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Governance and entrepreneurship in family firms: Agency, behavioral agency and resource-based comparisons

Isabelle Le Breton-Miller [a,b], Danny Miller [a,b,*], Franck Bares [a]

[a] HEC Montreal, Canada
[b] University of Alberta, Canada

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ABSTRACT

There remains a good deal of uncertainty as to whether and under which governance conditions family firms, even large, publicly traded ones, are entrepreneurial. We shall argue that agency theory, behavioral agency perspectives, and the resource-based view all posit both positive and negative influences regarding entrepreneurship in family firms, while empirical studies, collectively, are no less ambiguous in their findings. We use each of the above theories to propose various governance distinctions that can reconcile these contradictions and suggest when family firms will be most and least entrepreneurial.

Introduction

Family firms have been criticized in numerous quarters for their conservatism, their neglect of financial and growth objectives, and their unprofessional nature (Bertrand & Schoar, 2006; Bloom & Van Reenen, 2007; Gomez-Mejia, Haynes, Nunez-Nickel, Jacobson, & Moyano-Fuentes, 2007). And yet, these firms are the dominant form of organization in the world, and account for a substantial proportion of publicly traded companies (Miller & Le Breton-Miller, 2005). Surely, given their share of the global economy, there must be some family firms that are entrepreneurial – that is capable of responsive product-market renewal (Schumpeter, 1942). Clearly, however, there are important differences within the breed. Indeed, it has been demonstrated that family firms vary greatly in their governance structures and this can have an important impact on their conduct and performance (Miller, Le Breton-Miller, Lester, & Cannella, 2007, Miller, Minichilli, & Corbetta, 2013; Villalonga & Amit, 2006). In short, it may matter to the extent of the entrepreneurial effort just who owns, governs and runs the business (Gomez-Mejia, Hoskisson, Makri, Sirmon, & Campbell, 2011).

Unfortunately, despite recent research and conceptualizing, we remain ignorant of under which circumstances family firms are most entrepreneurial. The theories that can best inform this domain – agency, behavioral agency, and resource-based theory – evoke conflicting insights, whereas the empirical findings remain inconclusive. We shall attempt to draw some fine-grained governance distinctions in an attempt to gain a better understanding of when family firms are most likely to be entrepreneurial. In doing so, we hope to condition the application of popular conceptual frameworks on family firm behavior to entrepreneurship among these organizations. Given the emphasis of much of the conceptual literature, our domain will be large, publicly traded companies, where issues such as agency and opportunism are most relevant.

We should make explicit a key assumption at the outset: We are not proposing that entrepreneurial behavior, particularly in its more active form, is always desirable. This very much depends on the capabilities and resources of the firm and the challenges and uncertainty in its environment (Thompson, 1967). However, given the pace of change in many industries, and the accompanying threat of relative stagnation, innovation, risk taking and proactive creativity, will be needed periodically to renew a firm. This is particularly true in family businesses that hope to remain evergreen to provide careers for next generation family members.

Although there have been numerous definitions of entrepreneurship, our focus will be on the well-known concept of entrepreneurial orientation (EO): that is, a firm's tendency to engage in ventures that are proactive, involve risk taking, and are innovative (Covin & Slevin, 1989; Miller, 1983, 2011). We are using Miller's (1983) interpretation of EO as actual, not merely desired or intended behavior. The rationale for the concept is that all three components are required, albeit in different measure, for behavior to be considered entrepreneurial. For example, innovation that

* Corresponding author at: HEC Montreal, 3000 Cote St. Catherine Road, Montreal, QC, Canada H3T 2A7. Tel.: +1 514 484 7768.
E-mail address: danny.miller@hec.ca (D. Miller).

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is reactive and involves little risk can hardly be considered venturesome. Thus most of the work on EO treats it as an integrated construct, and that is our own position (Covin & Wales, 2012; Miller, 1983, 2011). Moreover, although there has been debate over whether EO refers to an attitude of an entrepreneur or a set of behaviors of corporations, a significant body of research has favored the latter position, and that will be our emphasis here (see the reviews by Covin & Lumpkin, 2011; Covin & Wales, 2012; Wales, Gupta, & Mousa, 2013). Indeed, following Miller (1983), we shall use the terms EO and (corporate) entrepreneurship interchangeably.

Conceptual conflicts regarding family firm conduct

Family business scholars have relied in large part on three important theories to explain family firm strategic conduct: agency theory, behavioral agency theory – including that relating to socioemotional wealth preferences – and the resource-based view. As we shall see, each of these theories offers arguments both for and against entrepreneurship taking place in family firms.

Agency theory suggests that because in family firms, ownership and management incentives are aligned, or due to the superior monitoring capabilities of major owners, agency costs are low (Fama & Jensen, 1983). Where opportunism is reduced, it can be argued that there will be ample financial resources available for entrepreneurial initiatives. On the other hand, other scholars, again using an agency framework, claim that major family owners may use their power and knowledge to exploit minority shareholders, diverting resources required for innovation to parochial purposes (Shleifer & Vishny, 1997). That in turn might constrain entrepreneurship.

Behavioral agency scholars have taken a different tack. Based on work in behavioral economics, they argue that family business owners, given their existing endowment, will be risk averse, preferring to hold on to what they have rather than risking it on new ventures (Wiseman & Gomez-Mejia, 1998). That would constrain entrepreneurial behavior where the endowment considered relates to current family security, capital or income. Gomez-Mejia et al. (2007) elaborated on this theme in their notion of *socioemotional wealth* (SEW), arguing that family owners will use their business to satisfy socio-emotional needs such as providing jobs to offspring. Although this may drive conservatism, it could equally be argued that the intention of passing on a healthy business to later generation kin provides an incentive for entrepreneurial renewal (Miller & Le Breton-Miller, 2005). Again, a popular theory is ambiguous in its implications for family firm entrepreneurship.

Finally, we come to the *resource based view* (RBV). Some have argued that family firms will be restricted in their access to many of the resources required for entrepreneurship (Bertrand & Schoar, 2006). For example, the desire to keep family control over the firm restricts financing options, whereas nepotism and entrenchment may restrict the pool of competent managers (Bloom & Van Reenen, 2007; Mehrotra, Morck, Shim, & Wiwattanakantang, 2011). On the other hand, it has been argued that because of their long-time horizons, these firms are astute *stewards* of their human and intangible resources (Arregle et al., 2007; Habbershon, Williams, & MacMillan, 2003; Miller, Le Breton-Miller, & Scholnick, 2008).

In short, agency, behavioral agency (including SEW) and RBV perspectives surface both positive and negative factors regarding the relationship between family governance and entrepreneurship. We shall argue that variations in family firm governance may help determine which polarities of each of these theories apply, and therefore how entrepreneurial family firms can be.

Gaps in the empirical literature

This absence of conceptual resolution is accompanied by conflicting empirical findings. Some studies show family firms to be resistant to innovation and entrepreneurship. For example, research on family firm innovation – a component of entrepreneurship – has demonstrated family firms to be less innovative and less able to leverage their patents than non-family businesses (e.g., Block, 2012; Gomez-Mejia et al., 2011). Similarly, Miller and Le Breton-Miller (2011), in examining entrepreneurial orientation in large public family firms, found these firms to be far less entrepreneurial than their lone founder counterparts.[1] Other work has shown family businesses firms to innovate only when pressured by bankruptcy risk or under-performance (Chrisman & Patel, 2012).

However, other studies have found that families can be great sources of intergenerational entrepreneurship and incubators of nascent entrepreneurs (e.g., Discua Cruz et al., 2013; Miller et al., 2008; Schjoedt, Monsen, Pearson, Barnett, & Chrisman, 2013). Moreover, research on large, enduring family companies has shown some of these to be excellent deal makers and innovators, in part because of their willingness to invest in the future of an enterprise that sustains the family over generations (Miller & Le Breton-Miller, 2005).

Given these disparities, once again, a key insight toward resolution may lie in the details of governance. Not all family firms have the same preferences or capacities. *We shall argue that governance arrangements will provide insight into those critical elements that shape entrepreneurship in family firms*, and shall present propositions to that effect. Their contribution will be to reconcile conceptually the conflicting notions in the field.

Theory and propositions

We shall deal in turn with agency, behavioral agency (SEW) and resource based theories, attempting from the logics of each to discern more precisely the governance conditions under which family firms are most apt to be entrepreneurial.

Agency and governance

Traditional agency theory is concerned with information asymmetries between owners and their agents that allow the former to appropriate resources from the latter (Fama & Jensen, 1983). Agency scholars might argue that concentrated ownership would facilitate more effective monitoring given the power and information access of large owners. Under that logic, family firms, because they have lower agency costs, will monitor better, curb opportunism, and thus have more resources to pursue entrepreneurial ventures, which they will be motivated to undertake as they are required for the long-term robustness of the firm. Moreover, major owners due to their long-term objectives and knowledge of the business, will ensure that any such ventures are not manifestations of CEO hubris (Anderson & Reeb, 2003). According to those arguments, family firm ownership and vote control might positively influence entrepreneurial behavior.

However, more recent agency scholars have studied a second type of agency problem in which majority owners are able, given their power and knowledge, to appropriate resources from minority owners (Shleifer & Vishny, 1997). For example, large family owners may be in a position to exploit other owners by appropriating generous salaries and perquisites for offspring or

[1] This is not a surprising result – especially for founder firms that have become Fortune 1000 companies having no nepotism or socioemotional distractions to curb risk taking and innovation (Bertrand & Schoar, 2006; Gomez-Mejia et al., 2007).