PRACE NAUKOWE UNIWERSYTETU EKONOMICZNEGO WE WROCŁAWIU nr 113
Ekonomia 2010

Aleksander Surdej
Cracow University of Economics

FAMILY FIRMS AND ECONOMIC DEVELOPMENT

Summary: The article discusses the relationship between the density of family firms and the economic development. The author shows that families are universally one of supporting factors of the creation of new businesses by supplying necessary capital, work or moral support. But families may become an obstacle to the growth of companies once they expand and need to change ownership or organizational forms. Thus, families may face a dilemma between orientation towards growth and willingness to maintain the control over the company. How and with what consequences for economic development this dilemma is solved depends on the institutional environment characterizing the economy. The second part of the article identifies mechanisms, which relate to the growth dynamics of family firms to selected institutional factors.

Key words: family firms, ownership and control succession, succession strategies, institutional environment institutions, economic development

1. Introduction

A growing body of articles in economics and related behavioral sciences has started to investigate the phenomenon of family firms, the causes of their persistence, their relative economic performance and their general impact on economic development. This is not just a new wave of scholarly interest in a rediscovered topic, but an extension of theoretically and practically important topics regarding an efficient corporate governance rules, market structure and market competition and other factors conducive to a dynamic economic efficiency.

Until recently the dominating view held that family firms are fading under the impact of the requirements of modern capital markets, which promote the play of impersonal forces within and outside an enterprise. Hence, a forecasts that firms built on individual's identity and family ties will be relegated to the niche markets and become obsolete since inefficient. But, the pioneering works of Andrei Shleifer, Rafael La Porta and others have restored the academic status for the topic, which seemed to have been liquidated with famous pronouncement by Alfred Chandler[1], who ascribed the economic decline of Great Britain in the beginning of the 20th century to the domination of family firms.

---

[1] A. Chandler, *Scale and scope*: *The dynamics of industrial capitalism*. Cambridge, MA: Harvard University Press, 1990.

Yet, despite ongoing efforts to formulate a theory of a family firm and its place in modern economic development researchers till now have produced solely partial insights, which do not create a coherent picture of family firm's economic role. This paper does not aspire to resolve the theoretical and empirical controversies, but is set in an exploratory way to link the current academic discussion with a broader issue of family firms' role in economic development. If it is true that family firms are not disappearing in most advanced economies, probably one should not portray their presence in less developed countries as a symptom of economic backwardness – an obstacle to economic development and a relic of the past. Rather it seems necessary to take a more nuanced view and to identify conditions under which family firms make productive contribution to economic development and conditions which make them less productive players. Such an attempt will be made in the concluding part of the paper.

2. Defining family firms

A significant part of the problem is the lack of precise definition of the phenomenon discussed.[2] There is no precise and shared definition of a family firm, and usually the following quantifiable and non-quantifiable criteria are applied regarding the ownership and management of the firm. With regard to the ownership criterion some authors count as a family firm a business that is owned by family without quantifying any required threshold. The majority of definitions however point to a dominant ownership position requiring for instance that a majority of (voting) shares, or the ownership of more than 50% of the shares/capital, belongs to a family. The introduction of numerical thresholds opens a possibility of creating a gradual scale of family firms by increasing or decreasing the required threshold of ownership depending on the size and legal form of the company. Thus, some authors set a threshold of at least 50% for partnerships or private limited companies, but only between 10% and 25% for public limited companies (or very large enterprises). In other cases, the precision is entirely forgotten for the sake of qualifying as family firms the firms where the family is to be the "largest owner".

Counting family firms might be even more complicated when we take into account the reality of the control pyramids. In a control pyramid a family controls a first level of depending firms by owning more than 50% of their shares. Each dependent firm from the first level might in turn control several firms, which can control subsequent firms (see the figure 1).

[2] The definitional problems should not be belittled. The development of academic analysis starts usually from concepts, goes to measurement, next to causal analysis in order to culminate with theories. Definitions are important as the set the intended meaning of words and minimize misunderstanding, they also assign limits, to delimit.

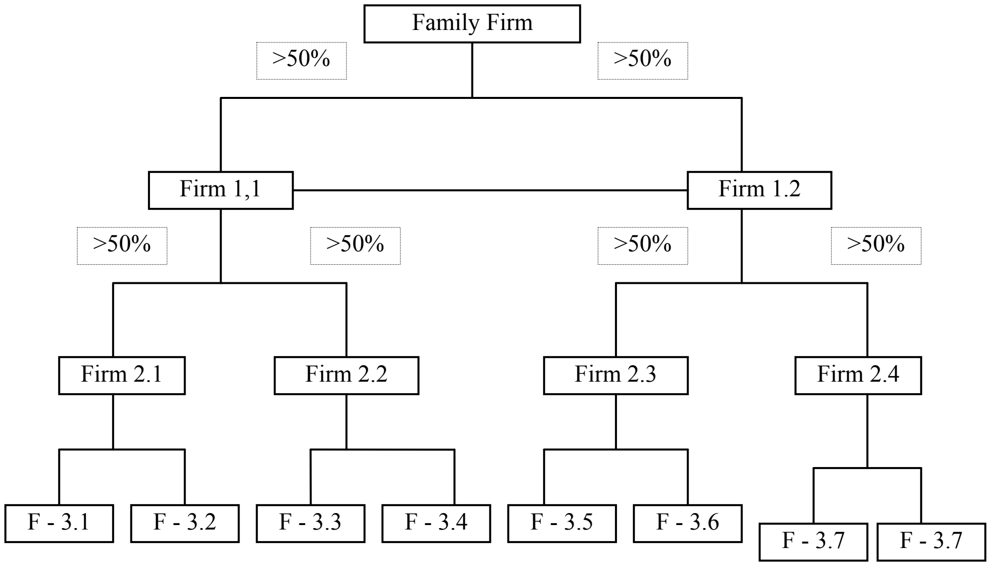


Fig. 1. Control pyramid

It can be shown that thanks to a multi-layer control pyramid a family (or any single actor) can control assets many times exceeding its own property.[3] Claessens, Djankov and Lang[4] showed that pyramid controls enable 15 wealthiest families to control 84% of Hong Kong GDP, 76,2% of Malaysia GDP, 48,3% of Singapore and 39,3% of Thailand.

Definitional problems do not end with the complexity of ownership issues. Some definitions require that families do take an active part in managing or „strategically controlling" companies. The participation in management can in turn take formal or informal forms. Formally, a family member (at least one, or two members) acts as CEOs, CFOs, chairman, board member or holds other positions in higher management. The presence of family in managerial positions is difficult to identify without detailed firms analysis, even more difficult is to detect informal family influence which often takes place undetected. The juxtaposition of the two criteria creates a host of possibilities with the extreme clear cut case of a firm in which a family has unified ownership and management control.

[3] Agnblad, Berglof, Hogfeld and Svancar have calculated that Wallenberg family controls firms whose value amounts to approx. 50% of the capitalization of the Stockholm stock exchange owning less than 10% of their shares thanks to the use of the control pyramid. J. Agnblad, E. Berglöf, P. Högfeldt and J. Svancar, *Ownership and control in Sweden: Strong controlling owners, weak minorities, social control*, in: *The control of corporate Europe*, eds. Barca and Becht, Oxford University Press, 2001.

[4] S. Claessens, S. Djankov, L.H.P. Lang, *The separation of ownership and control in East Asian corporations*, "Journal of Financial Economics" 2000, no. 58, p. 81–112.

Besides these two most important criteria management science scholars sometimes add a possibility that a company employs several family members in subordinated positions (as middle level managers or simple employees). Such a deep involvement and deep reliance on family internal labor market is for some researchers a proof that economic functions of firm and social needs of family can be harmonized. Others, however, see such practices as a sign of nepotism and an indicator of possible conflicts and low economic efficiency.

There is one more criterion, which turns a firm into an archetypical family firm – it is the fact that a firm is owned and controlled by a family in an intergenerational chain. Examples of firms founded in 1783 (like Hainsworth[5]) make headlines and attract public attention – but they are rare exceptions (some reasons why is so will be provided later in this text).

Summing up the previous discussion we should not be surprised that there is confusion about the concept of family firm and the importance of the phenomenon. Without claiming to say the final word it seems useful to put some order in a definitional dispute and to come up with a simplified typology of the phenomenon. Limiting the typology to two dimensions (ownership/management control) and three categories in each we end up with 9 different types of firms: some of which can be unequivocally called family firms and some definitely fall outside the range of family type firms.

The ambiguity comes on two sides of the continuum. On the one hand, most of very small and small (employing less than 10 persons) firms are almost universally counted as family firms since they depend so much on a founder/owner usually deeply embedded in a family (even if it is a sole owner company) and formally (but probably even more informally) they draw on family support (in terms of informal work and other support). But, such an identification does add little to deeper understanding of firms' organizational changes as most of such firms does not grow at all. On the other extreme, large corporate entities (like for instance Ford Motor Company or Fiat Group) are counted as family firms although their internal organization and management practices are perfectly impersonal (rule guided) and a presence of a (possibly non-competent) founder family member does not count much.

A possible way out of the state of irresolvable confusion would be to admit that the generic concept "family firm" has limited explanatory value unless it is purposefully restricted and used as an instrument to solve theoretical or empirical puzzles. Having said so, I would propose to focus on the way family firms' transformations are thorn between the aspiration to grow and the need to control firm as a family asset at an example of a succession. To restate: a central problem in the analysis of family firm is the problem of resolving the conflict between growth and control (and in a background decoupling the family's wealth from the trajectory of

---

[5] *Descendants in the ascendancy*, "Financial Times", 5.08.2009.

firm's development). This perspective could also allow to better understand the impact of family firms on economic development.

Table 1. Family firm typology

		Who manages the company?		
		Individual	Family	Professional managers
Who owns the company?	Individual	Family firm in nuce (a typical start up situation)	Firm involving family in the work for its development	Firm with delegated management
	Family	Family firm with management responsibility of one its member	Classical family firm	Family company with externally hired board
	Wider group of subjects	Public company with a dominant manager (for instance Nokia with Jorma Olila)	Company with family management (firm captured by family)	Classical public company

Before introducing other elements in the exploratory investigation of the link between family firms and economic development it is necessary to note that in family firms there is indeed a **strong interrelationship between the family and the business**, that the family is (formally, but also informally) intertwined with the company, not least because the firm is the family's main asset and that economic well being of the family depends on the fate of the company.

This interrelationship creates special problems as the family and the firm are governed by different logics and this juxtaposition creates special problems.

Table 2. Family and firm as behavioral systems

	Family	Firm
Locus of identity	Collective identity	Individual autonomy
Type of relations	Personal relations particuralism	Rule based universalism
Nature of transactions	Mutual moral and social obligations	Exchange
Type of efficiency	Dynamic (socializing efficiency[6])	Static efficiency

The importance of managing family/firm interface has become even more important since families are being rapidly transformed (especially in Western Europe

[6] By introducing the notion of dynamic efficiency it is stressed that family has a significant role in forming an entrepreneur by developing entrepreneurial personality; involvement in firm's activities, offering its members to be employed in the firm or obligating them to work for the family firm and creating an opportunity to take over the family firm in an intergenerational succession.

and in the US) with changes in frequency of marriage, divorce, remarriage, childbearing, cohabitation or changes in family forms (two-parent families, one-parent families, cohabitating couples, same sex families, and extended-family households). If one adds the phenomenon of demographic ageing it comes as no surprise that the survival of the family firm (not to mention its development) is threatened by family changes and demographic decline. This statement builds a bridge to the question which institutional factors might reduce the likelihood of family firm decay in a succession process.

3. Economic impact of family firms

The lack of precise definition creates enormous problems when it comes to the assessment of the economic weight of family firms. The academic literature abounds in generic statements which are impossible to verify. Having said this one can try to make a provisional assessment.

At the most general level scholars say that family firms are one of most important sources of wealth creation and the growth of employment in contemporary societies.[7] Estimations say that family firms account for from 70 to 80 percent of all firms in Europe and from 40 to 50% of total EU's GDP.[8] Most European SMEs are family businesses, and some of the largest European companies are also family businesses. The relationship can be reversed to conclude that the family business sector is dominated by SMEs, and particularly by micro enterprises with less than 10 employees. The data about the US economy show that family firms account for 75–90% of all firms and they generate about 60% of the country's GDP.[9] But the magnitude of error might be high due to both conceptual ambiguity and measurement problems.[10]

There is also a broad agreement that low income countries and medium income countries undergoing postcommunist economic and social transformations display even higher share of family businesses as those countries witness an entrepreneurial revolution after decades of etatism. Despite the recognition of the importance of entrepreneurship for economic development in less developed countries (low and medium income countries), there is a dearth of empirical data describing the size and structure of private sector in these countries. The research of Kantis, Angelli

[7] J.L. Ward, *Perpetuating the family business*, Palgrave Macmillan, New York 2004.

[8] I. Mandl, *Overview of family business relevant issues*, the report for the European Commission, 2008.

[9] J.H. Astrachan, M.C. Shanker, *Family businesses' contribution to the U.S. economy*: *A closer look*, "Family Business Review" 2003, September.

[10] Gersick et al. estimate that family firms account for 65% to 80% of all businesses. K. Gersick, J. Davis, M. Hampton, I. Lansberg, *Generation to generation: Life cycles of the family business,* Harvard Business School Press, Boston, MA, 1997.

and Koenig[11] shows that approximately 97% of firms in Mexico and Thailand are Micro and Small Companies [MSEs] – companies that employ less than 50 employees. This share is very close to the data about the MSEs sector in such diverse countries like for instance Poland (almost 98%) or the US (approx. 96%). MSEs are dominating numerically the economic landscape of most countries. But, it is not only their quantity that is important for economic development – as stressed by Naude,[12] low income countries exceed advanced countries as to the number of self-employed and micro-enterprises, but fall behind in the share of medium sized firms. In several Latin American states MSEs employ over half the working population. One study found that firms employing less than 10 employees generated 58% of total employment in Paraguay, 54% in Mexico and 53% in Bolivia. MSEs contribute approximately 31% of total GDP in the Dominican Republic, 13% in Kenya and 11% in Pakistan.[13]

Thus, based on existing evidence it is justified to conclude that family firms dominate the world of SMEs and MSEs. This is by no means a suprising conclusion. Much more controversial is the debate regarding family ownership and control of large companies.

The analysis of the phenomenon started from Shleifer and Vishny[14] seminal work on the identity of the largest shareholders in a sample of 456 of the Fortune 500 corporations in 1980. They found that among them 207 are institutions, 149 are families represented on the board of directors, and 100 are other corporations or family holding companies not represented on the board. The surprise of the discovery consisted of the fact that academics and public opinion strongly believed in the domination of impersonal, institutional control of modern corporations.

More recent analysis, for instance La Porta et al.[15], examined the ownership and control structures of the 20 largest publicly traded firms in each of the 27 richest economies, as well as ten smaller firms in some of these countries. La Porta and his coauthors identified who controls the firms by looking at the identities of the ultimate owners of capital and voting rights. They found that 36% of the large firms in their sample are widely held, 30% are controlled by families or individuals, 18% are controlled by the state, 5% are controlled by a widely held financial institution, and 5% are controlled by a widely held corporation. For the smaller firms and using a less restrictive definition of control (a 10% threshold as opposed to 20%), the

[11] H. Kantis, P. Angelli, V.M. Koenig, *Desarrollo emprendedor – America Latina y la experiencia internacional*, Inter-American Development Bank, Washington 2004.

[12] W. Naude, *Entrepreneurship in the field of development economics*, in: *Frontiers in entrepreneurship*, ed. B. Urban, Heinemann, Johannesburg 2008.

[13] S. Nichter, L. Goldmark, *Small firm growth in developing countries*, World Development, 2009.

[14] A. Shleifer, R. Vishny, *Survey of corporate finance*, "Journal of Finance" 1997, vol. 52, no. 2.

[15] R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *Corporate ownership around the world*, "Journal of Finance" 1999, no. 54, p. 471–517.

fraction of family-controlled firms in their sample rises to 53%. Claessens et al.[16] examined 2980 corporations in nine East Asian countries and find that over two-thirds of the firms are controlled by families or individuals. Faccio and Lang[17] analyzed the ultimate ownership and control of 5232 public corporations in 13 Western European countries and find that 44% of the firms are family-controlled, and 34% are widely held. Anderson and Reeb[18] found that founding families are present in one-third of the S&P 500 corporations during 1992–1999.

The data in the table below (table 3) demonstrate that family control of large companie is a common phenomenon across countries and continents.[19]

Table 3. Firms controlled by families (CbF) and firms with dispersed shareholders (DS) among the largest firms in selected countries (in %)

Country	Control Threshold Set at 10%		Control Threshold Set at 20%	
	DS	CbF	DS	CbF
Argentina	0	65	0	65
Australia	55	10	65	5
Belgium	0	50	5	50
France	9	70	18	64
Greece	5	65	10	50
Hong Kong	10	70	10	70
Indonesia	0.6	69	5	72
South Korea	40	35	55	20
Mexico	0	100	0	100
Great Britain	27	34	69	20
Italy	8	65	16	60
USA	39	23	70	6

Source: R. Morck, D. Wolfenzon, B. Yeung, *Corporate governance, economic entrenchment and growth,* "Journal of Economic Literature" 2005, September, vol. 43, p. 655–720.

Researchers of developing economies noted a strong presence of family controlled firms (or business groups)[20] in countries such as India (India's family business houses exemplified by Ambani brothers who together account for about 5 percent of the Indian), Turkey (the Turkish family holdings), and the Latin American and Spanish famliy business groups.

[16] S. Claessens, S. Djankov, L.H.P. Lang, *The separation...*, op. cit.

[17] M. Faccio, L.H.P. Lang, *The ultimate ownership of Western European corporations*, "Journal of Financial Economics" 2002.

[18] R. Anderson, D.M. Reeb, *Founding-family ownership and firm performance: Evidence from the S&P 500,* "Journal of Finance" 2003, no. 58, p. 1301–1328.

[19] One should not terminological change: the authors tend to use the term: family controlled firms instead (although such a usage does happen) of family firm tout court.

[20] A. Suehiro, *Family business reassessed*: *Corporate structure and late-starting industrialization in Thailand*, "The Development Economics" 1993, vol. 31, no. 4.

A striking difference between advanced economies (high income countries) and developing economies (low and medium income countries) is that in advanced economies large *family controlled companies* are, at the same time, public companies with corporate governance structure of public companies and subordination to the accounting rules of public corporations. In developing countries large companies should be rather called *family owned and controlled companies* and more often they are governed in a family empire style with little public transparency.

This difference has multiple consequences for national economic systems. Family presence (ownership and managerial control) in large companies in advanced economies is a reflection of wealth distribution with no negative (and possibly positive impact on the general efficiency of the economic system – this point will be elaborated later), whereas family business groups in developing countries might signal the practice of "insider business entrenchment" with negative impact on competition, possible negative spill over on the quality of public spending (corruption and collusion with politicians). Thus, it seems that large family owned and controlled firms are different economic realities depending on the institutional environment in which they function. In a demanding legal and political environment they add stability and long term orientation to companies, in a "fragile state"[21] or weak state they tend to add to the structural distortions in the economy, to the reduction of competition, public policy corruption and to the general reduction of economic efficiency. This conclusion, although apparently strong, can be only partially supported in the subsequent analysis of the flows (or lack of flows) between categories of family firms in developing countries. But, before moving to this problem, we shall briefly examine economic properties of family firms.

4. Comparative performance of family firms

The analysis of economic properties of family firms has identified the factors and reasons which account for their potential strength and possible weaknesses. Due to the limitation of space we will list and shortly present the main conclusions stemming from the ongoing discussion.

Family firms are said to have a long term investment horizon, meaning an orientation towards the long term value maximization.[22] This orientation is opposed to a short term profit orientation apparently characterizing non-family firms. The long term orientation is ascribed to the existence of controlling principals whose time horizon exceeds the life span of typical firms – namely to families. The existing empirical evidence shows that family firms are rather conservative in invest-

---

[21] Fragile state is a concept developed by Wim Naudé and Mark McGillivray within a WIDER Helsinki research program on the quality of governance and policies.

[22] H. James, *Owner as manager, extended horizon and family firm*, "International Journal of Economics and Business" 1999, no. 6, p. 41–56.

ment and market behavior, but this feature slows down their pace of development, when there are opportunities not to be missed and generally good market weather. The positive side of the family firm conservatism is that they are more resistant, if a crisis hits as in general they are less indebted and with more stable clientele. But, business survival and independence might be not consistent with profit maximization and family firms might suffer from excessive risk taking avoidance.[23]

The current state of research does not allow us to answer the question how the family factor influences the behavior of public firms quoted on the stock exchange. On the one hand their managers are under pressure to report profits on a quarterly basis (the factor which shortens investment time horizon), on the other hand the presence of a controlling family representative(s) on the company's board might act as an assurance of the permanence of the executive in its post despite weaker short term results. It is unclear which effect is stronger.

Family firms are portrayed as having strong relationship with financial market institutions and the strength of this relationship is based on family firm reputation gained from lasting contacts. But this feature might be (there are no empirical analyses) more the effects of a long series of interactions than the presence of family (the link is indirect and might go via the stability and long term orientation of a family firm).

The most important however seems to be the effect of family involvement in the management.[24] The direct control of the owner over the management curbs classic agency costs[25] and assures strong alignment between incentives of owners and managers.

But, there is nothing like "wonderful world of family firms" – family firms are affected by several problems which might reduce their economic efficiency. Family firms might not be able to diversify their investments what reduces their growth opportunities. The pursuit of family control might restrain the access to equity capital, the preference to family members might lead to the executive entrenchment and nepotism.[26]

Reliance and over reliance on family and relatives reduces the range of business partners as families might use their dominant position to extract private bene-

---

[23] H. DeAngelo, L. DeAngelo, *Controlling stockholders and the disciplinary role of corporate payout policy*, "Journal of Financial Economics" 2000, no. 56, p. 153–207; R. Anderson, D.M. Reeb, *Founding-Family Ownership...*, op. cit.

[24] R. Anderson, D.M. Reeb, *Founding-Family Ownership...*, op. cit.

[25] H. Demsetz, *The structure of ownership and the theory of the firm*, "Journal of Law and Economics" 1983, no. 25, p. 375–390; L.R.Gomez-Mejia, K. Haynes, M. Nunez-Nickel, K. Jacobson, J. Moyano-Fuentes, *Family owned firms: Risk loving or risk averse?*, "Administrative Science Quarterly" 2007, no. 1, p. 106–137.

[26] L.R. Gomez-Mejia, K. Haynes, M. Nunez-Nickel, K. Jacobson, J. Moyano-Fuentes, *Family owned firms…*, op. cit.

fits and their presence in the management may exacerbate agency costs.[27] Thus, family firms encounter problems with mobilizing partners to raise equity capital and its expansion pace might suffer from it.

The coexistence of family (as dominating partner) and others (as subordinated partners) creates a host of problems which have been thoroughly examined by the academic literature. Thus, Nielsen argues that conflict between controlling blockholders and minority shareholders is higher when the blockholder controls the management. Anderson and Reeb as well as Morck, Wolfenzon, and Yeung[28] observe that families are used to be reluctant to retain a fair proportion of independent directors on their boards. Furthermore, treating families as a genre of insiders, Hermalin and Weisbach explain that insider-dominated boards of directors might decide about firing a manager on the base of insider information instead that on the firm's performance.

The general conclusion from the literature can be formulated as the following statements: 1) the quality of corporate governance is negatively correlated with the ratio of control to cash-flow rights (i.e. wedge) of the main owner,[29] and 2) the ability of a dominant blockholder to extract private benefit depends on the degree of legal protection within a country.[30]

Table 4. Governance structure and productivity of large family firms

	Family ownership share		
Family board representation		High	Low
	High	US (now)	UK (end XIX)
	Low	Germany (now)	UK (now)

To put it differently one can say that family firms are constrained in their growth opportunities in an institutional environment which tolerates the propensity for hidden actions, self-dealing (or tunneling) and for creating privileges for friends or families.[31] In such an environment family firms either do not growth, or take a form of "defensive", "rent seeking" organizations.

---

[27] R. Morck, D. Wolfenzon, B. Yeung, *Corporate governance, economic entrenchment and growth*, "Journal of Economic Literature" 2005, September, vol. 43, p. 655–720.

[28] R. Anderson, D.M. Reeb, *Founding-family ownership...*, op.cit.; R. Morck, D. Wolfenzon, B. Yeung, *Corporate governance...*, op. cit.

[29] L. Bebchuk, M. Roe, *A theory of path dependence in corporate ownership and governance*, "Stanford Law Review" 1999, vol. 52, p. 127–170; M.Giannetti, A. Simonov, *Which investors fear expropriation? Evidence from investors' portfolio choices*, "Journal of Finance" 2006, June; R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *Investor protection and corporate valuation*, "Journal of Finance" 2002, June.

[30] A. Shleifer, R. Vishny, *Survey of corporate finance*, "Journal of Finance" 1997, vol. 52, no. 2; F. Panunzi, A. Ellul, M. Pagano, *Inheritance law and investment in family firms*, in: Scientific Commons, 2009, available at http://www.bepress.com/feem/paper266; K. Lins, *Equity ownership and firm value in emerging markets*, "Journal of Financial and Quantitative Analysis" 2003, vol. 38, no. 1, p. 159–184.

[31] A. Shleifer, R. Vishny, *Survey of corporate...*, op. cit.

This conclusion can be illustrated with a historical example. It was already mentioned that Alfred Chandler[32] ascribed the decline of economic position of Great Britain (and especially the fact that Germany exceeded it as the world's main industrial power) to the domination of family owned firms. But, Julian Franks, Colin Mayer, and Stefano Rossi[33] questioned Chandler's thesis documenting that Great Britain around the turn of the 19th and 20th century was not a country dominated by family owned firms (cell upper right in the table 4), but a country where "[…] families rapidly relinquished ownership, (but) retained control through their positions on the boards of directors (cell right down in the table 4). The new data lead thus to a different, than Chandler's, interpretation: Great Britain's economic performance suffered not from family firms as such but from incentive mismatch between the extent of family control and family's financial stake.

5. Organizational growth and economic development

Economic development in modern times depends on the strength and vitality of private enterprise sector. Not denying that the government has a role in developing infrastructure (for instance transportation and energy) the overall economic efficiency stems from the efficiency of the private enterprise operating in competitive markets. Several authors have remarked (most convincingly Wim Naude)[34] that the private sector in developing countries (low income countries) suffers from high quantity/low quality private enterprises. Based on the data from 76 countries Naude[35] has discovered that developing economies are characterized by a high number of self-employed as entrepreneurs as almost 1/3 of all employed (29,41%) are registered as self-employed entrepreneurs – twice as much as in advanced economies (15,25%). Developing economies, notes Naude,[36] are also characterized by high early stage entrepreneurial activity (measured as the combination of nascent entrepreneurs and new business owners – the data from GEM Global Report – www.gemconsortium.org). Thus, for instance in Peru early stage entrepreneurial activities are at 35%, whereas in Japan only at 2,7%. In general, developing economies have the total entrepreneurial activity at 14,2%, while for advanced economies this indicator amounts to 6,6%.

Several authors have examined the causes of a wide spread self-employment and early stage entrepreneurial activities. Acs[37] has pointed to the lack of well paid

[32] A. Chandler, *Scale and scope...*, op. cit.

[33] J. Franks, C. Mayer, S. Rossi, *Spending less time with the family: The decline of family ownership in the UK*, NBER WP, 2004, no. 10628.

[34] W. Naude, *Entrepreneurship in the*…, op. cit.

[35] Ibidem.

[36] Ibidem.

[37] Z. Acs, *How is entrepreneurship good for economic growth*?, "Innovations" 2006, winter.

wage-employment at early stages of economic development, which leads to the structurally forced entrepreneurial activities that are survival oriented and are characterized by low overall productivity. At a higher level of economic development many such entrepreneurial activities lose attractiveness as the availability of paid employment eliminates such low quality business initiatives. Wim Naude[38] has generalized the relationship between the number of early stage entrepreneurial activity and the level of economic development confirming econometrically that there exists a U-shape relationship between entrepreneurship and economic development as the number of new business initiatives increases when an economy reaches the development stage called "innovation driven growth".

The empirical evidence presented so far justifies a tentative conclusion according to which developing economies are "abundant in entrepreneurial initiatives", but most of these initiative lead to a poor quality entrepreneurship with self-employed and microenterprises dominating the landscape of private business. Small businesses in developing economies do not grow up as they are either intentionally designed to provide an income necessary to survive or they are unable to grow (despite attempts at the firm's development). Again, this observation is confirmed by empirical evidence as for instance the survey of 28 000 MSEs in Africa and Latin America shows that less that 3% of MSEs expand by four or more employees after start-up.[39]

The U-shape relationship generalizes the empirical evidence, but it seems incomplete as it does not answer the question "who generates paid employment if entrepreneurs in developing economies are trapped into a survivalist business model". Unless we assume an exogenous supply of jobs, we have to make the firm development endogenous identifying possible barriers to the growth of the size of enterprises in developing economies.

If one remembers that most entrepreneurial ventures in all economies (and in developing ones in particular) lead to the creation, at some stage, of a family owned and controlled firm, it seems interesting to explore the following question: what factors, which make family an entrepreneurship nurturing environment, might block family firms' further development.

Figure 2 illustrate the possibility that family firms might not be of an optimal size, that they might be too small, because growth strategy is inherently risky, it often requires broadening the range of shareholders and facing the problems of changing business routines.

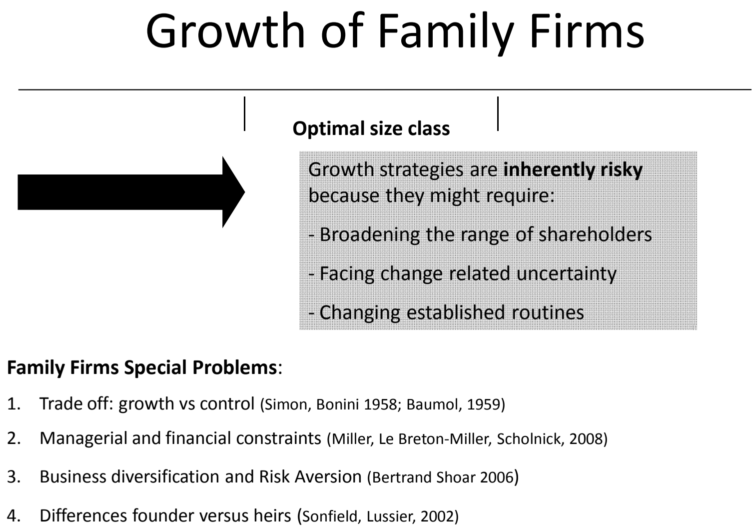
Family firms might be thorn between the willingness to grow but fear of losing family control and they might choose growth slowing managerial and financial solutions. Thus the strength coming from the family financial and work support might

---

[38] W. Naude, *Entrepreneurship in the*…, op. cit.

[39] C. Liedholm, *Small firm dynamics: Evidence from Africa and Latin America*, "Small Business Economics" 2002, vol. 18, no. 3.

lead to the emergence of self-created barriers for growth. This hypothesis will be further explored on the example of the problem of succession in family firms.



1. H. Simon, C. Bonini, *The size distribution of business firms*, "American Economic Review" 1958, September; W.J. Baumol, *Business behavior, value and growth*, Macmillan, New York 1959.
2. D. Miller, I. Le Breton-Miller, B. Scholnick, *Stewardship vs. stagnation: An empirical comparison of small family and non-family businesses*, "Journal of Management Studies" 2008, January, no. 45 (1), p. 50–78.
3. M. Bertrand, A. Schoar, *The role of family in family firms*, "Journal of Economic Perspectives" 2006, no. 20 (2), p. 73–96.
4. M.C. Sonfield, R.N. Lussier, *First-, second- and third-generation family firms: A comparison*, "Family Business Review" 2004, vol. 17, no. 3, p. 189–202.

Fig. 2. Growth of family firms

6. Succession scenarios in family firms

The succession issue has been identified as one of crucial factors for the functioning and growth of family firms. It is reported that on the international scale only 30% of family firms survive in the second generation, while less than 14% function in the third generation as family firms.[40]

From the theoretical point of view the succession in family firms is related with the dilemma how to preserve (and possibly increase) family wealth while transforming the company. Is it better to keep family control over the company, but pos-

[40] P.D. Fleming, *Case study – Helping business owners prepare for the future*, "Journal of Accountancy" 1997, May; C.H. Matthews, T.W. Moore, A.S. Fialko, *Succession in the family firm: A cognitive categorization perspective*, "Family Business Review" 1999, no. 12 (2), p. 159–169.

sibly harm its growth perspectives, or to transform it by diminishing the family control (or even eliminate it altogether).

Thus, there might be different types of succession. First type might be called a *defensive succession*, in which family tries to preserve the control over enterprise at all costs. Second type might be called a *transformatory succession,* in which the company is transformed so as to maximize the wealth of family even at the cost of reducing the family control.

It seems that the first type of succession dominates the world of MSEs (Micro and Small Companies) as they operate undiversified business and the firm's success depends very much on the use of idiosyncratic knowledge – tacit and informal knowledge which has been acquired over long time and their use is of limited application elsewhere. This might explain why small firms try to find the successor among family members, relatives or close friends. This explains also why a career path in such small firms is of limited value to outsiders. The conjunction of these two factors creates the peculiarity of succession in small family firms.[41] Holmstrom and Milgrom have suggested that this type of family firm can be analyzed as a "multi-target unit",[42] whose members contribute to the generation of income and profits but at the same time they are a community of organizational and entrepreneurial knowledge, and not the least, of emotional support. Thus, in family firms key people are renumerated for all the functions they fulfil.

But a different succession is needed when a family firm has grown or has been set to grow. A growing firm requires an access to external finance, if external financing comes in the form of equity, a firm governing structure has to change in order to accommodate outside investors. In addition, such a growing family firm has to hire external managers as it has no possibility to fill all posts of responsibility with qualified family members. These remarks support the statement that in a context of a family firm's growth a succession happens most likely before the owner founder reaches the age of retirement or physical incapacity. A growth oriented family firm will reach the threshold of succession as ownership, management and organizational transformation earlier than survival oriented family firms. In such growth oriented family firms succession means the introduction of formal rules that reduce the importance of personal relations and the introduction of accounting procedures which would increase the transparency of firm's financial operations to outside investors. A transformatory succession leads to the implementation of governance standards which would not differentiate family controlled companies from other publicly quoted companies. More, family controlled companies, may as it is shown by research of

---

[41] Using the criteria differentiating family firms we see that these firms are characterized by strong overlapping of family ownership, management control and involvement in day to day functioning.

[42] B. Holmstrom, P. Milgrom, *Multitask principal-agent analyses: Incentive contracts, asset ownership, and job design*, "Journal of Law, Economics and Organization" 1999, vol. 7 (0), p. 24–52, special I.

Ashiq Alia, Tai-Yuan Chenb and Suresh Radhakrishnan[43] on a sample of family controlled companies quoted at NYSE, perform better than non-family controlled companies in terms of the quality of financial reports, voluntary disclosure of negative information and voluntary information about internal corporate practices.

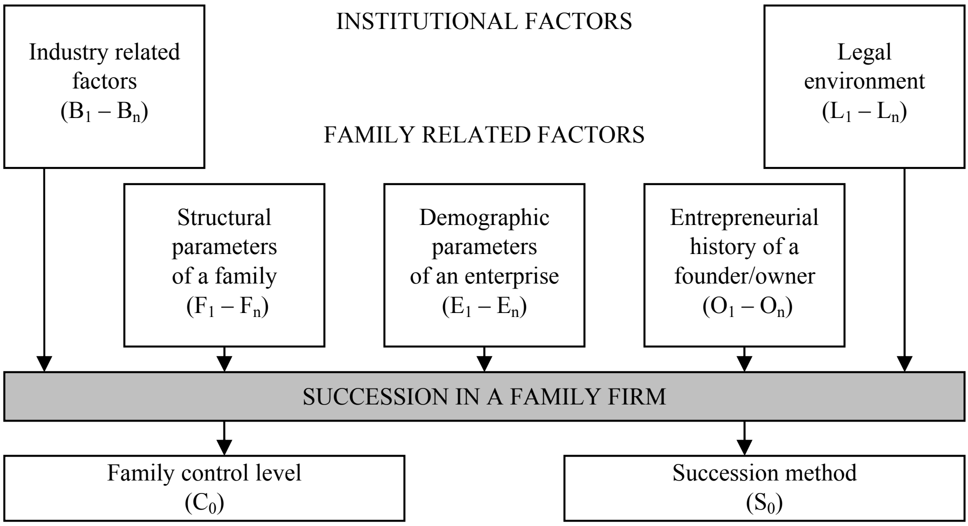


Fig. 3. Determinants of succession in family firms

Figure 3 summarizes the factors that determine the choice of succession methods in general. With reference to the discussion developed so far it should be stressed that the relative weight of factors changes depending on the type of succession. *A defensive succession* depends much on the family's structural parameters and on intra-family relationships (conflicts, emotions). *A transformatory succession* depends on the existence of institutional instruments, which help to solve the conflict between the growth orientation of a firm and the founder/owner interests in preserving/increasing family wealth.

7. Institutional development and succession type choice

Contemporary academic literature convergences in a conclusion that businesses often begin by taking advantage of small (relatively) networks support,[44] and that

[43] Ashiq Alia, Tai-Yuan Chenb, Suresh Radhakrishnan, *Corporate disclosures by family firms*, "Journal of Accounting and Economics" 2007, vol. 44, p. 238–286.

[44] A study of over 14 000 Mexican small enterprises shows that owners chiefly used their own savings (61%) or those of their family and friends (14%) to start their own firms confirming the relevance of what jokingly became known as "the 3F source – meaning Family, Friends and Fools".

network relationships play a key role in facilitating exchange in developing economies such as sub-Saharan Africa and that „These relationship differ from pure market exchange in that they perform economic functions other than trade itself, such as information sharing, informal enforcement of contracts, and interlinking”.[45] But, the exclusive reliance on informal networks limits the efficiency of market exchange and business growth. If an institutional environment does not provide formal instruments to substitute for informal ones, the economy suffers from unexploited efficiency gains and growth potential.

Family firms can be analyzed as firms whose foundation and functioning depends on a particular network – family. It is a network whose borders are defined by pre-existing bonds of kinship – that is why it is closed and its enlargement proceeds by births or marriages. Larger similar networks are also traced by pre-existing bonds of tribal or ethnic origins. Larger a network is, there is more gains to be achieved from trade or cooperation, but its expansion might increase the difficulty in triggering joint action (for instance entering exchange, completing transaction). Thus, a factor such as the strenght of family ties might be productive to initiate a firm, can prove detrimental to its growth. The quality of institutional environment seems to act as a factor determining the likelihood with which family firms implement growth oriented succession transformation.

There is a growing amount of economic literature devoted to the relationship between institutional factors and economic performance of firms[46] and more generally between institutions and economic development.[47]

It is not possible nor necessary to detail this discussion. For the sake of our argument I will reduce the concept of institutional environment to the following three variables: a) the development of capital markets; b) the minority ownership protection and c) the legal contracts enforcements.

The depth and institutional diversity of capital markets broadens the scope of succession methods in growth oriented family firms. Thus, for instance, the existence of venture capital funds allows family firms to get external financing from sources (financial institutions) which monitor them, but do not aspire to management control and it allows to draw on their experience in preparing the company for „going public”.[48] The existence and the size of the stock exchange allows a

F. Hernando-Trillo, J. Pagan, J. Paxton, *Start up capital, microentreprises and technical efficiency in Mexico,* “Review of Development Economics” 2005, vol. 9, no. 3.

45 M. Fafchamps, *Market institutions in Sub-Saharan Africa*, MIT Press, Cambridge 2004, p. 294.

46 See especially the articles in the “Journal of Financial Economics” (various issues).

47 G. Tabellini, *Institutions and culture*, “Journal of the European Economic Association” 2008, April–May.

48 These are not theoretical possibilities, but solutions implemented in such diverse countries like Poland (Zielona Budka – family firm producing ice-creams accepted venture fund financing, reduced its control, went public and withdrew from the public quoted company, but Mr. Grycan – the founder of Zielona Budka, started a new ice-cream producing firm called after his name Grycan, when due pe-

company to „leverage its capital" and to accelerate the development.[49] The table 5 below shows that advanced economies are characterizied by a higher level of stock market capitalization, which confirms a hypothesis that in such countries a family firm can be more easily transformed into a public family controlled firm.

Table 5. Stocks trades (total value as a % of GDP, 2007)

Country	2007	Country	2007
Hong Kong China	443	Thailand	44
Spain	206	South Africa	150
Iceland	244	Egypt	41
Italy	110	United Arab Emirates	70
Finland	222	Tunisia	2
US	310	Ghana	1
Norway	121	Chile	27
Korea	204	Nigeria	10
Germany	101	India	94
France	132	Argentina	3

Source: World Development Indicators Online, The World Bank.

The question of the strength of minority ownership protections is directly related to the growth oriented succession. A growing family firm is likely to acquire other (non-family) shareholders. Such family ceases to remain the sole owner, but it might remain the majority shareholder. But to get an external investor the family has to credibly signal among other things that it will not get involved in self-dealing and in extracting private benefits of the firm's control. Unless legal regulations reduce the threat of self-dealing, including the extraction of private profits through the transaction between related companies, external investors not related to the family will not have trust in investing in them.[50] Although Djankow, La Porta, Lopez-de-Silanes and Shleifer seem to link the strength of anti-self dealing regulations with the legal origin (according to them common law countries provide stronger protection than the Continental Europe Law Countries), it seems that in general the level of minority owners protection varies with the level of economic development and that developing economies are characterized by a weaker minority ownership protections regardless of the origin of the inherited law.

---

riod of abstention from competing activities has expired – see: *The ice-cream king of Poland*, "Financial Times", 22.07.2009.

[49] Family focused nature of business is perceived as one of principal obstacles facing the private equity financing, BUT Private Equity Financing might be 'help for family members to evolve beyond founders'. F. Eid, *Private equity finance as a growth engine*: *What it means for emerging markets*, "Business Economics" 2006, April.

[50] S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The law and economics of self--dealing,* "Journal of Financial Economics" 2008, no. 88.

Table 6. Where is enforcing contracts easy – and where not?

Easiest	Rank	Most difficult	Rank
Hong Kong China	1	Cameron	172
Luxembourg	2	Congo	173
Iceland	3	Syria	174
Latvia	4	Benin	175
Finland	5	Honduras	176
US	6	Suriname	177
Norway	7	Bangladesh	178
Korea	8	Angola	179
Germany	9	India	180
France	10	Timor-Leste	181

Source: World Bank, "Doing Business", 2009, p. 49.

The recognition of the importance of formal contract enforcement mechanisms comes from the observation that many economic transactions are not of instant and simultaneous character. A *quid* happens first and there might be uncertainty about *quo*. A promise to deliver *quo* needs to be backed by an enforcement mechanism. Subsequent reports of the World Bank[51] try to measure the quality of enforcing contracts in all countries. The data in the table 6 point at a positive correlation between the easiness of enforcing contracts and the level of country's economic development: developed economies (with notable exception of Latvia) score better in the ranking of contracts enforcement.

8. Conclusions: "The missing middle" hypothesis: organizational dynamics of family firms and economic development

The evidence presented in this paper and its discussion inspired by the economic theory leads the author to present the following conclusions.

The ongoing academic research of the persistence of the phenomenon of family firms does not adequately separate two qualitatively different realities. Family firms, which are typically micro and small firms characterized by a strong overlapping of ownership and management control and day to day involvement of family members in the functioning of the firm, and large publicly quoted companies where families of founders remain a controlling block (which can be as low as 20% or 10%) of shares. The proper family firms are characterized by a high degree of their familiness, which might become a barrier to growth; the large publicly owned, but family controlled, companies do not differ substantially from an average publicly

[51] The series "Doing Business" with the most recent report, "Doing Business" 2009 by the World Bank.

owned companies with regard to their corporate governance practices in countries characterized by a high quality institutional development.

Although the existing data do not allow for a precise diagnosis it seems that developing economies are characterized by a myriad of family firms (micro and small firms), which do not grow, and a few of large family owned companies or business groups with little upward flows in terms of firms' organizational growth, whereas in developed economies there exist more efficient channels (the factor discussed as the quality of institutional environment) for the transformation of small family firms into large public family controlled firms. Thus, it is possible to formulate a tentative statement that developing economies are characterized by a dearth of medium size family firms ("the missing middle hypothesis"), which are projected to become large publicly owned, but family controlled, firms.

Thus, and this is the last conclusion, the analysis of the succession in family firms should be transformed from a rather narrow perspective of identifying, educating and nominating a successor in order to keep the control of the firm in the hands of the family to a problem of analyzing succession choices in growth oriented companies as such a succession requires a deeper transformation of the enterprise organizational structure and corporate practices.

Literature

1. Acs Z., *How is entrepreneurship good for economic growth*?, "Innovations" 2006, winter.
2. Agnblad J., Berglöf E., Högfeldt P., Svancar J., *Ownership and control in Sweden*: *Strong controlling owners*, *weak minorities*, *social control*, in: *The control of corporate Europe*, eds. Barca and Becht, Oxford University Press, 2001.
3. Anderson R., Reeb D.M., *Founding-family ownership and firm performance*: *Evidence from the S&P 500*, "Journal of Finance" 2003, no. 58.
4. Ashiq Alia, Tai-Yuan Chenb, Suresh Radhakrishnan, *Corporate disclosures by family firms*, "Journal of Accounting and Economics" 2007, vol. 44.
5. Astrachan J.H., Shanker M.C., *Family businesses' contribution to the U.S. economy: A closer look*, "Family Business Review" 2003, September.
6. Baumol W.J., *Business behavior, value and growth*, Macmillan, New York 1959.
7. Bebchuk L., Roe M., *A theory of path dependence in corporate ownership and governance*, "Stanford Law Review" 1999, vol. 52.
8. Bertrand M., Schoar A., *The role of family in family firms*, "Journal of Economic Perspectives" 2006, no. 20 (2).
9. Casson M.C., *The economics of the family firm,* "Scandinavian Economic History Review" 1999, winter, no. 47.
10. Chandler A., *Scale and scope*: *The dynamics of industrial capitalism*. *Cambridge*, MA: Harvard University Press, 1990.
11. Claessens S., Djankov S., Lang L.H.P., *The separation of ownership and control in East Asian corporations*, "Journal of Financial Economics" 2000, no. 58.

12. Colli A., Pérez P.F., Rose M.B., *National determinants of family firm development? Family firms in Britain, Spain, and Italy in the nineteenth and twentieth centuries*, "Enterprise and Society" 2003, March, vol. 4, no. 1.
13. Davis J.H., Schoorman F.D., Donaldson L., *Toward a Stewardship theory of management*, "Academy of Management Review" 1997, no. 22.
14. DeAngelo H., DeAngelo L., *Controlling stockholders and the disciplinary role of corporate payout policy*, "Journal of Financial Economics" 2000, no. 56.
15. Demsetz H., Lehn K., *The structure of corporate ownership: Causes and consequences*, "Journal of Political Economy" 1985, no. 93.
16. Demsetz H., *The structure of ownership and the theory of the firm*, "Journal of Law and Economics" 1983, no. 25.
17. Djankov S., La Porta R., Lopez-de-Silanes F., Shleifer A., *The law and economics of self--dealing*, "Journal of Financial Economics" 2008, no. 88.
18. Eid F., *Private equity finance as a growth engine: What it means for emerging markets*, "Business Economics" 2006, April.
19. Faccio M., Lang L.H.P., *The ultimate ownership of Western European corporations*, "Journal of Financial Economics" 2002.
20. Fafchamps M., *Market institutions in Sub-Saharan Africa*, MIT Press, Cambridge 2004.
21. Fleming P.D., *Case study – Helping business owners prepare for the future*, "Journal of Accountancy" 1997, May.
22. Franks J., Mayer C., Rossi S., *Spending less time with the family: The decline of family ownership in the UK*, NBER WP, 2004, no. 10628.
23. Gersick K., Davis J., Hampton M., Lansberg I., *Generation to generation: Life cycles of the family business,* Harvard Business School Press, Boston, MA, 1997.
24. Giannetti M., Simonov A., *Which investors fear expropriation? Evidence from investors' portfolio choices*, "Journal of Finance" 2006, June.
25. Gomez-Mejia L.R., Haynes K., Nunez-Nickel M., Jacobson K., Moyano-Fuentes J., *Family owned firms: Risk loving or risk averse?,* "Administrative Science Quarterly" 2007, no. 1.
26. Hernando-Trillo F., Pagan J., Paxton J., *Start up capital, microentreprises and technical efficiency in Mexico*, "Review of Development Economics" 2005, vol. 9, no. 3.
27. Holmstrom B., Milgrom P., *Multitask principal-agent analyses: Incentive contracts, asset ownership, and job design*, "Journal of Law, Economics and Organization" 1991, vol. 7 (0).
28. James H., *Owner as manager, extended horizon and family firm*, "International Journal of Economics and Business" 1999, no. 6.
29. Kantis H., Angelli P., Koenig V.M., *Desarrollo emprendedor – America Latina y la experiencia internacional,* Inter-American Development Bank, Washington 2004.
30. La Porta R., Lopez-de-Silanes F., Shleifer A., *Corporate ownership around the world*, "Journal of Finance" 1999, no. 54.
31. La Porta R., Lopez-de-Silanes F., Shleifer A., *Investor protection and corporate valuation,* "Journal of Finance" 2002, June.
32. Liedholm C., *Small firm dynamics: Evidence from Africa and Latin America*, "Small Business Economics" 2002, vol. 18, no. 3.
33. Lins K., *Equity ownership and firm value in emerging markets*, "Journal of Financial and Quantitative Analysis" 2003, vol. 38, no. 1.
34. Mandl I., *Overview of family business relevant issues*, the report for the European Commission, 2008.
35. Mason C., *El financiamiento y las pequenas y medianas empresas*, in: H. Kantis, *Desarrollo y gestion de PyMEs: Aportes para un debate necesario*, Universidad Nacional de General Sarmiento, Buenos Aires 1998.

36. Matthews C.H., Moore T.W., Fialko A.S., *Succession in the family firm: A cognitive categorization perspective*, "Family Business Review" 1999, no. 12 (2).
37. Miller D., Le Breton-Miller I., Scholnick B., *Stewardship vs. stagnation: An empirical comparison of small family and non-family businesses*, "Journal of Management Studies" 2008, January, no. 45 (1).
38. Morck R., Wolfenzon D., Yeung B., *Corporate governance, economic entrenchment and growth,* "Journal of Economic Literature" 2005, September, vol. 43.
39. Naude W., *Entrepreneurship in the field of development economics*, in: *Frontiers in entrepreneurship*, ed. B. Urban, Heinemann, Johannesburg 2008.
40. Nichter S., Goldmark L., *Small firm growth in developing countries*, World Development, 2009.
41. Panunzi F., Ellul A., Pagano M., *Inheritance law and investment in family firms,* in: Scientific Commons, 2009, available at: http://www.bepress.com/feem/paper266.
42. Perez-Gonzales F., *Does inherited control hurt firms' performance?*, Ph.D. Dissertation, Harvard University, 2001.
43. Pérez-González F., *Inherited control and firm performance*, "American Economic Review" 2006, December, vol. 96, no. 5.
44. Schulze W.G., Lubatkin M.H., Dino R.N., *Exploring the agency consequences of ownership dispersion among the directors of private family firms*, "Academy of Management Journal" 2003, no. 46 (2).
45. Shleifer A., Vishny R., *Large shareholders and corporate control*, "Journal of Political Economy" 1986, no. 94.
46. Shleifer A., Vishny R., *Survey of corporate finance*, "Journal of Finance" 1997, vol. 52, no. 2.
47. Simon H., Bonini C., *The size distribution of business firms*, "American Economic Review" 1958, September.
48. Sonfield M.C., Lussier R.N., *First-, second- and third-generation family firms: A comparison*, "Family Business Review" 2004, vol. 17, no. 3.
49. Stavrou E., *Succession in family businesses*: *Exploring the effects of demographic factors on offspring intentions to join and take over the business*, "Journal of Small Business Management" 1999, no. 37 (3).
50. Suehiro A., *Family business reassessed*: *Corporate structure and late-starting industrialization in Thailand*, "The Development Economics" 1993, vol. 31, no. 4.
51. Tabellini G., *Institutions and culture*, "Journal of the European Economic Association" 2008, April–May.
52. Ward J.L., *Perpetuating the family business*, Palgrave Macmillan, New York 2004.

FIRMY RODZINNE W ROZWOJU GOSPODARCZYM

Streszczenie: Artykuł analizuje związek między częstotliwością występowania firm rodzinnych a rozwojem gospodarczym. Autor pokazuje, że rodziny są powszechnie jednym z kluczowych czynników wspierających powstawanie nowych przedsiębiorstw, dostarczając niezbędnego kapitału, pracy oraz wsparcia moralnego. Jednakże mogą stać się one przeszkodą dla rozwoju firm, gdy w fazie szybkiego wzrostu muszą dokonać zmiany form własnościowych i organizacyjnych. Rodziny stają przed dylematem – orientacja na rozwój czy chęć utrzymania kontroli nad firmą? Jak i z jakimi konsekwencjami dla rozwoju gospodarczego rozwiązywany jest ten problem, to zależy od cech otoczenia instytucjonalnego gospodarki. Druga część artykułu pokazuje mechanizmy wiążące rozwój firm z czynnikami instytucjonalnymi.