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Disentangling the effect of family involvement on innovativeness and risk taking: The role of decentralization

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ABSTRACT

This study investigates the effect of family involvement on family firms' entrepreneurial behavior through decentralization. Borrowing from agency theory and using a sample of 145 entrepreneurs, this study contributes to entrepreneurship literature by providing a fine-grained explanation about how a decision-making mechanism such as decentralization influences the relationship between family involvement and innovativeness, and risk taking of family firms. Furthermore, this study demonstrates the importance of considering heterogeneity of family firms and the focal role of decentralization in spurring up firm-level entrepreneurship.

1. Introduction

Family firms are an important area of research in the past three decades (Gedajlovic, Carney, Chrisman, & Kellermanns, 2012). Family firms owe their importance to the world economy and unique organizational structure (Zahra, Hayton, & Salvato, 2004), which consists of distinctive features like family involvement in management (FIM), generational succession (Kim & Gao, 2013) and strong family orientation (Uhlaner, Kellermanns, Eddleston, & Hoy, 2012). In recent years, many studies attempt to understand what makes family firms successful (Choi, Zahra, Yoshikawa, & Han, 2015; Dyer, 2006; Gedajlovic et al., 2012). However, this stream of research still does not manage to establish family firms' relevance in entrepreneurship (Uhlaner et al., 2012). The literature also presents conflicting findings about the effect of FIM on firm entrepreneurship and performance (Kim & Gao, 2013). These challenges may be mainly a product of studies looking at family firms vs. non-family firms (Chrisman & Patel, 2012), thus overlooking the fact that family firms are heterogeneous. Even studies that focus only on family firms fall short on investigating the effect of various antecedents on entrepreneurship and firm performance (Naldi, Nordqvist, Sjöberg, & Wiklund, 2007).

One antecedent is family involvement, which has some prominence in family-business research (Kellermanns et al., 2008). However, the mechanisms through which family involvement influences organizational outcomes such as entrepreneurship lack research (Kim & Gao, 2013). No studies explain clearly how variables such as decentralization (or low centralization), which are an important dimension of organizational culture (Zahra et al., 2004), usually become an outcome of family involvement (Lindow, 2013), and "get in between" family involvement and entrepreneurial engagement of family firms. Instead of investigating whether family firms are more entrepreneurial than non-family firms, this study provides a more appropriate research question to ask: What are the intervening variables that influence the relationship between family firm's characteristics and entrepreneurship? The present study takes an important step in this direction. More specifically, this research investigates how decentralization mediates the relationship between family involvement and innovativeness, and risk taking.

This study contributes to the literature of family firms and entrepreneurship. First, unlike many studies comparing family vs. non-family firms (Chrisman & Patel, 2012; Naldi et al., 2007), this study looks solely at family firms and captures firm heterogeneity regarding family involvement. Second, this study offers a fine-grained explanation of processes such as decentralized structure to uncover the indirect relationship between family involvement and entrepreneurial behavior of family firms.

The organization of this research is as follows. Section 1 posits hypotheses about family entrepreneurship employing agency-theory underpinnings. Section 2 explains the research design and presents the findings. Section 3 discusses results and offers conclusions and suggestions for future research.

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2. Theory and hypothesis development

2.1. Family involvement and innovativeness, and risk taking

The effect of family involvement on organizational outcomes builds on agency theory. Agency theory contends that agency costs arise because of self-interested individuals and their decisions oriented to their own preferences (Jensen & Meckling, 1976). Some agency theorists believe that family firms represent an ideal organizational form where the objectives of the owner align with those of the firm (Zahra, 2005). This close alignment leads to more effective decision-making that contributes to the continuation of the firm. Agency theorists also advocate that owners take a long-term and visionary approach to decision making because founders want to create a legacy of their success or because they wish to maximize their families' wealth. Owner-managers must demonstrate commitment to firms' success through pursuing entrepreneurial opportunities and supporting innovations (Zahra, 2005).

With the separation of ownership and management in family firms, more people participate in decision making and thus agency costs occur because of different preferences and information asymmetries of the owner (principal) and the employed management (agent) (Schulze, Lubatkin, Dino, & Buchholtz, 2001). These issues arise mainly because the individual managers have a short-term view and seek financial gains whereas the owners' preference is long-term interest and the sustainable development of the business. Besides these issues, agency costs in family firms occur because of relational and altruistic preferences (Mustakallio, Autio, & Zahra, 2002; Poppo & Zenger, 2002). Families tend to keep control of the firm and wealth in the family rather than wanting to share the benefits of the business with the 'outsiders.' On the one hand, family firms should be less prone to agency problems when ownership and control are in the hands of a few select family members (Zahra, 2005). On the other hand, Dyer (2006) offers a countering view that family involvement leads to higher agency costs because of the conflicting goals of family members. In particular, parental altruism may give rise to the hiring of family members (i.e., nepotism) (Schulze et al., 2001; Sirmon & Hitt, 2003) which in turn is likely to lead to monitoring difficulties of their job performance (Dyer, 2006). Parental altruism opens the door for the failure of family members to monitor each other, which causes agency issues such as opportunism, shirking, and adverse selection (Dyer, 2006). These agency issues must have an influence on firm entrepreneurship and performance. In addition, firm strategy has both financial and socio-emotional implications for family wealth and the longevity of the family business which, in turn, lead these firms to be more conservative (Gómez-Mejía et al., 2007; Nieto, Santamaria, & Fernandez, 2015). Consequently, these firms may be hesitant to engage in corporate innovation (Le Breton-Miller & Miller, 2009) or to undertake business strategies that lead to higher variability in performance (i.e., risk) (Zahra, 2005).

The level of conservatism may be stronger if more family members participate in the day-to-day operations of a family firm because these members strive for preserving family wealth at any cost. Thus, the precautionary approach of family members tends to manifest in the decision-making process within a firm. Zahra et al. (2004) argue that family involvement hinders entrepreneurship within family firms. As family involvement in managing business increases, non-family members might feel like they are not part of key decisions and have less freedom to act (Zahra, 2005). Non-family employees face the daunting task of turning to family members prior to introducing a novel idea about improving the business. The feeling of having less voice and freedom to act in a firm may eventually lead to losing these employees. This loss, in turn, would cause an organization to lack valuable sources of ideas that could spur innovativeness and entrepreneurial risk-taking (Zahra, 2005). Empirically, Chen and Hsu (2009) confirm these claims by showing that family firms are less innovative than non-family firms.

H1. : Family involvement relates negatively to innovativeness.

H2. : Family involvement relates negatively to risk taking.

2.2. The mediating effect of decentralization

Decisions in small businesses generally hinge on business owners' philosophies and their management style. Therefore, in small firms, delegating business tasks and applying the correct amount of control (i.e., high decentralization) constitute a challenge. Family firms gain prominence for their centralized organizational structure (low decentralization), which leads to even tighter coordination and control (Zahra et al., 2004). Supporting this view, previous research portrays family firms as restricting family members' involvement in the firm's decision-making process (Kellermanns & Eddleston, 2007). No literature exists regarding how family involvement affects decentralization. However, building on agency theory, several reasons support why having a larger number of family employees participating in business decisions should lead to less decentralized decision-making in operations. First, having a higher level of family involvement can cause more divergence in owners' goals, which may escalate agency costs. Second, when a larger proportion of family members are employees, the entrepreneur faces a dual concern: providing for employed family members and running a successful business. For family firms, offering continuous employment to family members tends to take precedence over achieving firm performance. Therefore, a way to satisfy these dual goals for the business owner is to exercise some care when granting autonomy to employees to safeguard family wealth and to ensure "succession of the business" (Miller & Le Breton-Miller, 2006). The discussion shows that higher family involvement in family firms should lead to lower decentralization (i.e., high centralization).

Previous studies report that low decentralization of decision-making impedes the use of imagination by employees and reduces the probability of finding creative solutions to problems within a firm (Caruana et al., 1998). In the context of family firms, low decentralization also concentrates the power in the hands of select individuals. This concentration of power leads to organizational rigidity, which impedes the exchange of ideas by employees, and thus has a suppressing effect on innovativeness (Zahra et al., 2004). Previous studies offer consistent empirical evidence of the stifling effect of centralization (i.e., low decentralization) on entrepreneurship (Caruana et al., 1998; Zahra et al., 2004).

Taken together, these relationships point out to the corollary that family involvement may have an indirect effect on entrepreneurial risk-taking and innovativeness through decentralization. High family involvement creates higher agency costs that lead to a lower degree of decentralization. In turn, decentralization has a positive effect on risk taking and innovativeness. Overall, this study contends that higher family involvement will lead to lower entrepreneurial risk-taking and innovativeness through decentralization. Fig. 1 depicts the model of this study.

H3. : Decentralization mediates the relationship between family involvement and innovativeness, so that family involvement has a negative indirect effect on innovativeness.

H4. : Decentralization mediates the relationship between family involvement and risk taking, so that family involvement has a negative indirect effect on risk taking.

3. Method

3.1. Sampling

The sample population for the questionnaire study included family-owned SMEs operating in three main sectors (manufacturing, retailing,