Research Memo

Recent analysis indicates that the convergence of rich and poor countries could take over 100 years, as opposed to previous predictions of 50 years, due to a return to tepid economic growth in emerging and frontier markets (Economist: Briefing, 2014). Postponed convergence of rich and poor countries is not only bad news for the developing world, but for OECD countries as well. Research has made clear that Economic growth in emerging and frontier markets is critical to the vitality of companies and economies in the developed world as well (Lawrence et al., 2013). Given that family owned businesses account for 70% to 90% of annual global GDP growth, and given that researchers have documented the propensity for most of these enterprises to stagnate, understanding the interactions between the institution of the family and business organizations will be critical for developing solutions to increase long-term economic growth in these underdeveloped areas (European Family Businesses, 2012; Miller et al., 2007). Neglecting family influence in theories for business growth in emerging markets would seriously limit the theory’s generalizability and applicability (Dyer, 2003).

Historically, economic production has been a central responsibility of family systems. However, many scholars predicted the demise of family-driven economic production in favor of rational public organizations owned by diverse shareholders, and run by professional managers (Aldrich and Reuf, 2006; Ryder, 2015b). While public corporations have made great advances, it is still limited to the Anglo-Saxon world, with the family enterprise persisting as the primary organizational form for economic ventures (La Porta et al., 1999; Georgas, 2003; Ryder, 2015). One basic assumption in economic theory is that inefficient forms of enterprise are eliminated by competition. Likewise, organizational theory posits that the prevalence of an organizational form is explained by that form’s fit with its environment. When evaluated by these standards, the family business appears to be an organizational form that is both highly efficient and remarkably persistent. However, there continues to be a notable absence of research that explains the “prevalence, prominence, or even existence of this economic institution” (Schulze and Gedajlovic, 2010; see also Begin and Fayolle, 2014).

Schumpeter’s economic model for explaining economic development postulates that two actors constitute the central forces of change within an economic system: the entrepreneur and an actor who assumes the risk of the entrepreneur’s innovations. Within this model, it is supposed that banking institutions are the social actor that assumes the risk for innovations until they hit the market (Schumpeter, 1934). However, evidence suggests that the family institution is the social actor which most often assumes the risk of entrepreneurship. According to the Family Firm Institute, 85% of new ventures are financed using family money (European Family Business, 2012). Furthermore, in the United States, “family owners risked over US$86 trillion in family assets - not business assets- for the sake of their businesses” in 1996 (Olson et al., 2003). Family-business interaction is not limited to small and medium sized enterprises. In fact, 33% of American companies with $1 billion or more in revenues are family companies (Ryder, 2015). The aforementioned descriptive statistics suggests that, contrary to Schumpeterian theory, the family institution is still the primary social actor which assumes the risk for new venture formation in both developed and emerging economies.

The discrepancy leads to the question: Does the family’s assumption of risk lead to better performance than the assumption of risk by banks or other social actors? It is widely held by
scholars that family businesses are risk averse, but it has still not been determined whether risk aversion helps or hinders the financial performance of firms (Carney et al. 2013; Mishra & McConaughy, 1999; Anderson et al., 2003). One view argues that an underleveraged capital structure could prohibit the new organization from seizing future opportunities (Carney, 2013; Mishra & McConaughy, 1999). In this case, family assumption of risk could hurt the performance of the firm due to the owning family pushing to pursue a more conservative strategy. However, the stewardship perspective postulates that a highly leveraged capital structure negatively affects financial performance because executives are focused on meeting short-term goals as opposed to focusing on maximizing long-term value (Smith & Warner, 1979). In this view, the assumption of risk by banks could hurt new venture performance due to pressure to meet short-term goals. Evidence has shown that the potential superior performance of family enterprises in comparison to non-family enterprises varies across European countries, and that the family enterprise remains a highly prevalent economic institution despite performance differences across contexts (Carney et al., 2013).

Another central argument for the persistence of the family enterprise in the developing context is that developing nations often have underdeveloped legal contexts making the family institution the only viable alternative for facilitating venture survival and economic exchange (Gilson, 2007). However, institutional prevalence may also be due to the appropriateness of the practice. Oft times, inefficient, or seemingly irrational, practice may persist in a society because a society’s belief system may deem the practice more appropriate than other more efficient counter parts (Scott, 2007). In the case of the family enterprise, it could be that the high familial obligations that are characteristic of families in Eastern nations make the family enterprise the most appropriate organizational form despite possibly being less efficient. Finally, institutional prevalence may also be due to practices becoming taken-for-granted social realities. In such a case, the practice becomes almost a subconscious act that is undertaken without conscious thought as to the utility or the appropriateness of the action (Scott, 2007). In either case, institutional prevalence due to appropriateness or due to taken-for-grantedness constitute viable explanations for the prevalence and persistence of the family enterprise despite its possible inefficiency as an organizational form in certain contexts. Written formally, the question guiding our current research is:

1. Which institutional actors are more likely to assume the risks of new venture formation in emerging markets?
   a. Which private business type (family or non-family) is more likely to fail? Why?
   b. Are reasons for failure of private family firms significantly different than the reasons of non-family private firms?

References


Begin, Lucie and Alain Fayolle. 2014. Family Entrepreneurship: What we know, what we need to know, in Fayolle, Alain, ed. Handbook of Research on Entrepreneurship, What We Know and What We Need to Know. Edward Elgar Publishing: Cheltenham: UK.


