Family Firms as a Case of Network Embeddedness: Theoretical and Practical Implications

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Abstract

Based on the network embeddedness literature, we argue that many characteristics of family firms can be explained through embeddedness in the family network. We extend this analysis by showing how embeddedness in other networks of similar kinds can produce corresponding business implications. The research and managerial implications are discussed.

INTRODUCTION

Recent literature has recognized that extant family business research is lacking a unifying theoretical foundation that would increase the legitimacy of the field (Chrisman et al., 2003a; Chrisman et al., 2003b; Sharma, 2004), and promote dialogue with other disciplines (Zahra and Sharma, 2004). In this paper, we argue that family firms can be studied as so-called network embedded firms (Halinen and Törnroos, 1998; Uzzi, 1996). By presenting a series of comparative case-examples, we show that many of the specific characteristics of family firms and their business implications may be derived from network embeddedness theory. The paper contributes to the fields of family business and organization research by generating both conceptual and practical implications.

PROBLEMISATION AND CONCEPTUALISATION

The importance of past family business research has been justified by the dominance of this organizational form in the organization of economic activity in most nations (Sharma, 2004). For research purposes, family firms have been defined in a multitude of ways, mostly related on the roles of the underlying family in determining: (i) control, (ii) strategy and vision, and (iii) unique resources and capabilities within the firm (Sharma, 2004), and are typically operationalised through ownership, management, and/or generational succession (Chrisman et al., 2003a). The broadest type of definition remains at the level where the family retains control over the firm through ownership. A middle-range definition deals with the family involvement in the everyday operations...
and management of the firm. The strictest definition requires both family control as well as the involvement of multiple generations in the everyday operations/management of the firm (Sharma, 2004). A cognitive dimension has also been applied, although it is theoretically problematic (Westhead and Cowling, 1998). Researchers generally agree that a major factor impeding the theoretical development of the field is the fact that no unambiguous definition exists for family firms (Chrisman et al., 2003a; Sharma, 2004; Zahra and Sharma, 2004).

For the purpose of this paper, we take the broad family firm definition to include firms that are strongly embedded in the social network constituted by a (single) family – whether constituted by control, by ownership, or access to unique capabilities and resources.

It has been shown that family firms share certain characteristics not so profoundly present in other types of organizations (Kets de Vries, 1993; Sharma, 2004; Stafford et al., 1999). The business implications, both positive and negative, of these characteristics, compared to other forms of organization, have also been evaluated (Anderson and Reeb, 2003; Gudmundson et al., 1999; Littunen, 2003). Our contribution in the search for more solid theoretical foundations for family business research is the argument that many of the specific characteristics of family firms can in fact be explained through the theory of network embeddedness (Granovetter, 1985; Halinen and Törnroos, 1998; Uzzi, 1996), representing also an integrative device across the different conceptions of family firms.

In general, the network embeddedness argument posits that organizations are embedded in larger social structures or networks (Andersson et al., 2002; Granovetter, 1985; Uzzi, 1996). Network embeddedness is characterized by plural linkages between actors, activities, resources and institutions in a social construct. Several types of network embeddedness can be identified, ranging from technological (Andersson et al., 2001), geographic (Dicken et al., 1994), political (Jacobson et al., 1993; Welch and Wilkinson, 2004), and social (Grabher, 1993, 2002). We argue that family firms are, in addition to being embedded in various other network structures, strongly embedded in the context of the family and thus the underlying social network. Thus, theoretically, family firms in fact represent a specific case of network embeddedness.

The idea being embedded within the family context as such is not entirely new. Many researchers have acknowledged that the reciprocal influences between the systems of family and business are key to understanding family business performance and other related phenomena (Chrisman et al., 2003a). Aldrich and Cliff (2003) explicitly propose a family embeddedness perspective be integrated into all entrepreneurship research to account for the fact that a majority of entrepreneurial activity is affected and is affected by the context of family. They present an extensive analysis of changing family roles and composition during the industrial era of American society, as well as apply life course theory to explain the effects of the family on the creation and recognition of new opportunities, as well as the decision to create and implement new ventures.

The ideas presented in our paper converge with the family embeddedness perspective to the extent that we see that the concept of family has profound effects on business and
vice versa. However, we extend and partly reverse the argument of Aldrich and Cliff (2003) in three ways. First, we focus explicitly on the network of social relationships in our analysis of embeddedness in the context of family. Second, we take the generic network embeddedness approach and argue that embeddedness in certain types of social networks may, on average, have positive effects on business performance. As studies have shown, embeddedness in the context of the family seems to often generate such effects (Anderson and Reeb, 2003). Third, we see that firms can equally well be embedded in other network contexts of similar kinds, and thus enjoy similar business implications. Taking the argument still one step further, we question whether managers can artificially generate or deliberately pursue such kinds of network embeddedness.

In our view, this conceptual standpoint has several implications on explaining: (i) the outcome effects of being a family business; (ii) differences between individual family firms; as well as (iii) structural similarities between family firms and certain types of non-family firms. An intriguing question to arise is whether certain network embeddedness related properties of family firms can enhance business performance, and whether structurally similar characteristics and effects can be identified or even created in other types of organizations.

To elaborate the relationship between family firms and network embeddedness, a comparison of firm characteristics and central concepts is required. Table 1 presents an overview of the central firm characteristics and theoretical concepts for both the domain of family business (Chrisman et al., 2003a; Kets de Vries, 1993; Sharma, 2004; Wortman, 1994; Zahra & Sharma, 2004) and the domain of network embeddedness (Andersson et al., 2002; Echols and Tsai, 2005; Fischer and Pollock, 2004; Henderson et al., 2002; Håkanson and Johanson, 1993; Rowley et al., 2000; Uzzi, 1996).

Table 1. Family firms and network embeddedness: Firm characteristics and theoretical concepts.

<table>
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<tr>
<th>Typical firm characteristics and theoretical concepts</th>
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<tr>
<td>The domain of family business</td>
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<tr>
<td>Altruism, stewardship</td>
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<tr>
<td>Nepotism</td>
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<td>Pronounced succession issues</td>
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<td>Concentration of power to owning-family managers</td>
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<td>Effects of concentrated ownership</td>
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<tr>
<td>Distinctive organizational culture and identity</td>
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<td>Influence of family values, attitudes, and norms</td>
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<td>Importance of non-economic goals</td>
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<td>Stability and long-term orientation</td>
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<td>Commitment, trust</td>
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<tr>
<td>The domain of network embeddedness</td>
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<tr>
<td>Reciprocity</td>
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<tr>
<td>Durability and stability of relations</td>
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<td>Social capital</td>
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<td>Interaction, exchange</td>
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<td>Social structure</td>
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<td>Dependency, contingency</td>
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<td>Power</td>
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<td>Plurality, heterogeneity</td>
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Clearly, the family business discourse and the network embeddedness discourse resemble each other, but there is a clear difference in emphasis. The family firm discourse is actor-centric, assumes the existence of central institutions (‘the family’) and deals with a phenomenon-oriented set of descriptive topics and characteristics. The network embeddedness discourse is far more theoretical, has a distinct epistemological stance, but is weakly or not at all anchored to any specific social construct. In other words, ‘a family is always a family’ but a network can be ‘anything’. This observation concerning the two different levels of abstraction provides an interesting opportunity for conceptual and theoretical cross-fertilization.

LINKING FAMILY BUSINESSES AND OTHER NETWORK EMBEDDED FIRMS

A second avenue for investigating the relationship between family firms and network embeddedness is to look for similar network embeddedness characteristics among family and non-family business firms. We explore whether network embeddedness manifests itself in the same way in family firms and firms embedded in some other significant network context. In Table 2, we present a conceptual comparison in which a selection of typical family business related characteristics: altruism, ownership concentration effects, nepotism, concentration of power to owning-family managers, non-economic goals and organizational culture, are identified in other types of organizations that are also characterized by a high level of network embeddedness.

In addition, we also present an abbreviated comparative case analysis, in which three family-non-family firm pairs are used to analyze the way network embeddedness characteristics of family firms can be represented in other types of firms. For the analysis, three different types of family businesses and respective non-family businesses have been selected. The first case pairing compares an owner-controlled and concentrated small scale family business (souvenir shop chain) to a multi-entrepreneur boutique consultancy (IT company founded by college friends). The second case pair involves a diversified, medium-sized hotel, spa and rehabilitation centre chain, in which the family is somewhat involved in the management, but non-family member managers perform the majority of management tasks. This company was paired with a major university trust strongly affiliated to a minority-language (Swedish-speaking) university in Finland. Finally, we compare two publicly listed companies characterized by professional corporate management, spread ownership and established rules of meritocracy. The first company is a global industrial manufacturing corporation, which employs over 100 members of the core family. Its pair is a large customer-owned cooperative that is a market leader in retailing. Additionally, both companies have focused activities significantly after diversifying in the 1980’s and 1990’s and are exhibiting fewer and fewer signs of network embeddedness. All case companies are Finnish and have been analyzed according to the way they have operated in 2002-2004, and they are thus temporally and geographically similarly embedded. With each characteristic, we identify the ways in which family businesses manifest network embeddedness. Furthermore, we analyze whether and how this type of network embeddedness could prevail in non-family business firms.
Table 2. A conceptual analysis of selected family business characteristics and their possible manifestation in non-family firms

<table>
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<tr>
<th>Characteristic</th>
<th>Network Embeddedness Explanation</th>
<th>Typical Business Implications</th>
<th>Possible Manifestation in Non-Family Firms</th>
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<tr>
<td>Altruism</td>
<td>Network embeddedness creates a strong-holding social structure featuring reciprocity and dependency between actors, as well as stability of relations.</td>
<td>Stewardship, lower agency costs, long-term orientation, less bureaucracy, converging interests and incentives.</td>
<td>Cases where strong, family-like relationships exist between key actors. E.g. partnerships or firms founded by the members of a friendship network.</td>
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<tr>
<td>Ownership concentration effects</td>
<td>A major proportion of the wealth of the family network members are tied to the same firm. Amplified interest for control by owners, increased dependency and strengthened ties between actors, durability, and interaction.</td>
<td>Less preference for external funding, diversification strategies, less risk taking, long-term orientation, shareholder activism.</td>
<td>Any firms where ownership concentrated to an identifiable network of actors and a major proportion of personal wealth invested. E.g. partnerships, firms owned by friends or employees.</td>
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<td>Nepotism</td>
<td>Strong kinship ties between the members of the family create incentives for securing the welfare and enhance the social status of own offspring and relatives. Control over the firm may be exploited to implement this.</td>
<td>Maintaining family control in the long-term, “training” of future successors early on thus increasing their knowledge of the business, also negative implications due to lack of meritocracy.</td>
<td>Situations where the members of the embedded network have the power and acceptance to favor own members and appropriate personal or network level gains thereof. E.g. ownership by employees or political parties, embeddedness in ethnic societies, academic networks or geographical area.</td>
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<tr>
<td>Concentration of power to owning-family managers</td>
<td>Quick decision-making, less politics. long-term, &quot;paternalism&quot;, informality, accumulation of business knowledge and social capital, succession episodes. Small agency costs. owners’ will in managerial decisions.</td>
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<td>Non-economic goals</td>
<td>Maximization of stakeholder wealth instead of shareholder wealth. Emphases on leadership, continuity, stability, also irrationality and opportunism.</td>
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Cases where the founder’s role is strong and/or ownership concentrated on a few individuals. Embeddedness in academic networks, partnerships, "friendships".

Cases where ownership is not the only driver of embeddedness. E.g. employee owned firms, as well as embeddedness in ethnic societies, academic networks or geographical area.
CASE PAIR 1

In the small-scale, family-owned souvenir shop chain, one can find traces of almost all of the six typical family business characteristics. Perhaps the most prevailing characteristics are the concentration of ownership in the family, as well as concentration of managerial power within the founder that has run the chain for over 15 years. These characteristics are in a sense preceding each other as the concentration of the family’s wealth in the chain implies that the family wants to keep tight control over the business. The logical consequence is that the founder has retained the CEO position up to date. The business implications of these two characteristics include a long-term orientation (both investment policy and company management), diversification (several locations), minimal agency costs by definition, as well as the managerial characteristics of informality, an excellent knowledge of the business, as well as concentrated decision-making. However, there is also evidence of nepotism (and thus also some type of altruism). The founder’s wife and two children also hold employment positions in the firm, further strengthening the family embeddedness. In line with the nepotism argument, the two sons of the family hold managerial positions in the company, thus “preparing for” the evident need for management succession at some point in the future. A strong, family-like organizational culture (or “familiness”) is present, as well as the increasing role of non-economic goals. For example, the firm is not pursuing high growth and thus economics of scale and scope.

In the IT consultancy company which was founded by a group of college friends, we find that the underlying network is not a family as such, but a tight network of people closely connected to each other through friendship. These friendship ties generate the embeddedness effect within the company. Ownership is obviously concentrated and again, a major share of the owners’ wealth is tied to the company. A long-term orientation and a less aggressive strategy are visible. However, an obvious difference is that the management of the firm is not concentrated to a single person, but spread equally across the founding team of four. This implies that the embeddedness of the friendship network of the founding team is very strong. Quick decision making, informality and sharing of social capital are strongly present. Nepotism is also present, as shown by the tendency of the team to hire people from their individual (and collective) friendship networks to work on IT consultancy projects. Altruism is also present, especially within the team. Indeed, without the trust, commitment and flexibility generated by the altruism, the friendship bonds would likely break and eventually the business activities would collapse. Due to the relative young age of the company (less than 10 years), the organizational culture is still forming. However, the characteristics of familiness, friendship and informality present in the working atmosphere can be regarded as elements of organizational culture. Finally, the presence of non-economic goals can be observed. The main goals of the company are to generate good personal income for the founders and workers, but the aim is not to build a high-growth, fine-tuned money-making machine through aggressive expansive strategies. One of the mottos of the team is to have fun and work in projects of personal interest.
CASE PAIR 2

The second case pair is based on a family-controlled, medium-sized, diversified hotel, spa and rehabilitation centre chain (later spa chain), as well as a major university trust strongly embedded in the minority language academic society.

The ownership of the spa chain is moderately concentrated to a family, which is also partly involved in the management of the firm. However, external, non-family members have been hired as managers to perform the majority of everyday management tasks. Both product-market diversification (hotels, spas, rehabilitation) as well as geographic diversification (Finland, UK and Germany) of the business is present. The firm has also shown exceptional entrepreneurial attitude by inventing and patenting a yacht hotel concept where a non-motorized yacht is placed on the waterline to extend hotel facilities given the limited availability of building land.

The university trust is of comparable size and is strongly embedded in the Swedish-speaking academic society in south-western Finland. The trust is owned by the students of the local Swedish-speaking university and has invested considerable wealth in buildings and facilities, stocks and other financial securities. The management of the trust is basically chosen from within the local academic society. Diversification is clearly present, as the trust is involved in providing financial support to the university, supporting academic research projects, managing the buildings and facilities, operating museums, and managing the trust’s wealth in general. Because of non-professional management, non-economic goals are clearly visible in the case.

CASE PAIR 3

For the third case pair, we start from a large, diversified, widely-held and professionally managed Finnish metal industry conglomerate. Although a publicly listed company, the majority of the shares of the company are owned by the original founding family, now encompassing several hundred individual shareholders. The company is professionally managed and very sophisticated corporate governance mechanisms and meritocracy-based hiring systems are in place. In fact, to keep the goals of the company and the family aligned, the company holds very large annual family meetings, whereby the status of the company and its business strategy are discussed together with the management and the owners. Some of the family members hold significant management positions in the firm, but they have acquired business experience from other firms, and have been selected to their positions solely based on meritocracy. In recent history, the increase in the number and power of non-family related management has diluted some signs of family embeddedness. Diversification, non-economic goals, altruism, high power concentration and strong organizational identity are less and less visible.

The pair of this company is a large Finnish retail chain that is owned by its customers (a cooperative). The chain is professionally managed and ownership is less concentrated. However, in the same way as the diversified industrial company “remains a family firm”, the retail chain is strongly embedded in the network of its large customer base, for they own the company. There are several mechanisms that promote and strengthen
this embeddedness, such as the loyalty/bonus program affiliated with purchasing an ownership share of the company. The cooperative structure makes the ownership even more interesting, as all shareholders are only allowed to own a same-sized share of the company. This resembles in many ways the large family network of the previous company. However, because of the existence of hundreds of thousands of shareholders, the associated network is much looser and the goals and aspirations of the network have a weak influence on the running of the business. Similarly, the concepts of altruism, nepotism, non-economic goals, member managers and organizational culture are not so relevant in this case. The business implications of the embeddedness through customer ownership are related to loyalty of the customer base, stability and long-term orientation. Diversification is also a salient feature of the chain.

THEORETICAL AND PRACTICAL IMPLICATIONS

From the perspective of family business, our study provides a novel explanation for understanding certain family business characteristics. According to our study, family firms should be understood as network embedded firms. When family firm characteristics are interpreted as network embeddedness, it becomes evident that family firms are conceptually similar to other network embedded firms. Different types of network embeddedness can be substituted with other types. Future research should explore which aspects of family firms can be substituted or compensated by other network aspects. Which characteristics are unique to which networks? Which characteristics are generic to any type of network embeddedness?

Future research should study the relationship between family firm characteristics and network embeddedness characteristics further. Instead of researching family business characteristics, researchers are provided with a way to link network embeddedness characteristics to business results. Given the varying evidence from family firms (Olson et al., 2003), this may explain differences between seemingly similar companies. Conceptualizing family firms in terms of network embeddedness also helps researchers distinguish between, categorize and identify family businesses in a deeper, more theoretical manner (Chrisman et al., 2003a; Sharma, 2004; Zahra and Sharma, 2004). Theoretical research on ‘family firms’ should expand the definition of a family firm and/or broaden its scope to include other types of network embeddedness. This conceptual repositioning should show in the data and other research materials employed.

In addition to researching network embeddedness, the above discussion leads us to hypothesize that firms embedded in different networks could also have similarities vis-à-vis network outcomes (business results). Both network embeddedness and family firms have been linked to company performance (Anderson and Reeb, 2003). This leads to two central questions that have potential managerial relevance. Firstly, can the benefits emerging from embeddedness in family networks be copied or substituted by other types of network embeddedness? Is being embedded in any network characterized by similar trust, social capital, path dependency, reciprocity, relationship durability and stability likely to produce similar business benefits? What is required from a network attempting to create a similar foundation for improving business results? Research
linking network embeddedness to organizational structure, corporate strategy or marketing mechanisms could shed light on how to emulate the success of family firms.

Secondly, managers should be curious as to whether network embeddedness can be built proactively or whether valuable networks are born as a result of a very long period of spontaneous network evolution (Hayek 1951). From the perspective of management practice, the question that arises is whether other types of organizations can “learn” from family firms. Essentially, if certain aspects of network embeddedness are associated with successful family firms, can other firms imitate these firms by copying the way they are embedded in their networks?

One possible avenue for creating network embeddedness is to respect the evolutionary aspects of network creation. This would imply focusing on developing structures, relationships and learning mechanisms that facilitate the possibility of spontaneous network development. A second, more aggressive network targeting strategy could attempt to copy success recipes from family firms. This would imply creating ‘fake families’, i.e. network embeddedness that would substitute family relationships with other contingency mechanisms such as incentives/sanctions, forced ‘family-type’ interaction between parties, or strict norms and rules. In any case, the management of network development and the role of different types of network embeddedness should be researched further.

Naturally, some of these questions are vague and even the more succinct ones need extensive elaboration before they can be operationalized to provide more robust empirical agendas. One of the most puzzling issues deals with the relationship between networks, network creation/evolution and network outcomes. Their relationship is complex and certainly not unilateral. Networks are created, strengthened or even born as a result of positive outcomes of networking. Networks existence is a prerequisite for their evolution. Crafting propositions and/or hypotheses for empirical testing might suffer from difficulties in simplifying the relationships between the reasons for networks, network characteristics and network outcomes.

References


