbles capability development and constrains growth (Chandler, 1990). The solution,

often, has been to prune away some owners and vest ownership in a few steward-like family members with ample discretion to run the business (Lansberg, 1999).

Proposition 4-2a. As generations progress, the dangers of family conflict and excessive resource demands grow. These developments will be associated with declines in financial performance and in the rate of company growth.

Leadership and Ownership Succession Challenges

As an FCB enters its second and later generations, it may be difficult to find a successor within the family. Relatives may not be competent, as the selection pool among them tends to be narrow (Le Breton-Miller et al., 2004). A bias in favor of family candidates, moreover, risks alienating other talented managers and degrading the caliber of management.

Ownership succession is another significant problem as the generations proceed. Many jurisdictions mandate that estate taxes be paid on the death of a major owner. This can drain capital reserves, curb valuable investment, and cause the business to pass from family control (Ward, 2004).

Proposition 4-2b. As an FCB ages, the difficulties of leader succession and ownership succession grow and this may compromise financial performance.

Conclusion

The picture we have painted of FCBs is multifaceted. It makes clear why there are so many disputes about the behavior and performance of this breed. The fact is that this is a very heterogeneous group of organizations. By highlighting only the major governance choices of these businesses, and their potential impact on agency costs and stewardship attitudes, we can anticipate myriad significant differences in their capabilities and, ultimately, their performance. Table 1 summarizes our propositions.

The overall pattern of the propositions suggests that FCBs do best when they take advantage of the

Appendix: Governance, Consequences, and Performance

Governance Choices	Potential Agency or Stewardship Consequences	Expected Performance Outcomes
Family Ownership & Control		
P1-1: Family ownership (but see P1-2)	Low monitoring and agency costs	Higher financial returns
P1-2: Family control or ownership concentration >30%	Exploitation of minority shareholders	Ultimately, a negative relationship between returns and concentration
P1-3: Presence of strong independent directors or blockholders	Better monitoring of the business; less exploitation of minor owners	Better returns at high levels of concentration
P1-4: Family control with little ownership	Less stewardship; more exploitation	Poorer returns under concentration
Family CEO		
P2-1: Family CEO	Very low agency costs and devoted stewardship	Better returns
P2-2: Family CEO	Long anticipated tenures, thus careful stewardship: long decision and career time horizons; few short-sighted decisions; long-term investments in R&D, training, infrastructure, and core capabilities	Higher and steadier financial returns; longevity
P2-3, & P2-4: Family CEO who controls firm through voting power	Ability to exploit minority shareholders and excessive discretion—thus unchecked risk and unorthodoxy	Poorer performance especially if no strong outsiders
Multiple Family Managers or Owners		
P3-1: Multiple family members on top management team	Robust monitoring and broad stewardship	Higher returns
P3-2: Distribution of family ownership	CEO unchecked discretion or contentious factionalism among blockholders	Poor returns
Multiple Generations in Business		
P4-1a, P4-1b, & P4-1c: Intention to involve later generations (i.e., keep the business in the family)	Long decision time horizons, as above; P2-2 especially relevant; pass on resources via financial stewardship, reputation building, connections with external parties; pass on tacit knowledge via apprenticeships, supportive top teams, cohesive organizations	P2-2 stewardship outcome is reinforced; better long-run returns and longer survival times
P4-2a & P4-2b: Actual involvement of later generations	More family members increase chances of conflict and resource shortages; succession problems	Poorer returns and slower growth; poorer overall performance

potential for lower agency costs and elicit attitudes of stewardship among leaders and majority owners. This is most apt to occur when voting control requires significant family ownership, when there is a strong family CEO without complete voting control and accountable to independent directors, when multiple family members serve as managers, and when the family *intends* to keep the business for generations. Often, these conditions are found in an established family business still being run by its founder. On the other hand, when ownership or control is too concentrated or dispersed, when control is exercised without much ownership, and when too many family members clash or drain resources, financial performance suffers. Such conditions may apply mostly to family businesses in their second generation or beyond. These differences in governance drive agency costs and stewardship attitudes, which directly, or via their impact on capabilities, drive performance, and explain why some FCBs do so well and others so badly.

References

- Adler, P., & Kwon, S. (2002). Social capital: Prospects for a new concept. *Academy of Management Review*, 27, 17-40.
- Allouche, J., & Amann, B. (1997). Le retour de capitalisme familiale. *L'expansion: Management Review*, 85, 92-99.
- Amihud, Y., & Lev, B. (1999). Does corporate ownership structure affect corporate diversification. *Strategic Management Journal*, 20, 1063-1069.
- Anderson, R. C., Mansi, S., & Reeb, D. (2003). Founding family ownership and the agency cost of debt. *Journal of Financial Economics*, 68, 263-285.
- Anderson, R. C., & Reeb, D. (2003). Founding family ownership and firm performance; Evidence from the S&P 500. *Journal of Finance*, 58, 1301-1328.
- Anderson, R. C., & Reeb, D. (2004). Board composition: Balancing family influence in S&P 500 firms. *Administrative Science Quarterly*, 49, 209-237.
- Ang, J. S., Cole, R. A., & Lin, J. W. (2000). Agency costs and ownership structure. *Journal of Finance*, 55, 81-106.
- Barney, J. (1991). Firm resources and sustained competitive advantage. *Journal of Management*, 17, 99-120.
- Barney, J., & Hansen, M. H. (1994). Trustworthiness as a source of competitive advantage. *Strategic Management Journal*, 15, 175-190.
- Bhattacharya, U., & Ravikumar, B. (2001). Capital markets and the evolution of family businesses. *Journal of Business*, 74, 187-219.
- Bubolz, M. (2001). Family as a source, user and builder of social capital. *Journal of Socio-Economics*, 30, 129-131.
- Burkart, M., Gromb, D., & Panunzi, F. (1997). Large shareholders, monitoring, and the value of the firm. *Quarterly Journal of Economics*, 112, 693-728.
- Burkart, M., Panunzi, F., & Shleifer, A. (2002). Family firms. *Journal of Finance*, 58, 2167-2202.
- Chandler, A. (1990). *Scale and scope*. New York: Free Press.
- Claessens, S., Djankov, S., Fan, J., & Lang, L. (2002). Disentangling the incentive and entrenchment effects of large shareholdings. *Journal of Finance*, 57, 2741-2771.
- Daily, C. M., & Dollinger, M. (1992). An empirical examination of ownership structure in family and professional managed firms. *Family Business Review*, 5(2), 17-36.
- Dalton, C., Daily, C., Ellstrand, A., & Johnson, J. (1998). Board composition, leadership structure and financial performance. *Strategic Management Journal*, 19, 269-291.
- Davis, J., Schoorman, R., & Donaldson, L. (1997). Towards a stewardship theory of management. *Academy of Management Review*, 22, 20-47.
- Davis, J., Schoorman, R., Mayer, R., & Tan, H. (2000). The trusted general manager and business unit performance. *Strategic Management Journal*, 21, 563-576.
- DeAngelo, H., & DeAngelo, L. (2000). Controlling stockholders and the disciplinary role of corporate payout policy. *Journal of Financial Economics*, 56, 153-207.
- Demsetz, H. (1988). *Ownership, control, and the firm*. Vol. 1 in *The organization of economic activity series*. New York: Blackwell.
- Dierickx, I., & Cool, K. (1991). Asset stock accumulation and sustainability of competitive advantage. *Management Science*, 35, 1504-1511.
- Donaldson, L., & Davis, J. (1991). Stewardship theory or agency theory. *Australian Journal of Management*, 16, 49-64.
- Ellington, E., & Deane, R. (1996). TQM adoption practices in the family owned business. *Family Business Review*, 9, 5-14.
- Faccio, M., Lang, L., & Young, L. (2001). Dividends and expropriation. *American Economic Review*, 91, 54-78.

- Fama, E., & Jensen, M. (1983a). Separation of ownership and control. *Journal of Law and Economics*, 26, 301–325.
- Fama, E., & Jensen, M. (1983b). Agency problems and residual claims. *Journal of Law and Economics*, 26, 325–344.
- Finkelstein, S., & Hambrick, D. (1996). *Strategic leadership*. St. Paul, MN: West.
- Fox, M., & Hamilton, R. (1994). Ownership and diversification: Agency theory or stewardship theory. *Journal of Management Studies*, 31, 69–81.
- Gallo, M., & Vilaseca, A. (1996). Finance in family business. *Family Business Review*, 9, 387–401.
- Gersick, K., Davis, J., Hampton, M., & Lansberg, I. (1997). *Generation to generation: Life cycles of the family business*. Boston, MA: Harvard Business School Press.
- Gomez-Mejia, L., Nunez-Nickel, M., & Gutierrez, I. (2001). The role of family ties in agency contracts. *Academy of Management Journal*, 44, 81–95.
- Habbershon, T. G., & Williams, M. L. (1999). A resource-based framework for assessing the strategic advantages of family firms. *Family Business Review*, 12, 1–25.
- Henderson, A., Miller, D., & Hambrick, D. (in press). How quickly do CEOs become obsolete. *Strategic Management Journal*.
- Hoopes, D. G., & Miller, D. (in press). Owner preferences, competitive heterogeneity and strategic capabilities. *Family Business Review*.
- Jacobs, M. T. (1991). *Short-term America: The causes and cures of our business myopia*. Boston, MA: Harvard Business School Press.
- James, H. S. (1999). Owner as manager, extended horizons and the family firm. *International Journal of the Economics of Business*, 6(1), 41–55.
- Jayaraman, N., Khorana, A., Nelling, E., & Covin, J. (2000). CEO founder status and firm financial performance. *Strategic Management Journal*, 21, 1215–1224.
- Jensen, M., & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3, 305–360.
- Kang, D. (2000). *Family ownership and performance in public corporations: A study of the U.S. Fortune 500, 1982–1994*. Working Paper 00-0051, Harvard Business School.
- Knott, A. M., Bryce, D., & Posen, H. (2003). On the strategic accumulation of intangible assets. *Organization Science*, 14(2), 192–207.
- Lansberg, I. (1999). *Succeeding generations: Realizing the dream of families in business*. Boston, MA: Harvard Business School Press.
- La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (1999). Corporate ownership around the world. *Journal of Finance*, 54, 471–517.
- Laverty, K. J. (1996). Economic “short-termism”: The debate, the unresolved issues, and implications for management. *Academy of Management Review*, 21, 825–860.
- Le Breton-Miller, I., Miller, D., & Steier, L. (2004). Toward an integrative model of effective FOB succession. *Entrepreneurship Theory and Practice*, 28, 305–328.
- Mass Mutual Study (2003), Available at <<http://www.ffi.org>>.
- McConaughy, D., Matthews, C., & Fialco, A. (2001). Founding family controlled firms: Performance, risk and value. *Journal of Small Business Management*, 39, 31–49.
- Miller, D. (2003). An asymmetry-based view of competitive advantage. *Strategic Management Journal*, 24, 961–976.
- Miller, D., & Le Breton-Miller, I. (2005). *Managing for the long run: Lessons in competitive advantage from great family businesses*. Boston, MA: Harvard Business School Press.
- Miller, D., Le Breton-Miller, I., Lester, R., & Cannella, A. (2005). *Family involvement, agency and financial performance in the Fortune 1000*. Working Paper, HEC Montreal.
- Miller, D., & Shamsie, J. (2001). Learning across the life cycle. *Strategic Management Journal*, 22, 725–745.
- Morck, R., Shleifer, A., & Vishny, R. (1988). Management ownership and market valuation. *Journal of Financial Economics*, 20, 293–315.
- Morck, R., & Yeung, B. (2003). Agency problems in large family business groups. *Entrepreneurship Theory and Practice*, 27, 367–382.
- Naphiet, J., & Ghoshal, S. (1998). Social capital, intellectual capital, and organizational advantage. *Academy of Management Review*, 23, 242–266.
- Palmer, D., & Barber, B. (2001). Challengers, elites and owning families: A social class theory of corporate acquisitions. *Administrative Science Quarterly*, 46, 87–120.
- Reid, R., & Harris, R. (2002). The determinants of training in SMEs in Northern Ireland. *Education & Training*, 44, 8–9.
- Schulze, W. S., Lubatkin, M., & Dino, R. (2003). Dispersion of ownership and agency in family firms. *Academy of Management Journal*, 46, 179–194.
- Schulze, W. S., Lubatkin, M. H., Dino, R. N., & Buchholtz, A. K. (2001). Agency relationships in family firms: Theory and evidence. *Organization Science*, 12, 99–116.

- Simon, H. (1996). *Hidden champions: Lessons from 500 of the world's best unknown companies*. Boston, MA: Harvard Business School Press.
- Teece, D., Pisano, G., & Shuen, A. (1997). Dynamic capabilities and strategic management. *Strategic Management Journal*, 18, 509-533.
- Villalonga, B., & Amit, R. (in press). How do family ownership, management and control affect firm value. *Journal of Financial Economics*.
- Ward, J. (2004). *Perpetuating the family business*. Marietta: Family Enterprise Publishers.
- Weber, J., Lavelle, L., Lowry, T., Zellner, W., & Barrett, A. (2003). Family Inc. *Business Week*, November 10, 100-114.
- Wiersema, M., & Bantel, K. (1992). Top management team demography and corporate strategic change. *Academy of Management Journal*, 35, 91-121.
- Williamson, O. E. (1999). Strategy research: Governance and competence perspectives. *Strategic Management Journal*, 20, 1087-1108.

Danny Miller is Research Professor & Chair in Strategy and Family Enterprise, and can be contacted at HEC Montreal and University of Alberta, 4642 Melrose Ave., Montreal; Danny.Miller@hec.ca. Isabelle Le Breton-Miller is Senior Research Associate, and can be contacted at Faculty of Business, University of Alberta, Edmonton, Alberta; LeBreton@generation.net.

The authors thank the Social Sciences and Humanities Research Council of Canada (Grant 410-2002-0007) for supporting this research. They are grateful to Joe Astrachan, Bert Cannella, Jim Chrisman, Dick Lester, Lloyd Steier, Pramodita Sharma, Barry Skolnick, and John Ward for comments on earlier drafts of the article.