ENTREPRENEURSHIP AND SMALL BUSINESS MANAGEMENT COLLECTION
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Family Business Governance

Increasing Business Effectiveness and Professionalism

Keanon J. Alderson

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Family Business Governance: Increasing Business Effectiveness and Professionalism
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First published in 2019 by
Business Expert Press, LLC
222 East 46th Street, New York, NY 10017
www.businessexpertpress.com

ISBN-13: 978-1-94999-130-7 (paperback)
ISBN-13: 978-1-94999-131-4 (e-book)

Business Expert Press Entrepreneurship and Small Business Management Collection

Collection ISSN: 1946-5653 (print)
Collection ISSN: 1946-5661 (electronic)

Cover and interior design by S4Carlisle Publishing Services Private Ltd., Chennai, India

First edition: 2019

10 9 8 7 6 5 4 3 2 1

Printed in the United States of America.

Dedication

To my family,
Sandy, Sean, Courtney, Cassandra, Dana, Jeren, Aurelia,
and the grandchildren not here yet.

Abstract

Family business is the most prevalent form of business organization in the world. Much of the existing literature on family and corporate governance focuses on the larger and often publicly owned corporations instead of the unique and special issues of the much more prevalent privately held (usually smaller) family businesses. This book presents research-based information to provide the reader a deeper understanding of the complex nature of family-owned businesses, their problems and challenges, and the unique governance structures and mechanisms that have been developed to properly guide a family business to greater effectiveness. For the family, such structures include having family meetings, a family council, and a family constitution. For the business, the board of directors provides experienced and knowledgeable advice and recommendations, as well as oversight and monitoring activities. For the owners, a shareholder's council and an annual shareholder meeting allow increased communication and voting on decisions. These family governance mechanisms have been shown to increase communication, reduce conflict, and improve decision making and professionalism. Each governance tool will be explored in depth. The audience for this book is family business owners, consultants, practitioners, and family business scholars. Cases provide readers an opportunity to apply their learning to real business problems.

Keywords

family firm governance; family business; family-owned enterprise; family business governance; firm performance; board of directors; governance; family council; family constitution; management; transparency; professionalism; corporate social responsibility

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Preface

I became interested in the subject of family business after working as a partner in my family's business when I was younger. I worked with my parents and brother for 17 years.

We did not have a successful succession of leadership to the second generation. Instead, we received a buyout offer, sold the business, and went our separate ways. More recently, I have employed my children in my own family business along with my wife. I studied family business decision making during my doctoral work and wrote my dissertation on the subject.

I still miss our family business. When in agreement, we could make lightning fast decisions and be implementing them within minutes. This enabled us to compete very successfully with several very large corporations in our industry. However, I wish we had been familiar with the principles of family and business governance. We could have benefitted from a family council. Family members could have had an outlet to air their views and participate in decision making. A board of advisors would have provided us with recommendations based on knowledge and experience.

Keanon Alderson
March 14, 2019

Acknowledgments

This book is a continuation of my first book *Understanding the Family Business: The differences between family and non-family businesses (2018).* In teaching my family business classes as well as performing research and consulting with family firms, it seems most of the family-owned firms could benefit by having an increased emphasis on governance. Many of the problems could have been prevented and/or managed by better governance procedures. This book explains in detail how to use governance tools as well as why and when. For example, the age-old problem of succession can be discussed sooner by having a family council and by the creation of a family constitution. Proper governance can help professionalize the family-owned firm.

I wish to thank California Baptist University for granting me a sabbatical to have the time to perform the research and write the draft of this book. I thank my students for their encouragement and tough questions.

I also want to thank my acquisitions editor at Business Expert Press Rob Zwettler for encouraging the publication of this book. Thanks to Charlene Kronstedt and Sheri Dean at BEP for answering all my questions. Thanks go out to the Entrepreneurship and Small Business collection guest editor Scott Shane. I would also like to thank Rene Caroline and her team for excellent copyediting and book production.

Prologue

What Is Governance?

There are various definitions of corporate governance. The definition depends on the particular situation of each business, suggesting firms may use different governance structures based on the size of the firm and whether the firm is publicly or privately held (Huse and Landström 2002).

Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring (OCED 2007).

Sir Alan Cadbury is the most noted governance scholar. He provides a simple definition: A system by which companies are directed and controlled (Cadbury 1999). The governance of a family firm is more complex than nonfamily firms. Family as well as business relationships need to be considered (Cadbury 2000).

In summary, the governance (how a company is directed and controlled) of a family firm is more complicated than a nonfamily firm. Nonfamily firms focus mainly on corporate governance. As we will discuss further in this book, there are three areas of governance in a family firm: governance of the business (corporate), governance of the family, and ownership governance.

PART I

Overview of Family Business

CHAPTER 1

Introduction to Family Business

Before discussing family and corporate governance, the reader should have some basic background knowledge in family business, and public and private business ownership. The following section is designed as a quick primer or refresher on need-to-know information that allows readers to be knowledgeable when presented with family business terms, mechanisms, and issues that can be prevented by and/or solved with more effective governance.

Throughout the world, family business is the most prevalent form of business. It is as much as 70 percent of all firms in the United States (Astrachan and Shanker 2003) and an even higher amount in Europe. Of the many companies today, chances are they started with family support and resources such as patient financial capital or low-cost family employees. Many companies would not exist without the influence and involvement of the founders' families.

Most family firms throughout the world exist as small and medium-sized enterprises, (SMEs). Many family businesses make a conscious and deliberate decision to stay small. They purposely do this to stay in control, make decisions as they desire, avoid the numerous problems of growing larger and more complex, and still make an excellent living. Some of these companies eventually scale up to become large corporations. The founders may decide to access outside financial capital through an initial public offering (IPO) and sell shares to the public. Of the companies that make up Standard & Poor's (S&P) 500 Index, fully one-third are considered family businesses. The same is true for the Fortune 500 list of America's largest public corporations (Anderson and Reeb 2003).

Millions of small family businesses exist all over the world. These families increase their standard of living by being business owners. They feed and clothe their families, pay the rent or mortgage on their homes, and send their children to school with the resources of the family business. They employ people and add to the local economy. Some businesses have been in the family for multiple generations. They are a significant factor in every country's economy and contribute to significant employment growth.

The Answer to Increasing the Professionalism of the Family Business

A major criticism of family businesses is that many are perceived to be unprofessional. They are called small and "mom-and-pop's." Many people believe they are not managed in an effective manner. They are considered not "business like." In some cases, the criticisms are true. The answer to many of these criticisms is instituting effective governance. By establishing effective governance structures, it helps increase the professionalism of a family business. Governance is key to formalizing procedures, increasing communication, increasing transparency to all stakeholders, making logical and rational decisions without emotion, and providing tools and techniques for the proper management of a firm.

Privately Held Firms

A company that has not sold stock to outsiders larger than a select group of individuals is known as a privately held company. It is privately owned. An interested investor cannot call their stockbroker and buy stock in the firm. Because it is private, the company can make all decisions on its own without any outside input or constraints. The business does not have to comply with the same Securities and Exchange Commission (SEC) regulations as a publicly held firm would. Most family-owned businesses are privately held. They have total freedom to act in their best interest, or, as is the case with altruistic behavior, to not act in their best interest. However, it is the family's decision alone to decide how to act, what goals to pursue, and what opportunities to seize, without needing to consult any public shareholders or outside stakeholders.

An example of a privately held large family corporation is Hobby Lobby. This company is completely owned by David Green and his family. Another example is Enterprise Holdings Inc., the owner of Enterprise Rent-A-Car and 100 percent owned by the Taylor family. It is the largest private owner of automobiles in the world. A private investor is not able to buy stock in either corporation because they are privately held and not public.

Publicly Held Firms

A company that has sold stock to the public and is listed on a stock exchange is considered by the SEC to be a publicly held company. The company must have a board of directors (BOD), report their financial statements publicly, and do so in a timely manner. The company is managed by upper management: the chief executive officer (CEO), chief operating officer (COO), chief financial officer (CFO), and president of the corporation. The BOD provides oversight to management, has legal authority to act for the benefit of shareholders, and has significant legal liability if they do not do so in an ethical and responsible manner. The board has the power to hire and terminate the CEO.

The introduction of Sarbanes–Oxley (Sarbox) financial accountability requirements was a sea change in corporate governance. It tightened up requirements for publicly held companies and instituted much more transparency and reporting. Directors of the organization now have legal liability when sitting on the BOD rather than being a mere figurehead. The legislation required boards be restructured to include outsiders rather than a board full of company insiders and yes men.

Facebook, Google, and Netflix are all public companies. Examples of large publicly held *and* family-controlled firms are Ford Motor Company, still controlled by the Ford family for over a century, and Walmart, controlled by the Walton family. The general public could buy stock in these companies if they desired.

Definition of Family Business

It is unfortunate that family business researchers have been unable to arrive at an agreed-upon definition of what is and is not a family-owned

business. At one time, there were 34 definitions of family business (Sharma, Chrisman, and Chua 1996), which make comparisons and generalizations between various firms difficult, if not impossible. As an example, is multibillion-dollar family-controlled Walmart similar to the family-owned lawnmower shop on the corner of Main Street? It would be difficult to compare the two. However, both are considered family businesses. So, the definition is vital to understanding family business. The following lists several family business definitions:

1. Ownership control (15 percent) or higher by two or more members of a family or a partnership of families.
2. Strategic influence by family members on the management of the firm, whether by being active in management, continuing to shape culture, serving as advisors or board members, or being active shareholders.
3. Concern for family relationships.
4. The dream (or possibility) of continuity across generations.

(Poza and Daugherty 2014, p. 7)

In a family business, a family member is the chief executive; there are at least two generations of family control; a minimum of 5 percent of the voting stock is held by family or trust interest associated with it (Colli, Fernandez-Perez, and Rose 2003).

A family business is one in which a family has enough ownership to determine the composition of the board where the CEO and at least one other executive is a family member, and where the intent is to pass the firm on to the next generation (Miller and Le Breton-Miller 2003).

The family business is a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families (Chua, Chrisman, and Sharma 1999).

Many other definitions reduce the amount of ownership required to have control over an organization and its strategies. The three main similarities between the definitions are:

- Desire to pass on to future generations.
- Ability to exert its control over the company.
- Two or more members of a family or families involved.

These three items will allow a broad discussion of both *family-owned* businesses and *family-controlled* businesses in this book.

Family-*Owned* Businesses

If a founding family owns 100 percent of the stock in a privately held firm, they have what is considered a *family-owned business*. The family owns the company; they own all the stock; there are no outside-of-the-family shareholders. The family is free to make *all* the decisions themselves and can run the company any way they desire. There are no outsiders to tell them what to do or how to run their business. That is a key point; it is *their* business. The family has complete ownership, and thus complete control of the firm. An example of a family-owned firm would be the corner market, owned by a husband and wife and employing their children. They own 100 percent of the business.

Family-*Controlled* Businesses

If the founding family sells stock to the public and has numerous outside-the-family shareholders, it is considered a publicly owned company. The family no longer has the total freedom to run the company as they would if they owned all the stock and were privately held. The stockholders have voting rights, there needs to be transparency in communication, and all stakeholders need to be informed. The BOD has responsibility for oversight of the business to protect the shareholders and stakeholders. The board may vote against the families' wishes. The family no longer owns or runs the company outright. It is no longer completely *their* business.

However, a family, through its sheer number of shares, or with a separate class of voting shares, can effectively control a company even without full ownership. This is called *family controlled* since the family controls

the firm through its ownership rights (shares of stock), through its voting rights, and often both.

Ford Motor Company is an example of a family-controlled company with a dual class or special class of shares commonly referred to as super shares or voting shares. These special “B” class shares allow voting rights of a single share to be worth many times that of common stockholder’s shares. This is how the Ford family effectively controls the multibillion-dollar automotive company with only (approximately) two percent ownership of the shares yet 40 percent of the votes (Automotive News 2013). Warren Buffet–controlled Berkshire Hathaway Inc. has two classes of shares. The “A” class has 10,000 times the voting power and 1,500 times the economic interest (value) than the class “B” stock (Cunningham 2014). Buffet enjoys a larger number of votes than his ownership stake would normally consist of through his use of dual class stock. Another example of a family-controlled firm is privately held Koch Industries, where the Koch family owns 84 percent of the stock. With this outright majority of the stock, they control the firm.

When there are large individual stockholders in a firm, those stockholders wield significant power and influence. They may select and recommend members for the BOD who are “family-friendly” insiders. Through the BOD, they can influence the board (by their number of favorable directors) and management and set the strategy and direction of the firm. In the case of the Koch family, only 16 percent of a dissenting view could ever oppose their wishes, which would be quickly outvoted.

The Walton family owns 41 percent of the stock of publicly held Walmart. If the family votes as a group, their 41 percent stake is larger than any other major shareholder. Because the firm is publicly owned, there are numerous individual stockholders. It would be nearly impossible to get the hundreds of thousands of individual Walmart stockholders to come together and agree on a proposal the family does not support and to outvote the family.

The Quandt family owns 41 percent of the shares outstanding of BMW. It is a public company, but the family has enough shares and thus enough votes to effectively control the company. Lastly, Cargill is a huge multibillion-dollar global company that is privately held by the Cargill and MacMillan families, who collectively control 85 percent of

the firm's shares. It is important to understand the difference between a family-owned business and a family-controlled business. The governance mechanisms are often different for each.

How Family Businesses Are Different Than Nonfamily Businesses

As every family business owner knows, when they turn on the financial news they rarely, if ever, hear anything relevant concerning a company of their type of ownership. They usually hear about large publicly owned businesses. Their company is not like General Motors, or Netflix, or Apple. Their company has both unique opportunities as a family-owned business, and different and hard to manage challenges (Gersick, Davis, Hampton, and Landsberg 1997). When a family business is functioning well, there is good communication among family members, a high amount of trust, and quick decision making, which can be a tremendous competitive advantage over its competitors. Speed is a tremendous competitive advantage that well-functioning family firms possess. They can enter new markets quickly and can tie up supplier relationships with contracts and effectively bar their competitors from copying their strategy. "Quick decision making is critical in business and tight-knit families in business move fast" (Poza and Daugherty 2014, p. 16).

When a family business is not functioning well, it is most likely caused by lack of communication. This is commonly associated with interpersonal and dysfunctional conflict which is very disruptive and can lead to ineffective decision making. Consider a company that has problems and is slow in making decisions. It is easy to see how the company could face difficulty with strategically planning for the future. Having slow responses to changes or competitive threats to their business places the company at a competitive disadvantage that could seriously impact the company's ability to compete and win in the marketplace. This type of dysfunctional family business would most likely be reacting to situations instead of being proactive and making their competitors react to *their* moves in the marketplace. That is not a recipe for domination in the marketplace. It can be a symptom of poor governance.

When naysayers declare there is no difference between a family firm and a nonfamily firm, they do not have a complete understanding of family business. They are not aware of the unique problems and opportunities faced by families in business together. In addition, as opposed to nonfamily-owned businesses, there are governance tools and mechanisms that do not exist at nonfamily firms. To effectively thrive in the marketplace, a family-owned business needs to institute good governance practices. This is the solution to critics of so-called "unprofessional" family business.

Because of the addition of the family unit within a business, which is by far the biggest difference between family firms and nonfamily firms, there are numerous differences that nonfamily firms do not have to face. When we see a multigenerational firm that has succeeded for decades or multiple generations, it is deserving of respect. We must ask ourselves: How did they overcome all their unique challenges? How did they persevere and succeed? What can we learn from them?

An excellent example of family perseverance in the face of numerous adversities and challenges is the Italian-based Beretta Firearms Company. They are in their 15th generation of family ownership, with the 16th being groomed presently (Martin 2014). They are the oldest manufacturing company in the world. They have been taken over by the Pope, Mussolini, and then Hitler. They went through two world wars. They have never been more successful, and now have a Beretta merchandise division and sell some of the finest firearms in the world. Some are considered works of art and retail for over a hundred thousand dollars. What have they done as a family to manage through all that adversity and still be family owned?

A contrasting example is the story of the Dassler brothers and Adidas and Puma. The two brothers took over their father's shoe company. They popularized what are now known as athletic shoes. The brothers and their wives had significant interpersonal conflict that devolved into serious dysfunction. One brother broke away from the family business and started a competing athletic shoe company. The two companies were based in the same city on opposite sides. There were local bars that were restricted to Adidas workers and supporters only, and others for Puma allies.

The brothers were not on speaking terms for several decades (Smit 2008; Gordon and Nicholson 2008).

Suppose the CEO of General Motors was sued for divorce. Would the entire company be put into turmoil? Would it threaten the company's existence as a going concern? Certainly not! Now visualize the husband and wife founders of a family business getting a divorce. Their children all work at the firm. Sides would be taken, blame issued, conflict would break out, decisions would go unmade, and the disruption would be constant. This example is just one situation that makes family-owned businesses different than nonfamily businesses.

Founder Centrality

A common issue among future generations in a business is the continuing influence of the founder that rises above the entire organization, a phenomenon referred to as "founder centrality" (Crittenden, Athanassiou, and Kelly 2000, p. 27) or "generational shadow" (Davis and Harveston 1999, p. 311). Such influence can have both positive and negative factors associated with it. It helps future generations, in that they tend to follow the original mission or vision of the organization as set by the founder, including caring for long-term employees, the community, and their customers. The influence becomes negative if the successive generations are not allowed to make their own decisions or are second-guessed by a meddling founder who has not fully retired. This negative influence has been a major reason for future generational members to exit the family firm. The family council may be a way to allow the next generation of leadership to emerge from under the negative shadow of the founder.

A positive aspect of founder centrality is the superior performance seen by some founder-led organizations. This describes firms where the founder is seen to be central to the organization, such as Mark Zuckerberg at Facebook, Jeff Bezos at Amazon, Michael Dell at Dell Computers, or Elon Musk at Space X and Tesla. It is difficult to imagine these companies without their founders. The founder is *central* to the organization. In family firms, it is a necessity to consider the central influence of a family business founder on the top management team (TMT) and on

the firm's strategic values, goals, and behavior (Crittenden, Athanassiou, and Kelly 2000).

Family First or Business First?

Family businesses can also be divided into two main types based on their goals. What is the purpose of the company? Is it to provide for the family? Is it to employ family members, even those who may not be very productive? This type of company is described as being *family first* (Poza and Daugherty 2014). The family comes first, before the business. In this type of business, family members benefit. They may have higher than market rate salaries and may personally benefit from cars and travel on the company. Family members often see the company as a bank and receive low interest loans when needed.

The opposing view is a *business first* business. In this type of business, the family realizes the business is number one. The business exists to benefit the family, but the business must succeed at all costs. Without the business, the family does not have much. This type of company will keep a large amount of cash in the bank *for the bad times*. This type of company will not employ too many family members, especially ones that are not productive. The company will be run very conservatively in order to stay in business and pass on to the next generation. One company I consulted with had one year's worth of income in the bank just waiting for the proverbial rainy day! Their concern was that after taking over from their father, whom they saw sacrificing and working hard, it was certainly not going to be them (the two brothers) who let down the numerous family members of the third generation the business supported.

Family Firm Financial Performance

A recent area of research that has fueled considerable discussion and debate among scholars is the superior financial performance shown by larger family firms over their nonfamily counterparts. There is conflicting research on financial performance differences between family and nonfamily firms. Recent research has shown that family businesses show a higher return on investment (Miller and Le Breton-Miller 2005), have greater value,

are operated more efficiently, and carry less debt compared to nonfamily businesses (McConaughy, Matthews, and Fialko 2001). Family firms in the S&P 500 Index over the period 1992 to 2002 had higher profit margins and a higher reinvestment of revenues when compared with nonfamily firms (Lee 2006). Anderson and Reeb (2003) presented evidence showing that large family businesses in the S&P 500 Index performed better than nonfamily firms did. Miller and Le Breton-Miller wrote a book based on a yearlong study of 46 successful large family-controlled companies, including Hallmark, L. L. Bean, IKEA, the *New York Times*, SC Johnson, W. L. Gore, and Cargill (2005). The authors showed evidence that family firms outperformed their nonfamily counterparts and presented key attributes of long-term, successful family firms. Family firms have been described as "nimbler, more customer oriented and quality focused, and more active in the community. As a result, they tend to outperform nonfamily firms" (Ibrahim, Angelides, and Parsa 2008, p. 95). A study of 100 large family-owned firms by Credit Suisse showed family firms have outperformed nonfamily firms by a wide margin on numerous financial measures for the 10-year period from 2006 to 2016 (CS Family 1000, 2017).

Members from the Boston Consulting Group studied 149 publicly traded, family-controlled firms with sales of more than $1 billion. They compared results with a control group of nonfamily companies of the same size and sector, and country of origin. The results showed that during years of economic growth, the family firms did not outperform their nonfamily peers. However, during times of recession, the family-owned firms significantly outperformed nonfamily firms. When the researchers looked at data across numerous business cycles from 1997 to 2009, the average long-term financial performance of the family firms was greater than for the nonfamily firms in every country studied. The researchers speculate this was due to several factors, including family firms focusing more on resilience than performance and not maximizing their profits during positive economic times to increase their survivability during bad times. They manage the downside more than they manage the upside. The family firms were very long term in their thinking, making decisions that would be beneficial 10 to 20 years later (Kachaner, Stalk, and Bloch 2012).

Conversely, other research has presented the opposite view: that family firms are not efficient, do not manage their capital well, and have a lower return on investment. To help answer the question of whether family firms outcompete nonfamily firms, research was undertaken to find a definitive answer. The answer is: It depends. Miller and Le Breton-Miller (2011) suggest that a lone founder pursues an entrepreneurial orientation (EO) and has an advantage over second-generation family firms as the family firm has numerous social identities, loyalty, and family obligations to be concerned with, and thus underperforms due to conservatism. One study looked at 369 manufacturing businesses and found that family involvement in the management of the firm was a positive aspect and reduced its risk of failure (Revilla, Perez-Luno, and Nieto 2016). A 2015 study examined more than 350 articles on family business from 37 finance and management journals and found family business performance was moderated by succession and proper and professional corporate governance (Pindado and Requejo 2015). Investor perception on ownership concentration, and the value associated with it, is shown in a report by the Organisation for Economic Co-operation and Development (OECD). The analysis shows investors place a three percent valuation premium on firms where family insiders wield significant, but not absolute, control. Conversely, for emerging market firms where multigenerational families are majority owners, investors assign a valuation discount of 5 to 20 percent (2007).

In summary, the answer to the question of whether family firms outperform nonfamily firms or not depends on the definition of family business, which generation is in control, and if sound governance mechanisms have been employed.

Trust

A major component of the family business's competitive advantage is the high levels of trust among the family members, as well as customers, suppliers, and employees. Among family members, the trust is relational and interpersonal. Family trust is founded on connections that are much deeper than the sheer economics of the business. The foundations of trust include shared common experiences, common family characteristics,

family identity and history, as well as a united value system and mutual goals. Trust is usually greater among family members than among non-family members and when compared with nonfamily firms. When trust is not sustained over time, conflict increases and management (agency) costs rise (Eddleston, Chrisman, Steier, and Chua 2010).

Trust plays a vital role in family firms and is a main differentiating factor between family firms and nonfamily firms. Steier (2001) proposes the role of trust as a governance mechanism in a family firm as helping to decide which governance structures to use. Building and strengthening mutual trust among the stakeholders is a critical issue for family business governance (Ward 2003).

High levels of trust have been shown to be important for consumers, suppliers, and other stakeholders as well. In a survey, family businesses were perceived as more trustworthy than nonfamily firms (75 to 59 percent). Trust of family businesses is high among the customers, suppliers, community, and employees (Edelman Trust Barometer 2017).

Problem Areas for Family Businesses

Problem areas for families in business are similar and relatively universal such as poor communication, conflict, bad decision making, failed succession, and lack of planning. Ever since Biblical times and the story of Cain and Abel, there has been interpersonal conflict, sibling rivalry, and poor communication among families. When a family comes together and forms a business unit, the same familial problems appear and can multiply. Sibling rivalry that may have started at an early age is still common and may become more pronounced in the business. In the family business, problems become more prevalent and apparent due to the family being in such close proximity with each other, and much of the family wealth is often tied up in the business. Some family members will be employed at the business and have both their wealth and livelihood intertwined in the business and with their family. Conflict can be very problematic and is common in family business (Davis and Harveston 1999; Alderson 2015). If not managed appropriately or prevented, it can derail a business and stifle growth.

To maintain family harmony, many family businesses squelch any differences of opinion, and thus suppress much of the constructive and

healthy debate. It is difficult for sons and daughters to disagree with their parents, because such action is often seen as disloyal or disruptive (McCann 2007). This lack of open communication has the effect of limiting healthy discussion, potential business opportunities, as well as the entire strategic planning process. The effect is often a forced dependence upon the status quo, resulting in a lack of investment in new and emergent businesses, reduced market share, failure to recognize and respond to competitive threats, and product decline (Ward 1987).

There are numerous other situations such as poor communication, petty jealousies, entrenched CEO leadership, lack of a succession plan, nonfamily management feeling they are not respected or properly rewarded, poor decision making, problems recruiting nonfamily management, chain of command, and reporting issues (a family member reporting to another family member or to a nonfamily manager).

A global survey of 2,802 senior executives of family firms showed 43 percent of the respondents did not have a succession plan in place (PWC 2016). This is a significant problem that could result in the failure of the firm and put the family's wealth at risk. This shows once again the importance of proper governance. Creating a succession plan would be an immediate topic of discussion for any governance board or organization.

Altruism can be common in family firms (Jensen 1998) and often confounds outside advisors and other professionals. Why a firm would keep a long-term employee who was not contributing productively can be answered by the loyalty the family firm has to the employees and to the people who helped build their business. Nepotism is another problem area. It is a positive situation when a family member is promoted based on skills and experience. However, when a member of the family with little to no experience is promoted over other long-term employees (nepotism), it can cause a host of problems including a failed succession and lack of acceptance by the stakeholders, contributing to low motivation among the employees.

Drug and substance abuse issues are surprisingly common, especially among the second or third generations when money has become plentiful. If an employee had a substance abuse issue while working at a Fortune 500 firm, they would be investigated by the company's human resources department and there would be a formal corporate policy to follow. Some

companies would require the employee to take a leave of absence and attempt rehabilitation, but for many companies there would be zero tolerance for this behavior and the employee would be terminated. In a family firm where the employee is also an owner, and the employee is someone's son, daughter, or brother, this issue becomes very complicated to manage. It is not easy to terminate a close family member. It causes stress among the family members and can be disruptive to the effective functioning of the company.

Triangulation

Triangulation, a common event in family firms, occurs when two warring family members bring in a third party to gain influence. As an example, a sister and a brother are at odds, and they each enlist the help of their mother to explain their viewpoints and lobby in their favor. The third party acts as a sounding board, which temporarily relieves the tension. However, continuing this type of communication is not healthy. Often, the advocacy of the triangulated person on behalf of another can make the conflict larger. The result is a problem with three people now, rather than only the original two. The best solution in this scenario is for the triangulated person to refuse to become involved and to individually counsel each family member to talk directly with the other (Rhodes and Lansky 2013). In large family businesses, multiple family members can be involved, and it can leach into entire branches of the family. Productive business is not occurring; instead, politicking is the main task at hand. At larger nonfamily companies, similar petty issues also arise, but there are policies and procedures, and a human resources department involved to help settle disputes or make recommendations for improvement.

Pruning the Family Tree

Pruning refers to family members or branches of the family being bought out by other members or branches of the family. This technique can enable a family firm to avoid conflict, possible dysfunction, and ownership dispersion by maintaining control of the business in one branch of the family. It allows inactive shareholders to turn their investments into cash and can help avoid the problem of having a multitude of owners a

few generations in the future, which can cause increased conflict due to disparate goals and delayed decision making. Pruning family branches may be a possible solution to the problem of ownership imbalance. The pruning strategy is not without problems. Disagreeing over proper valuation can cause significant family conflict to the point of family members not speaking to each other. Family members who have sold may express considerable regret if the firm goes on to greater success. Due to the limited liquidity of the shares and the prohibition of selling stock to nonfamily members, this can be a ripe area for disagreement (Pearl 2010).

Generational Succession

The most problematic area for families in business is a leadership succession from one generation to the next. Many family companies fail to have a successful intergenerational succession (Ward 1986; Poza and Daugherty 2014). This can lead to a loss of family identity, wealth, legacy, and social standing in the community, and often a closure or outright sale of the business. Having effective governance structures in place enables the succession process to start and be more effective, increasing the chances of a successful succession.