Top Management Teams in Family-Controlled Companies: 'Familiness', 'Faultlines', and Their Impact on Financial Performance

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ABSTRACT   This article examines the affect of family management on performance of the company. We examine how familiness can provide further insights beyond the classical demographic measures of top management teams (TMTs) in explaining variations in firms' financial performance. We combine arguments on the 'bright' and 'dark' side of family involvement in the firm; we complement positive predictions on family involvement with negative predictions and develop family firm-specific measures of TMTs' familiness. Results indicate that while the presence of a family CEO is beneficial for firm performance, the coexistence of 'factions' in family and non-family managers within the TMT has the potential to create schisms among the subgroups and consequently hurt firm performance. We find support for a hypothesized U-shaped relationship between the ratio of family members in the TMT and firm performance. Additional evidence related to interactions between firm listing and CEO type on firm performance is then presented and discussed.

INTRODUCTION

Within family business literature there exist both theoretical discussions of agency relationships and empirical search for evidence on how agency costs may affect corporate financial performance of family-controlled firms (Chrisman et al., 2004). While Jensen and Meckling (1976) argue that concentrated ownership reduces agency costs, other scholars observe that private ownership and owner-management expose highly concentrated firms to agency threats that the Jensen and Meckling model ignores (Schulze et al., 2001). Other researchers emphasize the unique benefits that family involvement may provide to the firm (Habbershon and Williams, 1999). Scholars identify competing approaches grounded in two dominant paradigms in the mainstream managerial literature (Chua et al., 2003b). The first approach draws on agency theory, and uses this paradigm to posit a 'dark side' of family ownership, placing emphasis on the risks of

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'agency transfers' within the family unit (Lubatkin et al., 2005; Schulze et al., 2002, 2003). The second approach draws on the resource-based view of the firm. It posits a 'bright side' of family ownership and management through the 'familiness' concept (Habbershon and Williams, 1999; Habbershon et al., 2003), which says that family firms differ from non-family for the unique resources and capabilities they develop. Such approach also looks at how such idiosyncratic resources may generate abnormal financial returns for the family firm (Habbershon et al., 2003). A third approach suggests that altruism and consequences of altruism (i.e. the Samaritan dilemma) complicate decision-making in family firms (Schulze et al., 2001). They argue that altruism, in which family management favours decisions that enhance the firm's profits, fundamentally character-izes a family firm because the utility functions of key decision makers are linked, thereby influencing the incentives facing these key decision makers. Based on this research, one can conclude that if altruism is tempered and the consequences of joint utility are well managed, agency cost can be greatly reduced and thus lead to superior firm perfor-mance. This ongoing debate on the advantages and disadvantages associated with family ownership and management has led scholars to devote increasing attention to firm outcomes as a way to further understand the relationships between family characteristics and firm financial performance (e.g. Anderson and Reeb, 2003; Villalonga and Amit, 2006).

This article builds on past research and attempts to explain the financial outcomes of family-controlled firms by incorporating an upper echelon perspective (Finkelstein et al., 2008; Hambrick and Mason, 1984). We do so by combining insights from two strains of literature. First, we look at the strategic management literature that argues that some of firm performance is a reflection of its top management team (TMT) (Hambrick and Mason, 1984). Second, we incorporate insights from the family business literature that addresses questions of how family involvement in the firm contributes to its financial outcomes. The reason we chose to combine strategic management research with family business literature, and particularly with the upper echelon perspective, is because of two major shortcomings in past research.

First, family business literature overlooks the importance of family top executives, with the exception of a recent study by Ensley and Pearson (2005) that recognizes the significance of the level of 'familiness' of the TMTs, defined as the level of family involvement within the group of top executives in family firms. Second, the upper echelon research focuses mostly on large public companies and fails to explore firms with highly concentrated ownership. These two shortcomings fail to address the predictive power of TMTs' characteristics on the performance of medium and large family-controlled firms, which often combine the distinctive features of large public companies with the typical traits of family firms, such as family involvement (Miller and Le Breton-Miller, 2006).

We aim to assess whether family involvement in the TMT, and thus the TMT familiness, helps explain variations in firm performance. More specifically, we explore whether or not 'faultlines' (first elucidated by Lau and Murnighan, 1998), apply in the setting of family-controlled firms. We investigate whether familiness contributes to fac-tional tensions and consequent faultlines, which then influence firm performance. We argue that familiness sets up family and non-family factions in the TMT, and creates divides that impact performance.

THEORETICAL BACKGROUND

TMTs' Familiness, Family Involvement, and the Upper Echelon Perspective

Habbershon et al. (2003) discuss firm familiness as the 'firm level bundle of resources and capabilities resulting from the system interactions' (Habbershon et al., 2003, p. 452). Firm familiness is the advantage that firms derive from their controlling families in terms of unique or distinctive resources and capabilities that lead to advantage-based rents (Habbershon et al., 2003). Recent theoretical developments extend social capital theory to the familiness construct (Arregle et al., 2007), and explore how unique resources and capabilities of family firms are created through the interaction between the family and the firm (Pearson et al., 2008; Sharma, 2008). Although familiness is difficult to capture empirically, differences among family and non-family firms are often explored by considering family involvement in top managerial positions (Anderson and Reeb, 2003; Villalonga and Amit, 2006). There are two components to this involvement: whether the CEO is or is not a family member, and the degree of participation of family members in the TMT. We examine both facets, adopting the approach of Ensley and Pearson (2005), and consider the level of familiness in TMTs to be determined by the proportion of family members in the upper echelons of the firm.

The upper echelon perspective suggests that organizational outcomes can be predicted by certain managerial demographics such as age, gender, education, functional background, and tenure in the office (Hambrick and Mason, 1984). Though demographic characteristics cannot accurately capture the processes inside teams and among individuals (Pettigrew, 1992), most research on top executives and strategic leadership focuses on these attributes because it is difficult to accurately measure managerial values and cognitive attitudes (Finkelstein and Hambrick, 1996). Using the upper echelon perspective on familiness in top management teams casts additional light on the financial performance of family-controlled firms.

Upper echelon research generally focuses on the entire group of top executives as the appropriate level of analysis, and thus implicitly assumes an even distribution of power within the elite echelon of corporate actors (Dalton and Dalton, 2005). There is however, research supporting the argument that group characteristics are relatively less important than characteristics of its leader, i.e. the CEO (Cannella and Holcomb, 2005). This applies particularly to family-controlled firms, where a family CEO exerts a strong leadership influence on corporate decisions and outcomes. We therefore use a multi-level analysis of familiness and consider both the family business leadership (i.e. the presence or not of a family CEO) as well as the degree of presence of family members inside the TMTs.

The 'Bright Side' of Family Involvement

The CEO is generally regarded as the most important and powerful organizational actor. The CEO is the executive who has the overall responsibility for the conduct and performance of the entire organization (Finkelstein and Hambrick, 1996). Besides leading and directing the classical tasks of planning, organizing, coordinating, command-

ing, and controlling (Fayol, 1949), the CEO has three important additional tasks. First, the CEO is the charismatic representative of the organization (Fanelli and Misangyi, 2006). Second, the CEO is the leader of the TMT (Wu et al., 2005) and dominates the distribution of responsibilities and tasks within the team itself (Haleblian and Finkelstein, 1993). Third, CEO dominance provides the family CEO with both means and motive to behave 'altruistically.' Altruism is 'a moral value that motivates individuals to undertake actions that benefit others without any expectation of external reward' (Schulze et al., 2002, p. 252). Schulze et al. (2001, 2002, 2003), suggest that in this vein the family CEO will make decisions that favour profits and profitability for their family firm and thus benefit their family.

CEO dominance inside the organization, and especially within the TMT, is likely to be higher for family CEOs than for external appointees. So compared to non-family outside professionals, family CEOs manifest in fewer short-sighted acquisitions and downsizing decisions, and undertake more long-term R&D and capital expenditures, and thus develop more distinctive capabilities that produce higher financial results (Miller and Le Breton-Miller, 2006). This approach emphasizes the positive aspects of kinship relationships, and considers altruism as a family firm-specific resource with the potential to impact on family firm performance (Eddleston et al., 2008). As such, the altruistic behaviour of the family CEO will lead to inexorable profit growth as the CEO supports family profits whenever the trade-off between profits for the family and alternative outcomes is a close marginal call. These arguments are largely corroborated by recent research that provides consistent support around the idea that family leadership is strongly associated with financial performance (Anderson and Reeb, 2003; Villalonga and Amit, 2006). Evidence from these studies shows that familiness in firm leadership has a positive impact on performance. It is correlated to the strong commitment organizational leaders have to the firm they own. It also follows the classical arguments from agency theory, according to which the family relationships between top managers and owners may reduce agency costs and increase long-term incentives for top managers, primarily for CEOs (McConaughy, 2000). Hence:

> *Hypothesis 1*: There is a positive relationship between the presence of a family CEO and financial performance of the family firm.

The 'Dark Side' of Family Involvement

Lubatkin et al. (2005) propose a 'dark side' for the family relationships within the firm. They argue that family firms are theoretically distinct from private firms since agency relationships in family firms are highly influenced by family bonds, which in time may adversely affect the ability of the firm's owner-managers to exercise self control (Lubatkin et al., 2005). Family members within the TMTs of family-controlled firms have a potential to enhance rather than reduce the agency threats as well as subvert the CEO's altruism to their personal ends. While one would expect family members to be motivated to act in the best interest of the firm, idiosyncratic familial bonds create concrete incentives to behave opportunistically (moral hazard). Such moral hazards include free riding and shirking. In fact, research has shown that family members seek additional

compensation in the form of perquisites or through non-pecuniary rewards, such as withholding of information, misappropriation of firm resources, or simply reducing the efforts in the job (Lubatkin et al., 2005).

We now shift attention from the family CEO to the Family Ratio in the TMT, or the ratio of family members to outsiders on the TMT. We adopt an agency cost approach and hypothesize that the increase in family involvement, and thus increasing TMT familiness within the upper echelon, potentially enhances the misappropriation by family top executives and draws resources from the firm. Further, according to Schulze et al. (2001), if altruism in the family firm is not tempered and/or if other altruism-related dysfunctional conditions arise, this can become harmful. Hence:

> *Hypothesis 2a*: There is a negative relationship between the ratio of family members in the TMT and financial performance of the family firm.

An alternative argument from that of the agency cost approach is the group dynamics perspective, which considers the effect of specific 'divides' and 'schisms' that occur when both family and non-family members comprise the top management team. These arguments derive from the literature on TMT heterogeneity, which is both a positive and a negative predictor of firm financial performance without conclusive results (Certo et al., 2006). We label divides and schisms inside TMT as 'faultlines', along the lines developed by Lau and Murnighan (1998), who argue that people can be divided into subgroups based on one or more group attributes. They invoke the analogy of geological faults to illustrate how dissimilarities determined by team members' demographic or cognitive attributes create divides similar to the 'fractures in the earth's crust' (Lau and Murnighan, 1998, p. 328). Basic demographic faultlines can be gender divides between male and female subgroups, or educational divides, e.g. lawyers and engineer subgroups. Composite faultlines are concurrent divides among several patterns of basic attributes. Using the above example, schisms can occur between, say young female lawyer and old male engineer subgroups, which comprise gender, age, and education attributes concurrently (Barkema and Shvyrkov, 2007). The main argument related to faultlines is that the presence of such divides inside groups or teams can provoke subgroup conflicts that harm the group tasks' effectiveness (Lau and Murnighan, 1998). Since firm performance within the upper echelon frame is a reflection of the TMT's characteristics and task performance, such divides should have a negative impact on the firm's ability to perform. Along these lines, we follow the idea developed by Li and Hambrick (2005) that suggests faultlines occur when 'factional' groups pre-exist: groups where the 'members are representatives, or delegates, from a small number of (often just two) social entities, and are aware of, and find salience in, their delegate status' (Li and Hambrick, 2005, p. 794).

In the case of family firms, the most evident TMT divide is between family and non-family members. Family members share common culture, values, and norms inherited from their parents and relatives, along with a common pattern of education, and usually feel satisfied and rewarded with their occupation in the family firm (Chua et al., 2003a). Family members have a stronger emotional attachment to the firm. Emotional attachment enhances the level of commitment and involvement individuals have towards organizations, since they identify with the organization itself (Sharma and Irving, 2005).

This is not true of non-family managers. They share similar outside professional experiences as those of family members, but possess a common feeling of exclusion from the controlling family.

The group dynamic perspective predicts the emergence of 'schisms', which precipitate behavioural and emotional disagreements and tensions among family and non-family members. We hypothesize that the existence of faultlines among family and non-family top executives leads to behavioural disruptions that consequently hurt firm performance (Li and Hambrick, 2005). When there are few members of one or the other faction, the minority faction has less power to contest decisions. Conflicts and disruptions between family and non-family factions increase as the proportion of both factions increases in the corporate elite. This argues for the existence of a U-shaped relationship: firms with TMTs whose ratio of family to non-family is either high or low will perform better than the firms that have a strong representation of *both* factions. We hypothesize the following alternative hypothesis:

> *Hypothesis 2b*: There is a U-shaped relationship between the ratio of family members in the TMT and firm financial performance, with a faultline occurring when there is a 'balanced' representation of family and non-family managers in the TMT.

Interactions between Family Ratio and the Presence of a Family CEO

Returning to the role of the CEO, familiness in family firms manifests via the presence of a family CEO as well as the presence of other family members in the team. Consider how the presence of a family CEO interacts with the existence of a 'faultline setting', where both family and non-family managers are represented in the upper echelon (Cannella and Holcomb, 2005; Dalton and Dalton, 2005). Although we hypothesized a positive effect of a family CEO *per se*, the presence of a family CEO enhances divides among the family/non-family factions and thereby worsens the negative faultlines effect.

There are three reasons motivating our prediction. First, altruism by family CEOs creates the opportunity for family members to free ride (Schulze et al., 2002). Second, when the CEO of the firm is a family member, non-family managers feel more excluded and identify less with the firm. Since familiness is a key attribute distinguishing family and non-family factions within the TMT, the presence of a family CEO reinforces the schism. Third, the combination of a family CEO with a subgroup of family executives reinforces non-family managers' perceptions of that they have limited career progression opportunities (Chua et al., 2003a). So the presence of a family CEO combined with the presence of family members on the TMT strongly inhibits the perception by non-family top executives of their chances for promotion. The presence of a family CEO exacerbates the tensions created by strong representation of both the family faction and the non-family faction in the TMT. Therefore:

> *Hypothesis 3*: There will be a negative interaction effect between family CEO and Family Ratio – that is, the presence of a family CEO will enhance the U-shaped relationship between performance and Family Ratio.

Effects of Listing

Family control has also been investigated in the context of public listing of family firms (e.g. Anderson and Reeb, 2003; Gomez-Mejia et al., 2003; Villalonga and Amit, 2006). Listing of the firm is relevant to the role of familiness in family firm performance. Unlisted firms are not subject to the regulatory burdens that listed firms experience. The reduction in public and regulatory scrutiny from being unlisted is so profound that many firms are opting to go private, or to spin off private divisions. Family firms should be no different, so we should expect to see superior financial performance for unlisted family firms. Therefore:

Hypothesis 4: Unlisted family firms will outperform listed family firms.

What is the role of familiness in this context? Clearly, in a listed firm, non-family TMT members will have greater incentive and justification for invoking the fiduciary responsibilities and constraints imposed by public listing (Gomez-Mejia et al., 2003). This incentive is a reason and lever to resist attempts by the family members of the team to make marginal decisions in favour of enhanced profitability for the family. Public scrutiny of the firm's affairs acts as a disincentive to family members to nudge ambiguous decisions in favour of family profits. Their ability to invoke fiduciary responsibility tends to strengthen the hand of non-family members compared to family members. It acts as a brake on the power as Family Ratio increases the family firm members' ability to extract agency rents. The Family Ratio increasing the power of family members to extract rents becomes less than that of an equivalent unlisted firm. We expect the difference in performance between unlisted firms and listed firms to increase as the Family Ratio increases. Therefore:

Hypothesis 5: The negative relationship between Family Ratio and firm performance will be stronger for non-listed firms than for listed firms.

Finally, we expect an interaction between family CEO and listing. The reasoning is that the family CEO of an unlisted company is far less subject to the pressures of market and regulatory scrutiny than a non-family CEO in a listed company and will therefore have more leeway and more altruistic motivation to call equivocal decisions in favour of family profits (Miller and Le Breton-Miller, 2006). Hence, we hypothesize the following:

Hypothesis 6: The positive relationship between Family Ratio and firm performance will be stronger for non-listed firms with a family CEO than for listed firms with a family CEO.

METHODS

Sample and Collection of Data

We employed a survey method to collect data. The sample frame for the survey consisted of the top 500 industrial Italian family-controlled firms with respect to revenues, identified from public sources, such as AIDA (Italian Digital Database of Companies) and

Mediobanca R&S. We collected data on the ownership structure through the Consob (Italian Commission for the Stock Exchange) for the listed firms and through AIDA for the non-listed firms. Although there are several possible definitions of the family firm (Westhead and Cowling, 1998), we identify the family control as the power to appoint the board of directors, both directly and through financial holdings. This definition is in line with previous studies, according to which family control can be identified as the fractional equity holding by family members (founding or descendants), which allows ownership control over the company (Anderson and Reeb, 2003; Lee, 2006). Specifically, we consider a firm in family control where the same family owns more than 50 per cent of the shares. The threshold is reduced to 30 per cent for listed companies, which is reasonable given the features of the Italian stock exchange both in terms of average size and average stock ownership (Corbetta and Minichilli, 2006). Having both public and private firms in the same sample in the Italian context is not surprising. This is due to the very small number of public firms (less than 300 in total, including financial firms and high-tech ventures), and the presence of large private firms, often family-controlled.

Publicly listed family-controlled firms in Italy have strong familial characteristics: in 53.5 per cent of the family-controlled listed firms, the CEO is a family member, while the Chairman is a member of the controlling family in 71.9 per cent of firms. In 44.7 per cent of cases, both the Chairman and the CEO are members of the controlling family (Corbetta and Minichilli, 2006).

In mid-2005, we sent an electronic questionnaire survey to all CEOs, CFOs, and Chairpersons of these firms to gather information on their TMTs' characteristics. The electronic survey mode is preferred as it reduces the possibility of mistakes in the data entry procedures. Given that most of the information required in the questionnaire refers to objective data, we consider it proper to have at least one respondent as a key informant in the TMT for each of the firms involved in the survey. Surveys on top managers suffer from low response rates, less than 25 per cent (Pettigrew, 1992). To ensure the highest possible response, we followed some of the consolidated techniques in survey research (Carpenter and Westphal, 2001; Fowler, 1993; Groves et al., 1992). These included an in-depth pre-test to streamline the questionnaire, a review by a panel of experts in a leading global head hunting firm, a request for participation that emphasized the need for further research on TMTs, and engagement of respondents' interest in the topic. With respect to this, we invited participants in the survey to a seminar for the presentation of the most relevant results. We conducted a telephone recall and a further electronic mailing to convince non-respondents to take part in the survey.

In total, we received responses on 113 different TMTs in the same number of firms. Firm makeup included 35 with turnover higher than €500 million, 28 with a turnover between €250 and €500 million, and 50 with turnover lower than €250 million. The average turnover of firms responding is €771 million. In addition, listed companies made up 30 of the 113 (27 per cent) firms that responded, while the remaining 83 firms were private. It represents an overall response rate of 23 per cent, which is similar to the response rate obtained in previous studies. For each of these TMTs, we had at least one key informant among the three key figures we considered for the mailing. We also collected additional archival data for firms in the larger sample frame in order to check for the non-respondent bias. Data on firm characteristics from AIDA were used to

examine whether there were significant differences between respondents and non-respondents. We performed the non-parametric, two independent samples test using the Kolmogorov–Smirnov procedure on firm size, with the logarithmic transformation of annual sales. We compared the log size of both respondent and non-respondent family firms (Siegel and Castellan, 1988). This test assesses whether significant differences exist in the distribution of respondents and non-respondents for the variable we indicate, including differences in central tendency, dispersion, and skewness. The results of this test indicate that respondents and non-respondents come from the same population.

Variables and Measures

Dependent variable. The dependent variable for our study was the firm's Return on Assets (ROA), defined as the net operating income before extraordinary items divided by total assets. ROA is a well understood and common measure used in several studies on the impact of TMTs' characteristics on firm performance, and is particularly appropriate for manufacturing firms (e.g. Cannella and Shen, 2001; Carpenter, 2002; Finkelstein and D'Aveni, 1994; Geletkanycz and Hambrick, 1997; Henderson et al., 2006; Shen and Cannella, 2002). This measure has been used in other studies testing for the 'family effect' on firm performance (see, e.g. Dyer, 2006 for a review). Note a potential problem with this choice – family firms tend to be asset parsimonious, which enhances ROA, and firms judged by other standards like growth and Return on Investment (ROI) may be expected to suppress ROA. However, ROA is generally the one of interest to the target audience, namely the family business, so we chose to use it here.

Therefore, we used a self-reported measure of ROA according to the definition above. We did not use a market-based measure since 73 per cent of the respondents are from privately held firms. This choice allows for the most updated value of ROA, and provides information on smaller firms for which publicly available information is less complete and reliable. We checked for biases in which updated measures of ROA were available (approximately 80 per cent of the cases). With one major exception, there were no significant differences between the values reported in the questionnaires and the values provided by public databases. The single outlier was removed from the sample.

Independent variables. Independent variables were collected via the questionnaire survey. The questionnaire survey allowed us to gather information not publicly available, especially with respect to top executives. The survey helped determine the number of family members inside the TMTs more accurately than using public sources, which estimate family membership based solely on the family name. Such use of publicly available information does not identify kinship relationships with people having a different family name than the controlling family (Villalonga and Amit, 2006).

We asked respondents directly about the presence of a family CEO, and coded it as a dummy variable with value 1 if the CEO was a member of the controlling family. We computed the *TMT Family Ratio* by dividing the number of family members involved in the TMT by the total number of TMT members. *Listing* was defined as a dummy variable, having a value of 1 if the firm was publicly traded on the Milan Stock Exchange, 0 otherwise. We asked respondents directly about listing, and we double-checked with

secondary sources. The *interaction variables* were computed after we centred the TMT Family Ratio around its mean, in order to reduce collinearity of the interaction variables.

Control variables. Control variables included measures both at the firm- and TMT-level. At the firm level, *firm size* was measured as a logarithmic transformation of sales as reported from the respondents (Boeker, 1997), and we checked it with other publicly available sources. At the TMT-level, *TMT size* was measured as a logarithmic transformation of the total number of top executives in the TMT, as reported in the questionnaire. A definition of 'top management team' (TMT) was included in the questionnaire to avoid misunderstandings. It considered a TMT to consist of the CEO, CFO, and the Chairperson, and all the other top executives on the management board and/or reporting directly to the CEO of the firm. At the TMT-level, we also controlled for CEO tenure. This is important in family-controlled firms, where CEOs tend to remain in office longer and are more difficult to remove than in publicly controlled firms. *CEO tenure* was computed as the number of years in office the CEO served in the firm, as reported in the questionnaire. Given a relatively large number of missing data on CEO tenure, information was completed in approximately 10 cases with secondary data, such as specialized press, personal biographies, and additional ad-hoc phone interviews.

ANALYSES AND RESULTS

Table I presents the means, standard deviations, and correlations among all predictors, outcome and control variables.

There were significant and high correlations between TMT Family Ratio (and its square transformation) and the interactions terms with their originating variables. We tested the hypotheses through hierarchical multiple regression analyses, entered in multiple steps. We checked for outliers and removed them from the dataset, including three outliers for firm size and one for ROA. The final number of valid and complete cases (92) resulted from the removal of such outliers as well as a number of cases where there were missing values. This sample size is in line with previous studies on TMTs (e.g. Iaquinto and Fredrickson, 1997; Miller et al., 1998; Pelled et al., 1999; Simons et al., 1999; Smith

Table I. Correlation matrix

	Mean	SD	1	2	3	4	5	6	7	8
1. Firm size	12.57	1.50	1							
2. TMT size	2.03	0.65	0.29**	0.1						
3. CEO tenure	16.20	13.06	−0.17	−0.09	1					
4. Family CEO	0.62	0.49	−0.16	−0.07	0.24*	1				
5. TMT Family Ratio	0.27	0.24	−0.16	−0.39**	0.26*	0.35**	1			
6. Listing	0.27	0.45	0.07	0.11	−0.29**	−0.04	−0.15	1		
7. TMT Family Ratio^2	0.13	0.21	−0.05	−0.39**	0.29**	0.26*	0.91**	−0.12	1	
8. ROA	7.43	6.72	0.20*	0.03	−0.10	0.22*	0.01	0.01	0.08	1

Notes: Pearson's product-moment correlation coefficients. 1-tailed: * <0.05; ** <0.01, n = 92.

Table II. Regression models

Standardized beta coefficients n = 92	Model I	Model II	Model III	Model IV	Model V	Model VI	Model VII
Controls							
Firm size	0.24*	0.24*	0.18	0.19†	0.24*	0.17	0.13
TMT size	−0.04	−0.05	−0.01	−0.02	−0.04	−0.04	−0.05
CEO tenure	−0.19†	−0.19†	−0.23*	−0.24*	−0.18	−0.24*	−0.27**
Independent variables							
Family CEO	0.28**	0.29**	0.33**	0.31**	0.28**	0.32**	0.10
TMT Family Ratio		−0.02	−0.54*	−0.47†		−0.45†	−0.31
TMT Family Ratio^2			0.56*	0.75*		0.57*	0.52**
Listing					0.04	−0.02	−0.45**
Interactions Family Ratio/CEO							
TMT Family Ratio ∗ Family CEO				−0.27			
Interactions listing							
TMT Family Ratio ∗ listing						−0.23*	−0.33**
Interaction CEO/listing							
Family CEO ∗ listing							0.56**
R^2	0.13	0.13	0.18	0.19	0.14	0.22	0.32
Adj R^2	0.09	0.08	0.12	0.12	0.09	0.14	0.24
F sign	3.42*	2.71*	3.09**	2.83**	2.74*	2.92**	4.20***
F change	3.42*	0.04	4.44*	1.21	2.74*	2.15†	8.33***
Power (1-β err prob)	0.69	0.74	0.77	0.80	0.74	0.81	0.99

† 0.10-level; * 0.05-level, ** 0.01-level, *** 0.001-level.

et al., 1994; Sutcliffe, 1994; Tihanyi et al., 2000; Wiersema and Bantel, 1992). We examined the variance inflation factor (VIF) of each independent variable in each of the regression models presented below, in order to detect potential problems with multicollinearity. VIF values were particularly low in models I, II, and V (range 1.1–1.4), and slightly higher in models III, VI, and VII (1.2–7.9), and in model IV (1.2–10.3), so multicollinearity is generally not a problem in our study (Pelled et al., 1999). We estimated the post-hoc power of the regression models we present (Faul et al., 2007). Specifically, models IV, VI, and VII had high post-hoc power (0.80, 0.81, and 0.99, respectively), while models II, III, and V range from 0.74 and 0.77, which we consider acceptable. The only model with lower power is model I (0.69), the base case. We present the powers with the regression results in Table II. As evident from the table, all models were significant, with the adjusted R^2 ranging from 0.08 for the base case to 0.32 for the full model.

Results

All models strongly support the positive impact of the presence of a family CEO on firm performance (Hypothesis 1).
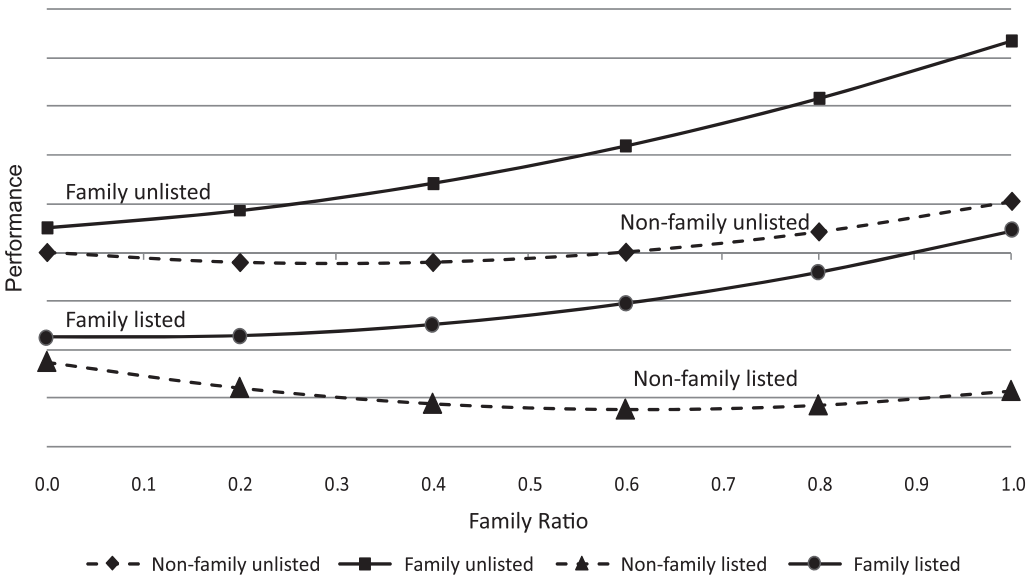
Figure 1. Performance for combinations of listing and CEO type

Hypothesis 2a is not supported. Instead support is found for the alternative Hypothesis 2b in model III; the effect persists in models IV, VI, and VII, all indicating a curvilinear relation between family firm performance and Family Ratio. There is no support for Hypothesis 3 in model IV – the correlation with performance of the interaction of family CEO with Family Ratio, though in the expected direction, is not significant. There is also no support for Hypothesis 4 – the coefficient for Listing is close to zero, so Performance does not correlates with Listing on its own.

On the other hand there is strong support for Hypothesis 5: the coefficient for interaction of Family Ratio with Listing correlates negatively and significantly highly with ROA. Finally, model VII strongly supports Hypothesis 6.

With respect to the control variables, CEO tenure has a negative correlation for all models, while firm size is generally positively related. Interestingly, TMT size is insignificant in all models. This suggests that the TMT size *per se* does not impact ROA. Rather composition of the TMT, as measured by Family Ratio, is what matters.

To understand the implications of model VII, which shows strong interaction term effects, we plotted ROA of family firms for four conditions in Figure 1 (listed versus unlisted and family versus non-family CEO). The implications of this figure are discussed further below.

DISCUSSION

The primary purpose of this study was to bring the upper echelon perspective and associated research on TMTs into the literature on family business. We examined the potential implications for family firm performance of familiness, as manifest in the form of CEO/family relationship and the proportion of family members in the TMT. We

sought to establish whether familiness can lead to faultlines in the TMT, which then lead to 'behavioural disintegration' among team members (Li and Hambrick, 2005) and thereby depress performance.

The Existence of Faultlines and the Impact of Familiness on Performance

The key research question motivating the consideration of familiness is to understand whether or not familiness is always beneficial for firm performance, and to what extent. Particularly, this article contributes understanding of whether family involvement in a business enhances or hurts the financial performance of family-controlled firms under different circumstances.

With respect to this, we argue for a distinction between familiness in the leadership of the firm, and familiness among the group of top executives at large. Our findings support that the presence of a family CEO positively contributes to firm performance, and the familiness concept can represent a theoretical explanation for that (e.g. Chrisman et al., 2004; Habbershon et al., 2003). This result is in line with other studies in the field, and reinforces evidence on the beneficial impact of family leadership in family-controlled firms (Anderson and Reeb, 2003; Villalonga and Amit, 2006), emphasizing the 'bright side' of family involvement in business.

On the other hand, we argue that the other manifestation of familiness, namely the proportion of family members in the TMT (the Family Ratio), leads to factional divides between family and non-family factions, which disrupt decision-making. Our findings bear this out – the relation between Family Ratio and firm performance is consistently curvilinear – and firm performance is best with the presence of only one (of either) faction and declines as representation of both factions increases. These findings provide support for the novel application of the faultlines concept. Our argument is that TMTs in family-controlled companies likely represent the ideal setting where natural faultlines occur among factions of family and non-family top executives. Both familiness and agency theory arguments may be helpful to provide an explanation for our results. From one side, entirely 'familial' TMTs (Ensley and Pearson, 2005) are likely to provide better results since they likely engage in a process of social capital building that is unique to the family firms (Pearson et al., 2008). This social capital resource dimension of familiness stresses the importance of family 'bonds' and family 'bridges' between the family and the business in creating unique resources and wealth (Sharma, 2008). On the other hand, when the upper echelons are stacked with external managers, predictions from agency theory apply. Specifically, non-family managers with enough power and delegated authority are able to act in their best interest, and are likely to align to the principal-owners' interests (Jensen and Meckling, 1976). This alignment, we argue, is particularly likely in the presence of family control.

The arguments above hence show that tensions and conflicts emerge when both 'principal' (owners and family members) and 'agents' (non-family managers) coexist in the same decision-making arena. A theoretical extension of the familial altruism perspective suggests that differences in treatment among family and non-family top executives potentially determines schisms among the two factions of executives whose harmful consequences go beyond the negative effects of 'altruistic costs'.

The evidence of detrimental effects on financial performance due to divides among factions of family and non-family managers provides suggestions for practice. Particularly, insights from this study suggest a careful consideration of the professionalization process. Such processes take place in a large number of family-controlled firms, as evident in well established claims in the family business literature (see, e.g. Chua et al., 2003a for a review). In this respect, evidence on faultlines effects suggests that owners should avoid obstacles to the transition from family based to professional management. The tendency owners might have to balance family-based appointments with that of outside professionals hides concrete risks. The first is to force coexistence among groups of individuals, which has been shown to be potentially harmful. Even though results of this study cannot be conclusive, they open up room for debate and further research to strengthen this fresh perspective on TMT faultlines. In addition to the potential lack of competence that the family business literature has already addressed (Schulze et al., 2001, 2003), family-based appointments enhance the risk of creating schisms among family and non-family members. While non-family executives are certainly willing to accept family-based appointments with outstanding managerial competences, family-based appointments driven by altruistic reasons simply exacerbate the conflicts among the two 'factions'.

Family Ratio, 'Faultlines', and Listing

Other interesting results are obtained with interaction terms.

First, evidence shows that unlisted firms always outperform their listed twin firm at all levels of Family Ratio, presumably due to the increased freedom of an unlisted CEO to spin marginal decisions in favour of profits for the family. The existence of relevant dissimilarities between listed and non-listed family-controlled firms can be motivated as follows. From one side, given the pressures on financial results listed firms' experience, the context of family-controlled firms is likely to favour that risk-averse agents will try to trade higher job security for higher emotional attachment to the firm and/or even lower earnings (Gomez-Mejia et al., 2003). In this respect, we argue, the risk of managerial entrenchment is especially strong for listed firms, and the harmful consequences of shirking or overconfidence in results are likely to be higher (Gomez-Mejia et al., 2003). Further, although public scrutiny and pressures on corporate boards to actively perform their role of control over managerial behaviour are definitely higher in listed as compared to non-listed family firms, the performance appraisal literature suggests that evaluators are more likely to positively judge employees when emotional ties exist between monitors and those being judged (Gomez-Mejia et al., 2003). Consequently, board members in family-controlled firms might be less inclined to negatively appraise their top executives, and also non-family members (given to emotional ties with the controlling family), and thus fail to objectively perform their control over managerial behaviours (Gomez-Mejia et al., 2003).

Second, we see that superior ROA is achieved by unlisted, family CEO firms compared to any other combination, and this effect increases as Family Ratio increases. We suggest that this reflects the free rein an altruistic family CEO gets from an increasingly powerful family faction as Family Ratio increases. At the opposite end of the ROA

spectrum is listed, non-family CEO firms with 100 per cent Family Ratio. We suspect that this reflects the major tension that a non-family CEO faces in the pressures to deliver to the regulatory market while contending with demands from a family hegemony.

Third, family CEO firms always outperform their twin non-family CEO firm in ROA – we presume this is due to the altruism effect (Schulze et al., 2002, 2003) in which the family CEO will tend to make close call decisions that favour family profits and lower free-rider agency costs (Miller and Le Breton-Miller, 2006). The difference in ROA performance increases as Family Ratio increases, reflecting the increased freedom the family CEO has as the proportion of family members in the TMT increases. This leeway increases disproportionately as the proportion of family members in the upper echelons increases. Both the previous evidences reinforce the potential of familiness in creating unique resources and wealth (Sharma, 2008) that we introduced and discussed earlier.

Previous results are represented in Figure 1, which shows other several interesting patterns on the effects of faultlines stemming from the interactions of Family Ratio with CEO type. For family CEO firms there is a steady, monotonic growth in ROA as the Family Ratio increases to 100 per cent. However, for non-family CEO firms there is a decline in ROA to a minimum at a faultline. Our suspicion is that ROA is diminished as increasing factional disruption stresses take hold, and then after the faultline ROA turns up again as factional stresses reduce.

Further, there are interesting faultline sub-patterns, depending on whether the firm is listed or not. For family CEO firms, as we have said, there is no faultline. As the Family Ratio increases, so does the performance increase, reflecting increased leeway and motivation for the CEO to exercise altruistic freedom. However, for non-family CEO firms there are faultlines that occur at different Family Ratios. For non-family *listed* firms, the highest ROA is at a Family Ratio of 0.0, and as the Family Ratio increases, ROA erodes until a faultline Family Ratio of 0.6. Then the increasing influence of family members correlates with increases in ROA, but never back to the performance accomplished by firms with a zero Family Ratio level. Family TMT members of listed firms need a clear majority (60 per cent) before this upturn of ROA takes place. We suggest that this is because the non-family members are in a much stronger position to invoke legal and regulatory reasons to dampen family members' efforts to boost family profits.

Finally, for non-family CEO *unlisted* firms, the highest ROA is at a Family Ratio of 1.0. From a local maximum at a Family Ratio of 0.0, ROA decreases as Family Ratio increases until a faultline Family Ratio of 0.3. After this the ROA turns up again, to a much higher local maximum at a Family Ratio of 1.0. The upturn takes place well before a majority of family members are in the TMT, indicating that reduced public scrutiny inhibits the ability of non-family members to control family-serving decisions.

Limitations and Future Research

The study suffers from some limitations, which indicate directions for future research. First, the dependent variable measure we used was ROA. Other dependent variables, like revenue growth, ROI, or share growth might yield different results. Since family firms are asset parsimonious, this will tend to enhance ROA compared to other firms, which may be expected to place greater emphasis on growth or other standards. So our

results may be biased by the choice of the dependent variable. Other dependent variables specific of family firms, such as firm continuity, might be considered (Miller et al., 2008). Hence our results should in no way be construed as suggesting that family firms outperform non-family firms in general. Second, our study is limited to a relatively small sample, and to one country (Italy), so generalization of results should be made with caution, and further tests in other empirical settings are required. Third, we need to explore more deeply whether and if the predicted divides and faultlines between family and non-family managers result in cognitive conflicts among sub-groups; future studies should attempt to relate behavioural dynamics inside family firms' TMTs to performance. There is also a need to examine the effect that a non-family manager's behaviour, satisfaction, involvement, and contribution has on the TMT decision-making process. Further study could measure the TMTs' task performance as outcome variables of TMTs' internal dynamics. Finally, our analyses are cross-sectional, so we need to consider TMT dynamics and firm performance over time. Longitudinal studies would provide additional insights into how evolution of the degree of familiness inside TMTs affects their task performance, and thereby the firms' performance as well.

CONCLUSION

The article contributes to family business literature showing both the 'bright side' of familiness and the 'dark side' of family involvement. It shows that for our sample both facets of familiness – CEO type and Family Ratio – are correlated with family firm performance, and in interactive ways. It also shows that family firm performance is related to interactions between firm listing and CEO type. Overall, the article provides empirical evidence supporting the construct of 'familiness' as a potential determinant of family firms' resource-building and value creation (Habbershon and Williams, 1999; Habbershon et al., 2003; Pearson et al., 2008; Sharma, 2008). Further, it provides preliminary evidence of the 'faultlines' concept (Lau and Murnighan, 1998), and thereby contributes to the understanding of the TMT role of composition in family firm performance. Particularly, it shows the problematic co-existence of both family and non-family managers in the upper echelons, given their contrasting objectives and aim. As such, the article extends the upper echelon perspective into the family business literature with several interesting insights for family firms' performance.

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