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Bad governance of family firms: The adoption of good governance on the boards of directors in family firms

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abstract

The concept of good governance, as the manifestation of a larger ideology of shareholder value maximization, is designed for and promoted by large, manager-controlled listed corporations. The increasing adoption and growing legitimacy of good governance have led to the formation of a dominant institutional logic, which family firms experience pressure to adopt. Particularly strong is the pressure to increase the independence of the board of directors. While the process of change towards more independent boards may not necessarily contribute to increased economic efficiency or be fully able to fulfill the governance needs of family firms, these firms continue to adopt such practices. Drawing on institutional theory, we propose that institutional pressure is the dominant reason for family firms to adopt board independence. We then deduce potential consequences of this change, including positive consequences in terms of creation of both social and economic value, as well as negative consequences in terms of dilution of board meetings, demotivation of managers and decreased collaboration in the boardroom. Our study suggests that the benefits associated with the adoption of good governance can become offset by a decrease in the strategic adaptability of a firm.

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Introduction

Shareholder value maximization has been termed ‘a new ideology of corporate governance’ and has become the point of convergence for the mainstream literature in corporate governance research (Lazonick and O’Sullivan, 2000). This ideology appeared in the United States during the 1970s, shifting the focus of large, managerially governed corporations from a ‘retain and reinvest’ to a ‘downsize and distribute’ philosophy (Fiss and Zajac, 2004; Stout, 2012). One manifestation of this dominant ideology is the concept of good governance, which has attracted the attention of researchers and policymakers as well as practitioners.

The diffusion of shareholder value ideology and good governance has been facilitated by the development of agency theory (Eisenhardt, 1989; Fama, 1980; Fama and Jensen, 1983; Jensen and Meckling, 1976), which remains the primary theoretical perspective on corporate control and the cornerstone of good governance (Aguilera and Cuervo-Cazurra, 2004). Web of Science citation index search results for the term good governance across disciplines (retrieved July 10, 2015) have increased nearly ten times in the last 14 years, starting with 116 records of the term in 2000 and reaching 1,137 in 2014. During the same period, the number of citations of works addressing the concept of good governance has increased nearly 30 times, indicating rapid development of this body of research as well as its scientific impact.

The dramatic shift towards the increasing influence of good governance is also depicted in the literature oriented towards practitioners. Articles in the business press encourage managers to improve the governance of their firms through increasing board independence (Argandona, 2014; Bebchuk, 2012; Nadler, 2004; Sonnenfeld, 2002). Recommendations to move towards greater board independence target not only large publicly listed corporations with dispersed ownership structure but also family firms (Bromilow and Morrow, 2014). Furthermore, the media have supported this movement by giving positive coverage to corporations signaling their adherence to good governance (Bednar, 2012). At the same time, insider-dominated boards have been ‘punished’ by negative coverage (Joe, Louis and Robinson, 2009). Increasing publicity of good governance resonates with large public corporations including Coca-Cola and Telenor, which have published good governance reports and included them in their annual reports of 2014, contributing to the normalization of good governance.

In line with this trend, the principles of good governance have been used extensively among policymakers, sometimes parallel to research discussions, and
sometimes ahead of them. Two influential regulatory documents – the Cadbury Committee report (1992; 2000) in the UK and Sarbanes-Oxley Act in the U.S. – both incorporated the rhetoric of shareholder value, conceptualizing it in good governance practice recommendations (Filatotchev and Boyd, 2009). Codes of good governance have subsequently spread to international political and corporate contexts (Jansson, 2013; Jansson and Larsson-Ölaison, 2010; Jonnergård and Larsson, 2007; Oxelheim and Randøy, 2005), indicating the existence of a general consensus regarding the direction in which governance standards are assumed to develop in the future.

The increasing adoption and growing legitimacy of good governance reflect the formation of a dominant institutional logic, referring to a set of commonly accepted governance practices serving the interests of the corporate elites, particularly the shareholders (Fligstein, 1985; 1987; Lazonick and O’Sullivan, 2000). This market-oriented logic, which originally appealed to large manager-controlled listed corporations with highly dispersed ownership structure (Lane et al., 2006) came to be adopted by companies with concentrated ownership structure as well as by private corporations (Pieper, 2003).

While shareholder value maximization concerns primarily the economic value, this may not necessarily be the primary objective for all categories of firms. Particularly different in this dimension are family businesses, which are motivated by non-economic goals such as retaining family control over the firm and the preservation of the family wealth (Gomez-Mejia et al., 2011). This incongruence between governance of family business and the dominant institutional logic of good governance has resulted in criticisms of the current governance practices of family firms (Bertrand and Schoar, 2006; Carney, 2005).

Being more responsive to conform to institutional pressure than non-family firms (Berrone et al., 2010), family businesses – both public and private – have increasingly adopted governance codes (Pieper, 2003; Yildirim-Öktem and Üsdiken, 2010). This said, the empirical research has not managed to confirm the claim of positive performance effects of good governance for firms in general (Seidl, 2006); neither has it consistently shown lower performance of family-dominated governance (Gomez-Mejia et al., 2001; Woods et al., 2012).

While the general perspective in corporate governance research is exploring the relationship between governance mechanisms and firm outcomes, little is known about how and why family firms respond to changes in the dominant institutional logic of corporate governance practices or about the consequences these changes bring to the firms. Reflecting on the increased emphasis on board control promoted by good governance, we explore what drives family business to
conform to the dominant institutional logic. Drawing on institutional theory (DiMaggio and Powell, 1983; Meyer and Rowan, 1977), we explain ideologically driven institutional change using the example of the increasing adoption of good governance by family firms and illuminating the potential consequences of this change.

Our analysis focuses on one particular aspect of good governance, namely the notion of board independence, which comprises one of the central tenets of good governance (Aguilera and Cuervo-Cazzura, 2004). Over recent decades, with the rise of shareholder activism, a shift of power has occurred from managerial dominance to greater power for corporate boards (Filatotchev and Toms, 2003; Nielsen and Huse, 2010). According to this widely accepted view, boards with a higher proportion of outside directors, independent from management, are able to exercise more vigilant control (Finkelstein et al., 2009). In line with this logic, researchers have documented a trend towards the adoption of more independent board structures among firms in general (Bhagat and Black, 2002; Gordon, 2006; Johanson and Østergren, 2010; Westphal and Zajac, 1997; Clune et al., 2014) and family firms in particular (Pieper, 2003; Yildirim-Öktem and Üsdiken, 2010).

In our study we put forward three main arguments. First, we question the economic efficiency of good governance for family firms; secondly, we illuminate the difference between the governance needs addressed by good governance and the actual governance needs of family firms; thirdly, we argue that family firms adopt good governance in response to institutional pressure. In the final part of the paper we discuss the potential consequences of adoption of good governance by family firms.

**Economic efficiency of good governance**

The motivation behind recommendations to adopt good governance largely builds on the economic efficiency arguments designed mainly for manager-controlled firms. The inclusion of independent directors on corporate boards, consistent with good governance, is assumed to reduce the risk of managerial opportunism, thereby maximizing the shareholder value (Fama, 1980). Based on this logic, family firms’ tradition to have a strong family representation at the board has been criticized for potential internal control problems (cf. Gomez-Mejia et al., 2011). Researchers generally view managers selected within and by the family as less competent, more likely to face problems of self-control and moral hazard (Anderson and Reeb, 2004; Fang et al., 2012). Family boards that are essentially passive organizational bodies, rubber-stamping the decisions of a
controlling family, do not contend problems of self-control and moral hazard supporting managers in pursuing their endeavors (e.g., Gomez-Mejia et al., 2011; Lubatkin et al., 2005). The lack of internal control mechanisms is seen as a potential reason for efficiency loss, which in turn compromises the ability of a firm to maximize shareholder value. The good governance recommendations aim at curbing these negative implications by appointing outside board members to exert more vigilant monitoring over managerial decisions (Miller and Le Breton-Miller, 2006) and to manage parental altruism (Lubatkin et al., 2005). According to this view, stronger control over managerial actions is assumed to minimize the agency costs of managerial opportunism and generate profits, ultimately maximizing shareholder value.

A surprising fact in the promotion of good governance is the limited amount of research supporting the normative assumptions behind the codes (Seidl, 2006). Empirical tests of the theories of board structure and board leadership underlying the good governance recommendations have shown little consistency (Bhagat and Black, 2002). In the context of family firms, a comprehensive review by Bammens et al. (2011) reports mixed findings regarding the relationship between board independence and firm performance. Some studies have found negative effects of board independence on firm performance (Klein et al., 2005) in family-controlled public firms. A number of conceptual arguments may contribute to explain the lack of empirical evidence of economic efficiency of good governance in family firms.

The inclusion of independent directors on the board of a family firm might not always lead to increased attention to the monitoring function (Goh et al., 2014). Previous research has distinguished other important tasks of outside directors besides monitoring; the tasks include resource provision, strategic advice and CEO counsel, as well as conflict resolution (Bammens et al., 2011; Collin, 2008; van den Heuvel et al., 2006). Family members, motivated by the desire to preserve their control over firm, can have a strong influence on the process of director selection (Miller and Le Breton-Miller, 2003). In this case, the family will be interested in selecting directors with specific characteristics to serve on the board, such as directors who are able to provide qualified advice for the CEO (Heidrick, 1988) or directors that do not challenge family control (Anderson and Reeb, 2004). In support of this, Cannella et al. (2015) show that family firms are more likely to employ directors with prior experience of serving on family firm boards, as they are more likely to support the goals of the family, thereby assuring the family’s control over the firm. This leads to the assumption that board independence emphasized as part of good governance may have less importance than other motivations for inclusion of independent directors on the boards in family firms.
Secondly, once the outside directors are selected, their ability to act as monitors may be significantly constrained by the family control over board decision making. Outside directors selected by the family may feel indebted, implying that they would not engage in vigilant control over managerial decision making, neither would they challenge the actions of family members representing the management or the board. Furthermore, family control over the board may imply assuming control over the information flow, for example through preparing board meeting agenda (Goh et al., 2014). In such situations the independent directors may find it difficult to place issues related to control on the board agenda. In addition, board decisions in family firms can be made outside board meetings through informal conversations between influential insiders (Gersick et al., 1997). Outside directors may not be able to take part in these discussions due to their limited contact with the firm and the lack of inside information and firm-specific knowledge (Baysinger and Hoskisson, 1990). Consequently, the inclusion of independent directors to the board may not necessarily increase control over managerial decision making in family firms, as advocated by good governance principles. This in turn questions the economic efficiency argument of good governance when applied to the context of family firms.

The governance needs of family firms

Several characteristics make family firms distinctively different from manager-controlled firms. Most notable are goal orientation towards both financial and non-financial goals (Chrisman et al., 2012; Gomez-Mejia et al., 2007), dominance of relational contracts, reliance on relational trust, and non-existence (or a different aspect) of the agency problem (Gibson et al., 2014). These characteristics form a set of governance needs for family firms, i.e. overall motivation forces for implementing governance in the firm. These needs, being substantially different from the governance needs in managerially governed firms, influence the functions of the board of directors. In this section we discuss the governance of family firms, focusing on the board of directors and compare it to the good governance principles, designed primarily for manager-controlled firms.

Non-financial goals are described as a characteristic fundamental for family firms (e.g., Zellweger et al., 2013). This is also embraced in the socioemotional wealth (SEW) perspective, where the family’s benefits from non-financial aspects of the firm are at the core of the firm’s values (e.g., Gomez-Mejia et al., 2011). According to this view, the loss of SEW implies the loss of status, informal ties with the family and the failure to meet family expectations (Gomez-Mejia et al., 2007). The non-financial goals of family firms may include the preservation of
control over the firm, the survival of the firm through generations, legitimacy and reputation gains (Berrone et al., 2010; Zellweger et al., 2013). Moreover, the long-term survival of a family firm is valued higher than its short-term profit (cf. Astrachan and Jaskiewicz, 2008). Consequently, because of the different goals of family firms (Chrisman et al., 2004), the maximization of shareholders’ economic value, emphasized by good governance (Fama and Jensen, 1983; Lazonick and O’Sullivan, 2000), can be less relevant for family businesses. Instead, the goal orientation of family firm governance can involve both economic and non-economic aspects.

The distinct goals of family firms imply a different nature of contract between the principal, represented by the controlling family, and the agent, represented by the management. In contrast to the formal agency contracts in manager-controlled firms based on the assumption of economic rationality, relational contracts in family firms can be based on mutual expectations that depart from this assumption (Gomez-Mejia et al., 2001). In particular, the relational contract in family firms can be influenced by non-economic motives, such as nepotism, i.e. preferences towards the other members of the kin (Collin and Ahlberg, 2012), family altruism (Corbetta and Salvato, 2004), as well as emotions and feelings such as rivalry and internal family conflicts (Tagiuri and Davis, 1996). These non-economic motives of the management and the board form the contractual relationships within the firm; clearly, they are largely informal in contrast to the more formalized contractual arrangements in manager-controlled firms (Mustakallio et al., 2002).

Furthermore, trust plays an important role in family firm governance (Gomez-Mejia et al., 2001; Pollak, 1985) defining the nature of relational contracts. In the context of family firms, trust derives from personal ties and kinship within the family, which makes it different from control-oriented ‘calculative trust’ discussed in the context of managerially governed firms (Corbetta and Salvato, 2004). Relational trust is based on emotions and feelings rather than economic rationality. The presence of a high level of trust created by collectivistic family culture makes individual goals subordinate to the goals of the family (ibid.). In contrast, managerially governed organizations possess a calculative trust, deriving from more formal agency contracts, forming a managerial philosophy relying largely on controlling rather than enabling.

Due to this different goal orientation, reliance on relational trust and the distinct nature of the relational contracts in family firms, the nature of the agency conflict in family firms is substantially different from the agency conflict addressed by good governance. While the focus of good governance is the effective resolution of agency conflict arising due to the separation of security ownership and control
Fama, 1980; Jensen and Meckling, 1976), family firms tend to preserve their control over firms through the inclusion of family representatives on the board of directors and the management of the firm (Lane et al., 2006). Hiring family members in these cases may not be considered to cause any agency costs, since it is in line with the goals of the principal (Chrisman et al., 2003; Chrisman et al., 2004). The congruence of goals between agent and principal is further facilitated through intense formal and informal contacts. Previous research has shown that the relationship between management and the controlling family often goes beyond formal exchanges involving strong informal ties (Gomez-Mejia et al., 2001). Since agency costs arise only if the interests pursued stand in contrast to the principals’ interests (Fama and Jensen, 1983), what would be considered an agency problem in a firm with dispersed ownership might not be considered an agency problem in a family firm. The family CEOs who have a large firm-specific investment in terms of ownership capital, firm-specific knowledge and SEW are expected to put the welfare of their firm prior to their personal interests, thereby minimizing the agency conflicts (Anderson and Reeb, 2003; Chrisman et al., 2004).

The low relevance of the classical principal-agent conflict for family firms does not imply that this organizational form is conflict-free. In fact, the presence of agency conflicts in family firms has been thoroughly discussed, in terms of the actual presence of diverging interests among family members, that is, a principal-principal problem; preferences towards family members, or nepotism, and related free-riding problems (e.g., Schulze et al., 2002); and conflict between family and minority shareholders (Chrisman et al., 2004), if such are present. While the literature on principal-principal conflict emphasizes potential agency costs arising from conflicts of interest between family and non-family shareholders, the presence of a strong family control may also increase efficiency through reducing opportunistic behaviors. Family managers that have long-lasting ties with the family are less likely to sacrifice the long-term wealth of the family for short-term personal benefits (Pollak, 1985).

The four distinct characteristics of family firm governance presented above form specific governance needs where the central need is the preservation of the socioemotional capital (Gomez-Mejia et al., 2011), rather than resolving the agency problem. According to the arguments presented, the differences between the governance needs of managerially controlled firms and those of family firms would be reflected in the dominating functions of the board of directors. While good governance grounded within the agency perspective emphasizes the control and monitoring functions of the board (Westphal and Zajac, 1994; Westphal, 1999), it is the conflict resolution function with resource and service provision, or strategic involvement, that may be viewed as more important functions of the
board of directors in family firms (Bammens et al., 2011; van den Heuvel et al., 2006). For example, the board’s engagement in giving advice has been found to contribute to better quality strategic decisions in family firms, as well as higher managerial commitment concerning such decisions (Mustakallio et al., 2002). The conflict resolution function has been discussed as particularly important for board governance in family firms. Since family firms have a dominant owner, the ability to negotiate the intentions of family and non-family owners becomes imperative (Collin, 2008). The board of directors thus constitutes a suitable arena to discuss diverging views of family owners (Bammens et al., 2011; Siebels and zu Knyphausen-Aufseß, 2012). Conflict resolution in family firms implies that affiliated or inside directors can contribute to the board’s decision making to a larger extent than independent directors. Consequently, considering the distinctive characteristics of family firms, the objectives emphasized by good governance and their manifestation in the functions of the board may not be fully applicable to particular governance needs of family firms.

Institutional pressure to adopt good governance practices

If good governance practices are not economically efficient or are misaligned with the governance needs of family firms, why would family firms adopt them by including independent directors on their boards? One reason for doing so is the institutional pressure (cf. Shipilov et al., 2010) stemming from corporate practices, regulatory frameworks and mainstream corporate governance research. Active promotion of good governance in these three areas has led to a formation of an institutional logic comprising a set of social norms and expectations, enforced by regulatory mechanisms that drive the process of adoption (Joseph et al., 2014). Family firms are responding to institutional pressures more than their non-family counterparts (Berrone et al., 2010; Miller et al., 2013; Yildirim-Öktem and Üsdiken, 2010). The explanation is that by doing so, family firms increase their likelihood of firm survival by creating legitimacy (Cennamo et al., 2012). Deephouse and Jaskiewicz (2013) argue that family members identify more strongly with their firms than non-family members. This strong identification serves as a source of motivation for family members to seek legitimacy of their firms in order to feel good about themselves and the firm they work in. Consequently, in the context of family firms, social legitimacy may constitute an objective which is superior to that of economic gains (Berrone et al., 2010).
Institutional context is claimed to have a substantial effect on the internal organizational environment of a firm and its governance practices (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Scott, 1995). The dominant institutional logic of good governance designed primarily for large manager-controlled corporations is enforced within normative (best practices), mimicking (successful examples) and coercive (regulatory) pressure for firms to adopt the institutional changes (DiMaggio and Powell, 1983). Family firms respond to this pressure by adopting a larger proportion of independent directors on their boards.

The normative pressure derives primarily from commonly accepted assumptions that define appropriate strategies (DiMaggio and Powell, 1983). In the case of good governance, board independence is a largely taken-for-granted assumption within the dominant perspective of shareholder value maximization (Joseph et al., 2014). According to general view, the independence of corporate boards assures vigilant monitoring of managerial decision making (Finkelstein et al., 2009).

Family firms have been criticized for their conservatism and lack of professionalism, due to the presence of strong family control over management decisions (Bertrand and Schoar, 2006; Carney, 2005). These criticisms derive from the agency perspective, where a strong family involvement implies opportunities for extraction of private benefits at the expense of non-family shareholders (Young et al., 2008). The governance needs of family firms such as the maximization of SEW may contradict the dominant institutional norms of managerially governed firms, concerned with the maximization of economic value (Chrisman et al., 2012; Gomez-Mejia et al., 2003; Shepherd and Haynie, 2009; Stewart and Hitt, 2012). Bearing in mind that reputation constitutes an important asset for family firms (Zellweger et al., 2013), refusal to conform to these institutional norms may have a strong negative impact on firm reputation. Being more sensitive to assessments by outsiders (Berrone, 2010) and adapting to these institutional norms may aid family firms’ reputation, thus maximizing the SEW of the family. In response to this normative pressure, researchers have depicted increasing professionalization of family firms: they refer to the change from family-dominated leadership to professional non-family managers (Gedajlovic et al., 2004; Lin and Hu, 2007).

Mimetic pressure constitutes another mechanism facilitating the adoption of good governance by family firms. A series of high profile corporate scandals including Enron, Tyco, and Parmalat have questioned the existing practices of corporate governance (Coffee, 2005), creating a symbolic uncertainty about how to govern a corporation (DiMaggio and Powell, 1983). Mimicking other
corporations constitutes one potential strategy of coping with this uncertainty \textit{(ibid.)}. Model corporations, from which the other firms ‘borrow’ practices, diffuse good governance through board social interlocks (Westphal and Zajac, 1997). By mimicking best practices and conforming to the prevailing institutional logic family firms may gain social legitimacy through improved reputation (Bednar, 2012).

Coercive institutional pressure to adopt good governance may come from non-family shareholders who have a stake in the firm’s capital. The inclusion of outside directors on family firm boards creates a signal of objectivity and professionalism (Heidrick, 1988; Hutcheson, 1999). The action is often taken and the signal given due to the pressure from non-family stakeholders including investors and banks that use their political power to assure the efficient use of their financial capital (Fiegener et al., 2000; Johannisson and Huse, 2000).

Coercive pressure to conform to the prevailing institutional logic of good governance also stems from the legal environment. Corporate governance codes provide corporations with a legal mandate to adhere to good governance (Joseph et al., 2014). Family firms are no exception from this pressure towards greater independence of the board. The codes of good governance designed for family firms stress the importance of board independence, creating both formal and informal pressure to adhere to good governance (Cadbury, 2000; ecoDa, 2010).

Previous research has argued that firms may respond to social pressure in different ways from active resistance, symbolic compliance or actual adoption of the institutional change (Oliver, 1991). This implies that even if family firms were to adopt good governance practices due to pressure from stakeholders or regulators and include more independent directors on their boards, these changes may still be entirely or partly ‘window-dressing’. In support of this observation, Yildirim-Öktem and Üsdiken (2010) find that Turkish family business groups tend to appoint as outside directors informally affiliated persons. The authors attribute this formal adoption of practice as a response to coercive pressure from governance codes. Another study by Selekler-Goksen and Yildirim-Öktem (2009) shows that Turkish family business groups resist governance codes’ recommendations in their compliance reports. For example, they may not explain why codes are not followed, or they may shape the definition of an external board member by defining retired employees as such. These findings imply that the adaptation to the dominating logic of good governance can occur de jure, while governance practices remain to be unchanged de facto.
The legitimacy gained through symbolic adoption of good governance can also affect other family firms in the industry forcing them to adhere to the dominant institutional logic. Particularly, the increasing adoption of more independent boards may lead to cycles of reinforcement and readoption of such practices by other firms, since firms tend to mimic the actions of one another (DiMaggio and Powell, 1983). Eventually these sanctioned behaviors can become internalized, transformed into norms and subsequently guide actual governance practices. In support, previous research has documented that the initial adoption of window-dressing to meet the prevailing institutional logic of greater female representation on the board transformed situations where there was merely a ‘token’ female director to situations where women were influential decision makers on the boards of Norwegian companies (Huse and Solberg, 2006). Similar dynamics can occur on family firm boards, implying that independent directors initially selected as tokens will gain legitimacy and exercise increasing control over strategic decision making.

Overall, good governance constitutes one of the manifestations of the dominant institutional logic. According to institutional theory, the pressure to conform leads to convergence in firms’ organizational practices. The pressure to adapt to the norms of good governance derives from normative, mimetic and coercive pressure to conform to the dominant institutional logic. Family firms are expected to follow the norms of good governance and are particularly pressured towards adopting more independent boards. These changes may happen de facto or de jure, when boards are formally but not effectively independent.

Potential consequences of good governance

Based on the foregoing arguments, we now identify and discuss several potential consequences of the adoption of good governance by family firms. First, we present the positive consequences: enhancing the firm’s competitive position, including reputation enhancement as well as access to external financial and non-financial resources. We then discuss the negative consequences, namely, the dilution of board meetings, demotivation of managers and decreased social cohesion at the board meetings, which in turn may decrease the strategic adaptability of the family firm.

Positive consequences of good governance

Firstly, the perceived adoption of independent directors as a symbolic gesture (Westphal and Zajac, 1994) through impression management and the fulfillment

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1 We thank an anonymous reviewer for this point.
of societal expectations may benefit companies both reputation-wise but also in terms of creating access to investor capital. The notion of ‘social worthiness’ (Thornton and Ocasio, 1999) referring to legitimacy gained through adaptation to the social norms, can bring important non-economic gains to family firms. Particularly, the inclusion of independent directors on family boards signals justice and equality of family firm governance (Craig and Moores, 2004), enhancing their reputation and the social status of the family members. These non-financial outcomes, derived from created legitimacy, contribute to the maximization of the socioemotional wealth of the firm (Berrone et al., 2010).

Besides the SEW gains associated with social legitimacy, adapting to the dominating institutional logic may provide family firms with access to external resources, both financial and non-financial. Increasing the independence of a board signals credibility of a firm and security of investors’ capital (Pfeffer and Salancik, 1978). In support of this argument, research shows that investors are willing to pay a premium for the corporate stock of firms that practice good governance (Certo et al., 2001; IRB, 2000). Thus, adhering to good governance may help family firms raise financial capital for development.

In addition to the financial advantages associated with conformity to institutional norms, the inclusion of independent directors can bring additional resources to the board, including valuable networks, information, strategic advice and counsel (Bammens et al., 2008). Van den Heuvel et al. (2006) show that CEOs of small and medium-sized family firms value the resource provision role of the board as more important than the control factor. Such tasks as the mediation of a succession process can be fulfilled by independent directors that can assume the role of mediators between the family and non-family shareholders. Furthermore, outside directors on family firm boards can also contribute to the increase of internal efficiency of their firm through disseminating the processes and routines of market-oriented governance stemming from the experience of other boards’ practices. This can particularly benefit a family business whose goal is to scale up its business and need an increased degree of formalization (Miller and Le Breton-Miller, 2006; van den Heuvel et al., 2006).

Negative consequences of good governance

While the benefits associated with increased independence of family business boards have been widely discussed in previous research, the potential negative effects have received considerably less attention. As it was argued above, the institutional conformity may increase social acceptance and enhance firm reputation (Bednar, 2012; Westphal and Zajac, 1994); however, it may also cause incongruence between good governance objectives and the specific governance
needs of family firms. This incongruence may lead to three main consequences, namely, the dilution of the board meetings, demotivation of managers and decreased social cohesion at the board meetings. These consequences may in turn lower the quality of strategic decisions undertaken by the board, resulting in the decreased strategic adaptability of a given firm.

The increased independence of the board may result in some board work remaining outside of board meetings, whether or not it had been conducted there before (cf. Nordqvist, 2012); or even in board work being intentionally moved outside of board meetings. Due to the existence of close ties between the board and the management in family firms, family members can make decisions outside the board meetings, and then get the decisions accepted at a formal board meeting afterwards (Khan et al., 2013). For example, this can occur if the independent director stresses financial goals and monitoring by the board, while the family wants to stress non-financial and family-related goals. Furthermore, due to the externalization of the board meetings, the decisions informally made by incumbent directors will not be properly evaluated, and may possibly be of a poor quality. By the same process, the competence of independent directors will remain unused despite its potential value for the strategic decision-making process.

Secondly, increased control and monitoring over managers in family firms will lead to the demotivation of managers. In family firms, where family members generally favor autonomy (e.g., Zellweger et al., 2013), increased control and monitoring will reduce managerial discretion, resulting in the impaired ability of a family member CEO to exercise his or her professional judgment. Managers, generally assumed to be highly motivated due to the complexity of job demands and to the presence of strong competition along the executive career path (Jensen and Meckling, 1976), may interpret as distrust signals the increased control by the board. The decline of trust and aversion to risk can in turn compromise the central function of firm executives as professional decision makers in a corporation. Demotivated executives, whose authority is questioned, will feel alienated and become less committed to their work (Mustakallio et al., 2002). Consequently, imposing additional control over managerial behavior will decrease managers’ intrinsic motivation to act in the interest of their firm (Ghoshal and Moran, 1996; Perrow, 1986).

Furthermore, the salience of control over strategic decision making will undermine the collaboration in the boardroom. Family firms have been referred to as ‘high-trust’ organizations (Corbetta and Salvato, 2004). The weakened trust will, in turn, bring out an ‘us versus them’ categorization between the family and independent directors, inhibiting collaboration at the board (Knapp et al., 2011).
As a result, the social cohesion at the board will become inhibited and in turn decrease productive interaction and information exchange among family and non-family members at leadership positions in the firm (Dawes, 1992; Shachter et al., 1951). Due to the lack of social cohesion and the salience of family and non-family categories, family executives may become more reluctant to seek strategic advice from the board (cf. Gulati and Westphal, 1999). Since family firm CEOs consider the advice function to be the most important board function (van den Heuvel et al., 2006), the decreased collaboration in the board room can lead to decrease in the strategic adaptability of family firms. The increased control may also be interpreted as a signal of distrust in the managers, leading them to engage in opportunistic behaviors due to social expectations (Knapp et al., 2011), decreasing collaboration even further. This in turn may result in the inability of the firm to adapt in a timely fashion to the changing forces of its external environment.

To summarize, while positive consequences for family firms adhering to good governance may exist in the form of both economic and non-economic benefits, the adoption of good governance may also have a negative effect on a family firm in terms of dilution of board meetings, demotivation of managers and decrease in collaboration in the boardroom. These consequences may in turn undermine the ability of a firm to generate timely, strategic decisions.

Discussion and conclusions

In this conceptual work we addressed the process of adoption of good governance by family firms through increasing emphasis on independence in the board of directors. We discussed the economic efficiency of good governance and then compared the needs addressed by its objectives with the governance needs of family firms. While the process of change towards more independent boards may not necessarily contribute to increased economic efficiency, or be fully able to fulfill the governance needs of family firms, these firms continue to adopt such practices, de jure, and possibly also de facto. Drawing on institutional theory (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Scott, 1995), we propose institutional pressure to be the dominant reason of adoption of board independence by family firms. We then deduce potential consequences of this change, proposing that the price for benefits associated with gained social legitimacy can be impeded strategic decision making and consequently a decrease in the strategic adaptability of a firm.

More broadly, from a corporate governance viewpoint, we analyzed the diffusion of the ideology of shareholder value maximization (Deakin, 2005), using the
example of family firms applying good governance principles. Good governance, being the manifestation of a larger ideology of shareholder value maximization grounded within the agency theory assumptions, is designed for and promoted by large managerially controlled diversified corporations and serves the interests of corporate elites (Gordon, 2006; Jensen, 2001; Lazonick and O’Sullivan, 2000). Family firms represent a contrast to the large publicly listed corporations with dispersed ownership structures in many aspects; particularly different are their governance needs concerning the maximization of the socioemotional wealth of the family (Gomez-Mejia et al., 2011). Despite their distinctive governance needs, family firms experience a strong institutional pressure to conform to the created institutional logic, either effectively or symbolically. The process of adoption of good governance facilitates the diffusion of shareholder value ideology.

This ideology is subsequently reshaped in accordance with the governance needs of family firms. Particularly in the case of a symbolic adoption of good governance, the latter can lead to different outcomes, such as improving reputation and exploiting resources brought by outside directors. One can speculate that the process of adoption may nevertheless lead to changes in family firm governance. For example, adhering to good governance may increase formalization and professionalization of family firm governance. Consequently, the diffusion of shareholder value ideology, through the adoption of good governance, may facilitate a change in the governance objectives of family firms, redefining the family firm’s governance.

In line with previous research, our arguments suggest that ideology constitutes an important factor shaping norms and practices of corporate governance (Embrick, 2011; Fiss and Zajac, 2004). The influence of ideology may even exceed that of economic rationality, which is evident in the case of good governance. Yet ideology is formed and induced by a set of corporate elite members, who preserve and reinforce it (Lazonick and O’Sullivan, 2000). While framed as benefiting shareholders, the goodness of good governance for the firm itself appears questionable (Stout, 2012). By contrasting the needs addressed by good governance principles and the actual governance needs of family firms, we show the existing discrepancy between the means (good governance) and the ends (governance of family firms). These discrepancies suggest that the application of good governance may not necessarily serve its original purpose, but instead contribute to the fulfillment of the interests of powerful elites (Joseph et al., 2014).

Our study contributes to the literature on family firms, focusing on how these firms adapt to institutional changes. The ongoing change in the institutional
frame is very important for family firms as they are claimed to be more responsive to institutional pressures (Berrone et al., 2010). Yet possessing their distinct characteristics, they seem to strive for social legitimacy through adopting the prevailing governance norms. The adoption to the prevailing institutional logic may be symbolic, without actual implementation of practices. But even symbolic adoption may lead to the dilution of board meetings and potentially inhibit the strategic decision-making process. Family firms may also strive for actual adoption of practices, increasing control and formalization of decision making. The latter may also come at the expense of inhibited strategic decision making due to demotivation of managers and decrease of collaboration at the board meetings. In addition, the symbolic adoption of good governance may contribute to the overall diffusion of shareholder value maximization ideology, as firms tend to mimic each other (Bednar, 2012; Westphal and Zajac, 1994), thus leading to further discrepancies between governance objectives and firm outcomes.

Based on the arguments presented in our study, we propose several recommendations for practitioners and policy makers. The practical recommendations are particularly designed for boards of directors in family firms as they constitute the focus of good governance norms. Our study highlights the question of applicability of the current notion of the board’s best practices grounded within agency theory. We suggest that recommendations of good governance have to be followed with caution. Particularly boards of directors in family firms may need to evaluate both the non-economic benefits of inclusion of independent directors against the negative implications of these changes for the strategic decision making process. In case of the adoption of good governance, boards may need to allocate more attention to assure effective collaboration and information flow at the board as well as to emphasize managerial motivation.

Our study also has implications for policy makers. In particular, the current recommendation to include independent directors based solely on agency theory may not achieve anticipated results in the case of adoption by family firms. The recommendation for best governance practices should be revisited to consider distinct characteristics and governance needs of this category of firms. The notion of good governance needs to be broadened to account for non-economic goals that create value for family firms. Furthermore, the symbolic adoption of good governance by family firms can lead to effects opposite to the original objectives in the form of dilution of board meetings. For example, decisions informally made by family directors will not be properly evaluated at the formal board meeting, and therefore directors will be held less accountable for these decisions. Instead of increasing accountability and transparency as the ultimate
goal of good governance, the adoption of more independent board structures may lead to situations where board decisions will be undertaken informally outside the board.

Our study outlines several directions for future research. One proposition for corporate governance scholars is to focus more on governance of family firms within the changing institutional context. Further elaboration and empirical examination of the process of adaptation of family firm governance to the prevailing institutional norms can generate important insights about governance in family firms. Furthermore, future studies may focus on empirical testing of the negative and positive consequences associated with the adoption of good governance by family firms. Other interesting avenues of future research include addressing the tradeoffs between non-economic benefits and negative strategic impact of adopting good governance principles by family firms. It is important to note that our study has treated the concept of family firms as a homogeneous entity; however, important variations in goals, values and business practices among family firms may emerge from research. Future research could focus on how the governance needs of family firms may determine the balance between positive and negative influence of good governance. It would also be interesting to investigate the performance results of family firms who adhere to good governance and those that do not.

references


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