Family Influence on Value Creation

A resource-based analysis of the value creation process in family firms

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Value creation, Family business, Family influence, Resource-based view

Introduction

Family business as a young field is still struggling with the question whether and how family businesses are distinct (Chua, Chrisman, & Sharma 1999). Adding to the recent discussion on value and performance related topics (Habbershon, Williams, & McMillan 2003) this paper aims to add to this discussion in exploring the question whether family influence onto a business affects value creation. And if it does, how does this take place and under what conditions. If family influence changes the process of value creation within a firm, this would lead to differences of family influenced business in an important area and add to the point made that family businesses are distinct.

In order to argue within a given and accepted framework, this paper employs the RBV, the resource-based view (Penrose 1959, Wernerfeld 1984, Habbershon & Williams 1999). The RBV contrary to other frameworks explains firm advantages on the level of the single firm rather than on the industry or market level. For the analysis of value creation, the individual organization is the relevant unit of analysis and therefore the RBV is an adequate framework for this analysis. It will be shown that the different types of values can be viewed as resources themselves as well as they can lead, through (re-)combination of resources, to further values. Values are therefore seen as both, input and output variables of the value creation process within the firm.

Value as term is both, well defined and at the same time without an agreed and over the literature employed definition. This confusion is rooted in the different ways the term *value* is defined in different academic areas. In the finance field, *value* refers to the (financial) outcome of the company, operationalized via performance (Rappaport 1996). In the psychological field, *value* refers to a core concept rooted in one's personality in early years, stable over time and situations, leading to beliefs and guiding action (Klein 1991). Hence, values in this sense are input variables of the production process, either on the individual level of people acting, on the group level by defining f.e. norms, or on the organization level in terms of the company's culture. In order to avoid confusion, we will refer to values as resources. The financial outcome of a production process here is a resource for the coming processes as well as the input variables are resources of the recent one.

As mentioned earlier the (re)combination of resources in the value creation process involves different levels of analysis, such as the individual, the group (here: the family), and the organization. Family influence will be operationalized via the F-PEC (Astrachan, Klein &

Smyrnios 2002; Klein, Astrachan & Smyrnios 2004). The F-PEC is a recent development in the family business field, defining the potential channels of influence a family can establish in a company. The F-PEC in this context defines the channels, power, experience, and culture, and provides an easy to use, validated instrument to measure family influence onto any company on a continuous scale.

This theoretical paper will have the following outline. First, we will differentiate the output variables. Looking at the short term perspective (1 to 5 years) we discuss performance as financial, human, intellectual, and social outcome of the value creation process. These different elements of performance then should create long term (up to the time a generation is in charge, e.g. about 30 years) wealth in all mentioned areas, from where they again become input variables of the ongoing value creating process. In order to find out whether and if, where and how, family influence affects the value creation process we will briefly sum up the discussion on performance, both, from the financial side as well as more recent attempts to find out what owner-managers define as intended outcome. From there we will move on to discuss how this output variables are shaped throughout the value creation process and where the family comes into the picture. Last part of the discussion of the value creation process will be the input variables, where they come from, how they are generated, how a company gets rid of those which are counteracting (shedding of unwanted resources) and how output variables become input variables of the on-going value creation process. In all parts the relevant question will be whether the processes described are shaped by family influence.

FAMILY INFLUENCE AS INPUT FACTOR

After decades of dichotomizing into family and non-family businesses in 2001 Astrachan, Klein & Smyrnios proposed a continuous scale to measure family influence onto any business. Meanwhile the concept has been operationalized and validated employing a sufficient big sample (n=1156) (Klein, Astrachan, & Smyrnios 2004). This concept allows employing family influence as a moderating/mediating variable instead of comparing family and non-family businesses. For this paper, we will discuss the value creation process under the focus whether family influence does affect this process.

Family influence following the F-PEC can derive from three different factors, namely power, experience, and culture. Power is operationalized via the extend the family holds voting shares of the company, the percentage family members form part of the management team, and the percentage of family members on the governance board. The maximum of family influence here would be 100 % in the case that the family holds all shares; all management members are family members as well as all governance board members. Experience is operationalized via the generation in charge in ownership and management. Culture is measured by the overlap in values of the family and values of the company on one hand, and by the family business commitment scale of Carlock & Ward (2001) which gives an in-sight of how committed family members are concerning the family's business.

Looking at the F-PEC, it becomes obvious that values are an integrated part of family influence. In businesses where we find a high score on the Culture subscale of the F-PEC, a family has a high potential to influence the resource (re)combination process via its values. Values, here in the sense of psychologically rooted values, guide action of the individual and the group/organization. Values here can be both, goals as f.e. independence, and guiding principles such as honesty. Values of this type on the other hand are also restricting factors in the economic process. For example the Merck family in Germany agreed that they will refrain from supplying any manufacturer of weapons with their products although these products would serve the purposes of these clients perfectly.

Looking at the other channels of influence we can see that at least the power subscale itself is dominated by value oriented items. Ownership implies to provide financial input to a company. Leadership by family members on the other hand provides intellectual and social input to the company. We can therefore conclude just by looking at the input factors that, if families are involved, they will bring in family influenced values to the process. The question to be answered is how the values being input factors, namely financial, human, intellectual, ethical and social values, are affecting the resource (re)combination process. This resource (re)combination process is viewed as the heart of any entrepreneurial process (Schumpeter 1934; Shane & Ventkataraman 1997). The question is whether and how families influence this process directly and indirectly. Before we explore this question further, we will briefly sum up the discussion on values as output variables as the term *value creation process* implies that values are the output of this process rather than to be the input as we already showed earlier.

VALUES AS OUTPUT VARIABLES OF THE VALUE CREATION PROCESS

Value creation is mainly seen as the creation of financial value. In recently published papers on firm value of family businesses authors refer to value as financial value. Villalonga & Amit (2004) define the firm's value by Tobin's *q* measured as the ratio of the firm's market value to total assets. The firm's market value here is the value of common equity plus total assets minus the book value of common equity. Anderson & Reeb (2003) employ Tobin's *q* for the external value and ROA (return on assets) as primary performance measures. This way of looking at value has a long standing tradition in management science. As Meyer (2002, 2) points out the systems employed reflects the financial business development and its pecuniary effect on the firm's outcome. In 2004, Neely & Adams (p. 2) stating that "…business performance is itself a multi-faceted concept" and ask for performance measurement systems that take more than only the economic criteria into account. This request is based on the notion that the output of the economic organization is not merely financial.

Apart from the financial output of an organization and the processes within this "black box organization", an organization generates also soft-fact related outputs. Looking at the human side we find intellectual output variables such as knowledge and skills of the employees which grew throughout the process of resource (re)combination. But also knowledge and skills generated in relationship with suppliers, bankers, clients, and the public are output variables and as such "value added" through the resource (re)combination process. Apart from the intraindividuel skills and knowledge, the mere number of human beings involved constitutes part of the wealth of an organization. From a long-term perspective to grow an organization through successful resource (re)combination processes leads to an increase in the number of employees. In this sense, the process adds to the human wealth of the organization by growing it. So growth in terms of people employed is an output variable.

Last not least, the interaction throughout the process breeds social outcome. While intellectual output is related to a single individuum, social output is related to groups interacting in a more refined way. Relationships built are a result, thus an output, of the process of interacting during the production process. Whether we are thinking of relationships within the organization, of relationships between the organization and other organizations or individuals, of individuals within the organization with either other organizations or outside individuals, the overall relationships added and potentially contributing to the future's firm's success are output variables of the recent process. As such, a network of a business can be viewed as output of former resource (re)combination processes.

To sum up we find five kinds of output as well as input variables of the resource (re)combination process:

- financial
- intellectual
- human
- ethical and
- social resources.

Taking a long-term perspective into account, this five variables on the long run should generate financial value (e.g. financial wealth), intellectual and human value (intellectual and human wealth), and social value (social wealth), all based on ethical values.

VALUES AS INPUT FACTORS OF THE PROCESS

To understand the *value creation process* taking place we have to distinguish between the direct creation of value, e.g. the interaction of the different types of values along the time line, and the broader economic process with outcomes, as we argued earlier in this paper, are also values. We first will explore how values as input factors influence the resource (re)combination process within the organization and than move on to a multi-level model of value development.

In order to explore whether family influence affects value creation, we have to specify the value creation process. Looking at the economic process within the organization in general, we find a combination process of tangible and intangible resources. Where we find resources which are distinct because of family influence, we can argue that the outcome of the process, ergo the values created, are as well distinct because of this family influence. Habbershon & William (1999) state that there is a distinct bundle of resources in family businesses, which they call familiness. Feurerer (2002), drawing on the resource scheme of Hall (1992, 610 f), shows that the influence channels of the F-PEC power, experience, and culture lead to regulatory, positional, and cultural resources. The combination of regulatory resources (resources which are guaranteed by law), positional resources (resources that result from positions family members hold within systems), and cultural resources (such as values, norms, and beliefs) can lead to functional resources. Functional resources are the combination of the three direct family influenced resources. Under functional resources we can summarize knowledge, skills, in short everything what people enables to do what they want to do or should do because of their power, experience, and culture.

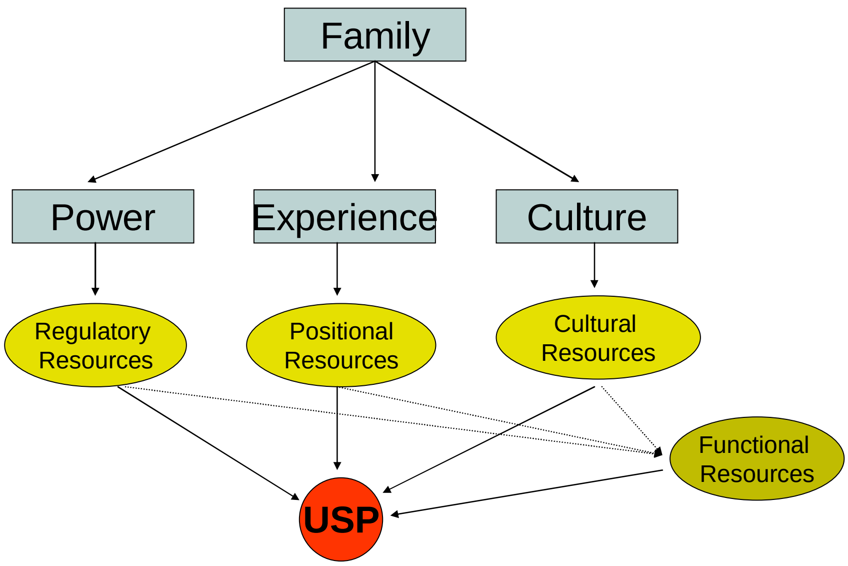

Figure 1. Family influence on different types of resources (Feuerer 2002, 33)

Taking a closer look at the organization the question is whether individuals leading the company can shape with their individual values the organization as a whole. In this case we could assume that the organizational structure of family influenced businesses is more stable than those without family influence. As values are shaped in early childhood, the assumption that values of different individuals from one family are more alike than those of individuals coming from different families. This is to say that leaders of a company coming from completely unconnected families, as we find it in companies without family influence, are more diverse than leaders coming from the same family. If the values of the individual leading a company do affect the organization, the change from one leader to the other in companies without family influence should be bigger than in family influenced one. On top, we know from research (Simon 1996, 226f) that the tenure of members of the management team and especially those of CEOs is higher in companies with high family influence.

Klein (1991) explored the question whether the values of the so-called “central individual” of a company shape its way of organizing itself. A central individual is defined as a sole owner-manager who has been leading a company for more than 10 years. Based on document analysis of 15 non-directive interviews Klein concludes that whether the central individual influences the organization depends mostly on the degree the psychological value system of this individual is differentiated. A highly differentiated value system shows high degree of abstraction, differentiation, integration, intensity, and clarity. Abstraction here is related to the level on which the individual names values. On the lowest level, people are talking about beliefs rather than values, on the highest they not only name and reflect values as being values but also reflect upon sense of life, values as goals and values as guiding principals. The degree of differentiation refers to the number of values and whether these values are distinct from each other. On top, it adds to the degree of differentiation if values as dimensions do have a high loading, e.g. if there are multiple categories referring to one value. Integration refers to the value system an individual has. High degree of integration means that the individual is aware of its values and that conflicts between values are clear to him/her. The total number of values is integrated in an internal system rather than it's inconsistent and conflicting. Intensity refers to the qualitative factor loading. Having analysed the interviews following the grounded theory practice (Strauss & Corbin 1967), multiple categories mentioned that refer to one value mean that there is a high intensity of the individual values. Clarity, last not least, refers to the clarity of language of the individual talking about values and value related questions.

Klein (1991, 186 f) shows that concerning content we find the values of the central person in subjective theories of the employees within the organization. The content of the value system of the central person influences the criteria employed for choosing and assessing employees and it provides a guideline during conflicts. Interestingly this value "swap" from the central person into the organization only takes place if the value system of this individual is highly differentiated. Looking at the formal aspects of the organization, we find authoritarian leadership style and emphasis on formal qualification rather than on social skills in those organizations that are led by people with undifferentiated value profiles. In these companies qualification refers to hard facts rather than to soft skills. They tend to centralize decisions whereas in organizations led by people with differentiated value profile we find decentralized decisions. While organizations led by people with differentiated value profiles are diverse as much as their leaders are, organizations led by people with rather undifferentiated value profiles are very much alike each other. We therefore can conclude that values of people leading a business do impact the business' organization, but that we have to take a closer look at the value profile of this leader. Again, only if the value profile of the leader is differentiated it leads to distinct resources within the company.

VALUE CREATION PROCESS AS RESOURCE (RE)COMBINATION

Values as input variables do not under all conditions influence the output of the system. To understand better the value creation process, we will distinguish between the different levels that are part of the process. Although values are at the first sight individual concepts, we find them as well on the more aggregated levels of the group, here the family, and the organization. Looking at table 1, we can see that not all types of values are found on the input and the output side of the process as well as not all types of values can be found on each level.

	Resource	Resource (re)process	Level
1	Human Resource	HR x HR = $HR_{1,2,3,....}$	Family
2	Ethical Resource	HR → value internalization → ER	Family
3	Ethical Resource	$ER_{differentiated\ value\ system}$ x HR_{mult} = ER_{org}	Organization
4	Intellectual Resource	HR → education($_{HR,\ IR,\ SR,\ FR,\ ER}$) → IR_{ind}	Individual
5	Intellectual Resource	IR_{ind} x IR_{ind} = IR_{mult}	Family
6	Intellectual Resource	IR_{mult} x IR_{mult} = IR_{mult}^2	Organization
7	Social Resource	HR_{mult} x HR_{mult} = SR (→ longterm communication)	Family and/or organization
8	Financial Resource	HR x IR x SR = FR	Individual
9	Financial Resource	FR_{ind} + FR_{ind} + FR_{ind} = FR_{Fam}	Family
10	Financial Resource	$FR_{ind/mult}$ x HR_{mult} x IR_{mult} x SR = FR_{mult}	Organization

Table 1. Resource (re)combination process on different level of analysis

For an individual to develop values rooted in its own personality, this individual has to undergo a process of value internalization. Mostly this process is triggered by upbringing and education. This is the reason why it is the group level, the family where upbringing and education in most cases take place, which is responsible for the values of the individual. This is true for both, individuals that are part of a business owning family as well as for those that are born into a family without any connection to a business. So the starting point for all values but the financial values is the family of an individual where value internalization is triggered. One further point to take into account is the long-term perspective of these values. Once they are rooted within the personality, internalized ethical values will only very rarely and if, under dramatic conditions, change. Reason for change can be the death of the partner, going bankrupted, life threatening illness and other catastrophes that one might come across in once life. Biographies without those dramatic crises are guided by rather stable values (Klein 1991, 45). These values might become more refined, e.g. more clearly organized in terms of priorities, goal conflicts, and awareness of limitations, but in the core they are stable.

By getting connected with other individuals these values are becoming part of bigger system. First of all, these value form part of the value system of the family the individual founds. The individual values here are transferred into social values. Apart from that they become the input factors for creating human wealth, in the sense that even still today families do produce human wealth in terms of having children and bringing them up. And within this system the values are transferred to the next generation again through upbringing and education. On the other hand these values become input factors of the resource (re)combination process in the above described way. The more central the individual becomes within the organization, the more the values shape the processes within this organization. Through the process values are transferred into again social value within the organization. Through education the individual also acquires intellectual values, which become part of the resource (re)combination process. At the same time the process itself breeds further intellectual values. So through the resource (re)combination process further intellectual values are grown. We can therefore conclude that the values of an individual, the ethical, intellectual, and financial values are transferred through the resource (re)combination process directly into social, intellectual, and financial values of a different level. Through the founding of another family the individual's values become part of the group's, here the family's, values. This group might "produce" further human value by having children, further ethical and intellectual value by educating these children, further financial value by aggregating the financial, social and intellectual values of the family in order to get an value added, and last not least, further social value.

Social value could by described as networks. The question again is whether networking a) has a different quality and b) a different outcome when families are involved. Looking at family influenced businesses we see less formal networking (Füglistaller et al, 2004) than in anonymous companies. On the other hand it can be argued that up to now studies do not take informal networks into account. Without having proved from research yet, we can observe in practice high levels of informal networking within and between families and family businesses. Through long-lasting interconnection within the family even over many generations this does make sense. Apart from that, families tend to exchange about education, e.g. schools, universities; about clients and suppliers; about other families with which they even might get closer connected via inter-marriage. In short, from golf clubs, rotary, to alumni organizations and family offices, there are multiple ways of networking within and between families that are only partly open to non-family-business members. While they might become an individual member of the network, the family members are members not in their own right but through membership within a distinct family. And as you cannot quit your family you cannot, in consequence, leave the network but as an individual. Concerning the social value as outcome of the resource (re)combination process are therefore highly affected by family influence.

Looking at the output factor *financial value* authors argue that family influence increases the financial value of a firm (Anderson & Reeb, 2003; Villalonga & Amit 2004). Other authors (Chrisman, Chua, & Litz 2004, 349) show that "*excluding the effects of agency cost control mechanisms,* the family and non-family firms in our sample had similar economic performance as measured by short-term sales growth". Looking at the resource (re)combination process as discussed above it becomes obvious that, whether family influence increases or decreases the *extent* of financial value creation, it influences the *way* of value creation. On the individual level, financial resources are a result of the combination of human, intellectual, and social resources. To distinguish a family from a non family influenced business, the input of financial resources, e.g. percentage of shares hold by the family, is one way. Financial resources of the family (the sum of the family's individual financial resources) are one element of the process of value creation. Looking at the organizational level, we can see that financial value creation asks for financial input of either one or more individuals, for human resources, intellectual resources and social resources. Apart from financial resources as input factor all other input factors are shaped by the family. We can therefore conclude that whether family influence enhances the level of value creation, it certainly influences the *way* of value creation. In companies where this influence onto value creation derives from a single family and their value set, it seems logical that the influence is more homogenous than in companies where this influence derives from various, unconnected families.

Discussion

It could be shown that family influence affects value creation to a high extent. All possible values; financial, human, intellectual, social, and ethical values are influencing the resource (re)combination process and are themselves influenced by the family. Looking at the source or the starting point of values, we come to the conclusion that values start within the family system. From the "production" of human beings, e.g. human values, rooting the ethical values and supporting the development of intellectual values, the family is responsible for anchoring the individual in long-lasting social networks. Then these resources become ingredients of the financial value creation process. Without intellectual and social resources an individual will not be able to even maintain the level of financial resources it starts with. Generating more financial resources is only possible by combining these resources with other intangible resources. Therefore we can conclude that in order to make sure that the economical well being of the incoming generation is more alike, we need to invest in intellectual and social resources rather than in financial ones.

Further research is needed to show empirically the interconnectedness of different kinds of values as input and output factors. The broadening of the perspective from sole financial focus to rather philosophical focus will probably cause discussions, but also rejection from the management world. On the other hand, with Enron and Parmalat, the idea of sole financial value creation without guiding ethical values has come to its end. It will be important to show how ethical, intellectual, human, and social values contribute to the overall financial well-being of society.

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