FAMILY BUSINESS GOVERNANCE STRUCTURES:
INCIDENCE AND EFFECTS

E. Alan Hartman
College of Business
University of Wisconsin Oshkosh
Oshkosh, WI 54901
FAX: 920-424-7413
TEL: 920-424-3441
Email: Hartman@uwosh.edu

Susan Schierstedt
Director, Wisconsin Family Business Forum
College of Business
University of Wisconsin Oshkosh
Oshkosh, WI 54901
FAX: 920-424-7413
TEL: 920-424-2257
Email: Schierss@uwosh.edu

Donald Gudmundson
Monfort College of Business
Campus Box 128
Kepner Hall 2053B
Northern Colorado University
Greeley, CO 80639
TEL: 970-351-2764
Email: Donald.Gudmundson@unco.edu

Abstract

The research focused on governance systems in family businesses and was based on survey data from 241 organizations. Analyses found 25 percent of the family businesses had no structured system and 75 percent had governance systems comprised of one or more of the following: boards of directors, advisory boards, and/or family meetings. Types of systems were related to desirable outcomes identified as revenue generation, family business continuity, and family/business planning. A key finding was that family businesses that had some type of a formal structure had a higher level of planning that led to higher revenues. The existence of either a board of directors or an advisory board was positively related to transitioning businesses to later generations. Implications for family businesses are discussed.

Key words: family business governance, boards of directors, family meetings.
INTRODUCTION

Governance issues in business organizations have received much attention in the last few years due to various scandals and the subsequent changes in US regulations related to financial reporting practices (Oswald, Muse & Rutherford, 2009). Although family firms have different governance needs than publicly traded firms, they still use some form of organization governance (Ward, 2003; Jara-Bertin, Lopez-Iturriaga and Lopez-de-Foronda, 2008; Voordeckers, Van Gils and Van den Heuvel, 2007). In non-family firms, “the governance role centers on corporate oversight on behalf of the shareholders and other stakeholders, maintaining managerial accountability, and ratification of strategic plans and investment proposals (Blumentritt 2006, p.66). Authors suggest that “Family ownership concentrates control and facilitates decision making, which can both lower governance costs and permit unconventional but strategically advantageous decisions” (Ward and Leif 2005, p. 1). This study examines family business governance structures and attempts to answer the following questions: What types of governance structures do family businesses utilize (for example, formal board of directors, advisory boards, family meetings)? If the roles, relationships and needs are different for family businesses, what forms of governance effectively address management practices such as planning and business performance?

Family business boards

Ownership separates governance systems in family owned businesses from governance systems in publicly owned firms. In family businesses, boards are just one partner in a complex governance process, rather than the dominant player. Research suggests that the majority of family businesses operate without boards or with boards serving as largely unused appendages (Pervin, 2001).

Research on boards in family businesses is limited, but some empirical studies have been conducted. In a preliminary study regarding the structure and management of family boards, Ward and Handy (1988) concluded that the CEOs of family firms with outside directors rated those boards as considerably more valuable than did the CEOs of companies with boards limited to insiders.

Another study conducted by Whisler (1988) found that “threshold” sized family firms with outside directors grew faster than similar firms without outside directors.

Ford (1988) reported the results of his study on tightly held firms, most of which probably could be classified as family businesses. He concluded that outside directors were neither as influential nor as effective as the other studies indicated.

The most comprehensive empirical data gathered on family businesses occurred in a series of studies entitled “American Family Business Survey,” during 1995 (Arthur Anderson & Co.), 1997 (Arthur Anderson/Mass Mutual), and 2003 (Mass Mutual Financial Group/Raymond Institute). These studies intended to provide an empirical overview of key aspects of family businesses in America. The 1995 and 1997 surveys included responses from over 3,000 family businesses, and the 2003 survey included responses from nearly 1,200 family firms. The results of the studies appear to be fairly consistent over time, indicating that family boards in general, although widely perceived to be valuable (roughly 60 percent were viewed as providing “good” or “out-
standing” value), meet relatively infrequently and provide no, or only modest, compensation to board members. Thus, it appears the role of boards in family businesses is limited. Although many of the writings summarized above discuss the potential contributions of boards, and particularly boards with outsiders, family businesses appear reticent to utilize boards heavily.

Much of the research on boards of directors for family businesses has attempted to assess their value using CEOs’ perceptions. Although CEOs’ perceptions about value are important, several related issues need to be explored. For instance, do boards have a direct impact on revenues or is the impact more indirect? Boards can play an important role in many arenas that could indirectly impact revenues such as encouraging several aspects of planning.

Blumentritt (2006), after arguing that a positive relationship should exist between the existence of a board of directors and planning, failed to find much support for this relationship. The results found weak support for a link between strategic planning and the existence of a formal board, and failed to find a relationship between succession planning and the existence of a formal board. However, the results did suggest that there was a relationship between the existence of advisory boards and both strategic planning and succession planning. The research isn’t clear on whether relationships exist between boards and various types of planning.

Boards in family business governance systems differ from boards in publicly held firms in both their basic functions and their operating complexity, and in roles that they play. These differences are driven by the fact that family firms are different than other businesses and impose special demands because of the need to consider a number of family issues (for example, family values, family financial matters, family members’ business participation) in board thinking and decision-making. There needs to be a mechanism for identifying key family issues, generating family consensus regarding those issues, and communicating the family stance on those issues to the organization in the form of a mandate (Pervin 2001; Aronoff and Astrachan 1997; Poza 2003). In well-developed family business governance systems, this mechanism often is referred to as the family council or family meeting.

**Family meetings**

Family meetings are “…periodic gatherings (that) bring the family together to share goals and decisions, discuss common problems, learn about the business, and preserve family identity, values and traditions” (Aronoff and Ward 1992, p.3). Aronoff and Ward (1992) emphatically stated that these family gatherings can help build both a stronger family and a stronger business, and that they believe “…family meetings are one of the two most important steps a business owner can take to ensure the continuity of the family business” (p.3).

These thoughts followed Ward’s (1987) discussion of his study of successful family businesses, in which he identified three principles that appeared to guide such companies: a commitment to the future, a system of extensive communication, and conscientious planning. The family meeting was viewed as the key vehicle for implementing these principles.
Although there is logic to claiming that family meetings are a key to family business success, there has been little empirical research that demonstrates the value of family business meetings or that identifies under what conditions they are valuable.

Only one of the three most comprehensive empirical data gathering surveys (Arthur Anderson & Co. 1995; Arthur Anderson/Mass Mutual 1997; Mass Mutual Financial Group/Raymond Institute 2003) in the series entitled “American Family Business Survey” had any questions regarding family business meetings. That study, in 1995, found 32 percent of family businesses held formal family meetings. Of those that held such meetings, 91.4 percent discussed business, 52 percent discussed ownership, and 49 percent discussed non-business topics. Those were the limited findings. Outcomes from having a meeting, or from the issues discussed, were not examined in the study.

A more limited study by Astrachan and Kolenko (1994) found 51 percent of the family businesses they surveyed hold regularly scheduled family meetings limited to family members in the business. Further, their research found that firms with governance practices that included strategic plans, boards of directors, and family meetings were related to business longevity, and with firm revenues to a lesser degree. Family meetings were not broken out as a separate item in the correlations, so it is not possible to determine if one of these practices, or a combination of them, is related to longevity.

In a more focused study on the way family meetings impact family business, Habbershon and Astrachan (1997) built a model to show how family meetings develop family unity through creating perceived shared beliefs regarding goals that may be an important stimulant of collective family activity focused on actions to achieve those goals. The study keyed on the theoretical model and on the ability of instruments to measure perceived agreement and not on empirical measurements of relating family meetings to outcomes.

The limited research on family meetings has not directly examined the relationship between the existence of family meetings and the level of strategic planning activities or the relationship between the existence of family meetings and organizational performance. This study examines these relationships.

**Theoretical framework**

While much has been written individually about boards of directors, family meetings and their desirability as a key element of any business, little empirical research has been conducted to demonstrate that this is so. Some of the research (e.g., Astrachan and Kolenko, 1994) suggests that the influence of these governance systems may happen indirectly through better management practices such as planning. While others suggest that the effect is more direct (Aronoff and Ward, 1992) by building a common sense of purpose for the family. Figure 1 shows the framework used in the present study to evaluate the direct and indirect effects of governance systems on family business performance. Business performance is defined in two ways: revenue generated and longevity of the family business.
Figure 1. Family Business Governance - Performance Theoretical Framework.

METHOD

Sample

A survey concerning family business governance was sent to 926 family businesses in a midwestern state. These were all of the businesses in the state that had been identified as being family owned and large enough to justify having governance structures (i.e., more than 9 employees). Of those 926 businesses, 244 returned surveys. Respondents were asked if the business was a family business; if they were not, they were dropped from the sample. Only three such businesses were identified, thus reducing the sample to 241, for a response rate of 26 percent.

Survey

The initial set of questions focused on the characteristics of the business, including revenue and the generation that currently controls the business. A second set of questions focused on business and family planning activities. The final set of questions focused on governance of the family business by asking about the existence of an informal board of advisors, existence of a formal board of directors, characteristics of the formal board, existence of family meetings, and characteristics of the meetings: business issues discussed, attendees, decisions made.
Table 1. Descriptive statistics and variable names for all variables used in analyses.

<table>
<thead>
<tr>
<th>Variable Definition</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age of company</td>
<td>52.49</td>
<td>28.85</td>
<td>212</td>
</tr>
</tbody>
</table>

**Outcomes**

<table>
<thead>
<tr>
<th>Variable Definition</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Generation controlling the business</td>
<td>2.15</td>
<td>.909</td>
<td>241</td>
</tr>
<tr>
<td>Revenue</td>
<td>3.50</td>
<td>1.740</td>
<td>238</td>
</tr>
</tbody>
</table>

**Planning**

<table>
<thead>
<tr>
<th>Variable Definition</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Have a written estate plan</td>
<td>0.66</td>
<td>0.474</td>
<td>216</td>
</tr>
<tr>
<td>Have a formal business mission statement</td>
<td>0.61</td>
<td>0.489</td>
<td>222</td>
</tr>
<tr>
<td>Have a written succession plan</td>
<td>0.33</td>
<td>0.472</td>
<td>217</td>
</tr>
<tr>
<td>Have a written family mission statement</td>
<td>0.12</td>
<td>0.325</td>
<td>218</td>
</tr>
</tbody>
</table>

**Governance**

<table>
<thead>
<tr>
<th>Variable Definition</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Have a formal board of directors</td>
<td>0.55</td>
<td>0.499</td>
<td>240</td>
</tr>
<tr>
<td>Have an informal advisory board</td>
<td>0.25</td>
<td>0.436</td>
<td>241</td>
</tr>
<tr>
<td>Hold formal family meetings</td>
<td>0.33</td>
<td>0.470</td>
<td>235</td>
</tr>
</tbody>
</table>

**Board of Directors’ Characteristics**

<table>
<thead>
<tr>
<th>Variable Definition</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of board outside family/business</td>
<td>17.07</td>
<td>25.901</td>
<td>132</td>
</tr>
<tr>
<td>Compensation of outside board members</td>
<td>2.24</td>
<td>1.140</td>
<td>58</td>
</tr>
<tr>
<td>Compensation of family board members</td>
<td>2.05</td>
<td>1.201</td>
<td>148</td>
</tr>
<tr>
<td>Number of formal board meetings per year</td>
<td>2.28</td>
<td>1.076</td>
<td>156</td>
</tr>
</tbody>
</table>

Descriptive Statistics

Table 1 summarizes the descriptive statistics for all of the variables. As seen in Table 1, the average company is in its second generation. Of the family businesses, 55 percent have a formal board of directors and 25 percent have an informal advisory board, but only 17 percent of the board members are outside of the family.

---

1 Actual generation, first = 1, second = 2, etc.
2 Coded 1=$0-$999,999, 2=$1Mil - $4Mil, 3=$5Mil - $9Mil, 4=$10Mil - $24Mil, 5=$25Mil - $49Mil, 6=$50Mil – $99Mil, 7=$100Mil - $199Mil, 8 = $200Mil or more
3 Coded yes=1, no=0
4 Coded 0 = 0, 1=$1-$999, 2=$1000-$4999, 3=$5000-$9999, 4=$10,000 or more
RESULTS

The following sections answer several questions related to governance. Table 2 summarizes the questions and analyses performed to answer these questions.

Table 2. Summary of questions asked and analyses performed.

<table>
<thead>
<tr>
<th>Question</th>
<th>Variables</th>
<th>Analyses</th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the most frequently used governance techniques?</td>
<td>Formal Boards, Advisory Boards, Family Meetings</td>
<td>Frequency (See Table 1)</td>
</tr>
<tr>
<td>What are the most frequently used combinations of governance techniques?</td>
<td>Formal Boards, Advisory Boards, Family Meetings</td>
<td>Venn Diagram and Chi Square Analysis</td>
</tr>
</tbody>
</table>

Most frequently used combinations of governance techniques

The first analyses were performed to obtain an understanding of the use of governance techniques of informal boards, formal boards and family meetings in conjunction with each other by conducting basic cross tabulations of formal boards, advisory boards and family meetings. The Venn diagram in Figure 2 graphically shows the combinations of governance techniques. The most frequent combination is having a formal board, no advisory board and no family meetings. The second most frequent is having no governance structure at all, but five percent of family businesses reported having all three governance structures.

Figure 2. Percentage of Family Businesses with Various Combinations of Small
Business Governance Structures.

To test if the pattern of structures was uniform, a Chi Square analysis was performed. Table 3 presents the frequency in each cell along with standardized residuals. The overall Chi Square analysis was significant (Chi Square = 27.44 (6), p < .001), which indicates the pattern of governance varies across the three structures. The standardized residuals identify individual cells that contribute to the significant effect (absolute numbers greater than two). To identify the specific variables that contribute to the significant effect, six Chi Square analyses were performed on the six combinations of 2x2 tables generated from these data.

Table 3. Cross tabulation of formal board, advisory board and family meetings.

<table>
<thead>
<tr>
<th>Family Meeting</th>
<th>Formal Board</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Yes</td>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advisory Board</td>
<td>No</td>
<td>58</td>
<td>68</td>
<td>126</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Adjusted Residual</td>
<td>-.1</td>
<td>.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>Count</td>
<td>14</td>
<td>16</td>
<td>30</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Adjusted Residual</td>
<td>.1</td>
<td>-.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>72</td>
<td>84</td>
<td>156</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
<td>15</td>
<td>34</td>
<td>49</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advisory Board</td>
<td>Adjusted Residual</td>
<td>-2.4</td>
<td>2.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>Count</td>
<td>16</td>
<td>11</td>
<td>27</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Adjusted Residual</td>
<td>2.4</td>
<td>-2.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>31</td>
<td>45</td>
<td>76</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Comparing the frequency of Formal Boards by Advisory Boards separately for those that held Family Meetings and those that did not indicated a significant effect only for organizations that held family meetings (Chi Square (1) = 5.92, p < .02). The frequency of formal boards was related to the frequency of advisory boards, but only if they also held family meetings. Having a formal board meant it was less likely that the business would have an advisory board if it also held family meetings. Although it might appear that the key issue is that few organizations had all three (formal, advisory, and family meetings), subsequent analyses do not support this interpretation.

The two 2x2 Chi Square analyses compared frequency of formal boards and family meetings separately for those that had an informal board and those that did not, and those comparisons produced no significant effects. The final two Chi Square analyses compared the joint frequency of advisory boards and family meetings separately for existence of a formal board or not. The results indicated that there were no differences in the two x two table for existence of a formal board (in this case, the frequency of having all three governance structures was not significantly different from the other frequencies when organizations had a formal board). If there was no formal board, it was much more likely that organizations with an advisory board also held family meetings. Apparently having both an advisory board and family meetings performs some of the functions of a formal board. Given that 83 percent of the members of formal boards are family members, that result is not surprising.
Governance techniques related to planning and organizational performance

The four planning variables (existence of succession plan, estate plan, family mission, and business mission) were combined into a single variable of Planning Intensity with a maximum score of four and a minimum of zero (Mean = 1.72 and Standard Deviation = 1.08). Table 4 displays the correlations between governance and Planning Intensity, Revenue and Generations. The correlations show that having a formal board of directors was related to Revenue and Generations, and all three governance structures were related to Planning Intensity.

Table 4. Correlations between governance structures, planning and performance.

<table>
<thead>
<tr>
<th>Governance</th>
<th>Planning Intensity</th>
<th>Revenue</th>
<th>Generations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board of Directors</td>
<td>.125</td>
<td>.123</td>
<td>.273***</td>
</tr>
<tr>
<td>Board of Advisors</td>
<td>.258***</td>
<td>.065</td>
<td>.056</td>
</tr>
<tr>
<td>Family Meeting</td>
<td>.250***</td>
<td>.100</td>
<td>-.076</td>
</tr>
</tbody>
</table>

*** p < .001  ** p < .01  * p < .05

The theoretical framework presented in Figure 1 was tested with regression analyses. For each performance measure (revenue and generations), two regressions were performed, one to test the direct effects of the three governance structures and one to test the indirect effects with a direct effect of Planning Intensity. (A final regression for each performance measure tested the governance effects after the effect of age of the business was removed. The results of these analyses reinforced the results of the first two regression analyses, hence they are not reported.)

Figure 3 summarizes the results of the regression analyses. The first number on each line is the Beta Weight from the first regression analysis (direct effects of governance without other variables removed). For Revenue and Generations, the number in parentheses is the Beta Weight from the second regression with the effect of Planning Intensity removed. The numbers below the last line in each combination are the multiple correlations for each regression (direct and with Planning Intensity included). If governance has a direct impact on revenue and generation without Planning Intensity being an intervening variable, then the two Beta Weights on each line should be roughly the same.

www.jyu.fi/econ/ejfbs
As the figure displays, all of the governance structures were positively related to Planning Intensity, with a multiple correlation of .36. Revenue had a positive correlation with formal board, but that effect disappeared after Planning Intensity was added to the equation. Planning Intensity was consistently related to revenue even when age with Outcomes.

**Figure 3. Beta Weights**\(^5\) for Governance Structures and Multiple Correlations\(^6\) with Outcomes.

---

\(^5\) *Beta weights* outside parentheses are from regression without Planning Intensity as a predictor, and *Beta weights* inside parentheses are from regression with Planning Intensity as a predictor.

\(^6\) *MC = multiple correlation*
of the company is considered. Although governance structures are not directly related to revenue, they are positively related to planning, which is consistently and directly related to revenue, hence governance has an indirect effect on revenue.

The results for generation that currently runs the business were dramatically different. Having a formal board showed a direct and consistent relationship with successfully transitioning to a later generation, while planning had no relationship. When Planning Intensity was included as a predictor, informal boards had a significant Beta Weight, hence having both a formal board and an informal advisory board were related to the business being run by a later generation.

Table 5. Summary of questions asked and answers.

<table>
<thead>
<tr>
<th>Question</th>
<th>Result</th>
</tr>
</thead>
</table>
| What are the most frequently used governance techniques? | Formal Board (55 percent)  
Family Meeting (33 percent)  
Informal Board (25 percent) |
| What are the most frequently used combinations of governance techniques? | Formal Board alone was most frequent (29 percent).  
No governance was second (25 percent).  
Formal board and family meetings was third (15 percent). |
| Are governance techniques related to planning and performance? | Governance structures were directly related to planning.  
Governance structures were indirectly related to higher revenue and directly related to later generations leading the business. |

Implications

Family businesses often do not have a formal governance structure for either the business or the family; however, those that do have one engage in more planning activities, which is related to revenue. Governance structures are related to successfully transitioning to later generations, even when the effect of age of the company is removed. Family meetings showed a relationship only with planning activities, but not to any of the performance measures, directly or indirectly.

DISCUSSION

In family businesses, governance systems are necessary to manage and govern the complex combination of family and business interests. Given the difficulty of governing the complex overlapping of family and business systems, it’s not surprising to find a great deal of variance in the forms of governance structures that have evolved over time in family businesses. This paper focused on identifying those forms and examining the relationship between the forms and desired outcomes relating to revenue generation, organizational continuity over time, and planning activities in family businesses.

The research found 75 percent of governance systems in family businesses are comprised of one or more of the following: boards of directors, informal advisory boards, and/or family meetings (sometimes more formally referred to as family councils). The most common of these was having a board of directors (55 percent), followed by family meetings (35 percent) and informal advisory boards (17 percent).
In examining the combinations of types of units in governance systems, widespread variability is found with each of the seven possible combinations having at least some family businesses reporting they used that combination. The most frequent combination was a board of directors, no advisory board and no family meetings. This type of system was found in only 29 percent of family businesses. Fifteen percent of the sample combined a board of directors with family meetings, and all other possible combinations were utilized in seven percent or less of family businesses. The conclusion is that there is no dominant governance structure for family businesses hence determining which system is related to the two performance measures may help identify the governance structure that should be chosen.

The adopted framework proposed both direct and indirect effects of each of the three governance structures. In examining the relationships of forms of governance structures to planning and organizational performance, a number of interesting results were found that have implications for governance systems in family businesses. The two key findings were that family businesses that had some form of governance structure had a higher level of planning activity, and that effort was positively related to higher levels of revenue generation. The effect on revenue was indirect for both types of boards but both direct and indirect for Family Meetings. As proposed by Habbershon and Astrachan (1997) family meetings can be focused on establishing goals for the family which is engaging in planning. It appears that the activities of the two types of boards do not include planning hence the indirect effect through the planning process. The boards may encourage the family business to engage in planning but the board itself does not do so. Family meetings may well help spur planning for the business as well as its own planning having an impact on revenues.

Astrachan and Kolenko (1994) found that there was a direct effect of some governance on longevity but they couldn’t determine which of the governance systems was related to longevity. The results in our study showed that successfully transitioning family businesses to later generations was related directly to having a board of directors or an advisory board. Holding family meetings had neither a direct nor indirect effect on transitioning to later generations. This may well be due to the focus of family meetings on internal family issues and not on succession plans which are more likely within the domain of the business governance system.

Further research focusing on the activities of business governance (boards of directors and advisory boards), the focus of the meetings and who participates will help us understand what contributes to successful transitions to subsequent generations. Some examination of family meeting activities may also show why they produce an indirect relationship to revenue.

The key conclusion is that there are key benefits to having some form of structured governance system in a family business, although which combination is best remains open. The optimal form of governance system is probably somewhat dependent on the goals of a specific family business and requires further investigation relating forms of governance to more specific goals. Further, there is the need for research to identify other factors (for example, respective roles of family members other than the owner/manager, the role of outside advisors and board members, the specific operating processes of the individual units making up the governance systems) that might further impact the alternative governance structures on the achievement of specific family and business goals.
REFERENCES


