ONE IN A SERIES OF REPORTS FROM THE WHARTON GLOBAL FAMILY ALLIANCE

Wharton Global Family Alliance

2012 Family Governance Report: *Sources and Outcomes of Family Conflict*

Raphael Amit
The Wharton School, University of Pennsylvania

Rachel Perl
The Wharton School, University of Pennsylvania

Wharton
UNIVERSITY *of* PENNSYLVANIA

Acknowledgments

First, we thank the families and Top Management Team (TMT) members who participated in this study. Their commitment of time and consideration in completing the survey has helped to illuminate both sources and outcomes of family conflict. We extend our appreciation to the team at the Wharton Global Family Alliance, particularly Sylvie Beauvais and Greg Pitter, for their outstanding work. As always, Laird Pendleton, our partner at the CCC Alliance, has provided valuable insights and support throughout this project. We also thank Professor Sigal Barsade for her important contribution in promoting this study.

This project was funded by the Wharton Entrepreneurship and Family Business Research Centre at the Centre of Excellence for Applied Research and Training (CERT).

July 2012

Contents

Section 1: Introduction and Background

1.a. The 2010-2011 Wharton Family Governance Study

Family businesses are comprised of families and the businesses they own. The goal of the 2010-2011 Wharton Family Governance Study was to examine the connection between the family domain and the business domain. This 2012 Family Governance Report presents our findings. More specifically, we sought to answer the following questions:

- How does family governance affect family conflict?
- How do family members' perceptions of fairness in decision making and resource distribution norms affect family conflict?
- How does family conflict, in turn, affect Top Management Team (TMT) conflict, TMT commitment, TMT risk taking, TMT information sharing and TMT interdependency?

Most data sources concerning family businesses have focused solely on the business. The uniqueness of this study is that it gives equal weight to the family and its dynamics and to the business and its managers. Thus, we are better able to illuminate the connection between the family and the business.

This study is part of the research program of the Wharton Global Family Alliance (Wharton GFA). The Wharton GFA, a unit of the Wharton School *(www.wharton.upenn.edu)*, is a unique academic-family business partnership established to enhance the marketplace advantage and the wealth creation contributions of global families that control substantial enterprises and resources. The Wharton GFA focuses its research on key issues affecting global families and their businesses, including Family Business Management and Governance, Wealth Management and Philanthropy. The Wharton GFA's mission is to create and disseminate ground-breaking knowledge about family-controlled businesses and about the families that are behind these firms, with a high standard of scholarship that has positive real-world impact.

As with other Wharton GFA benchmarking studies, this survey was designed and executed with strict attention to the goal of allowing families to learn from each other while maintaining total anonymity and confidentiality.

1.b. Key Definitions

Family business: We refer to family business as a business that is owned or controlled by a group of people related by blood, marriage or adoption. When a family owns or controls several lines of business, we use the term family business more generally, i.e., to refer to the family enterprise.

Family: We refer to family as those individuals related by blood, marriage or adoption who have, or will have, a claim to the family business. This definition includes members from multiple generations and multiple branches of the family—whether or not they work in the family business.

Family governance: We refer to family governance as the formal and informal rules and institutions that structure the decision-making processes.

See the Appendix for a more extensive list of definitions used in the study.

1.c. Procedures and Surveys

The study included two main phases:

Phase I was comprised of a background survey completed by one family member that included demographic and structural questions concerning the family and the family business. The background survey addressed questions such as size of family, number of generations who currently have equity in the business, size of business and age of business.

Phase II was comprised of two different surveys: a) a survey for family members concerning the family domain, and b) a survey for managers that centered on the family business domain. The family survey included questions concerning family business decisions, family leadership, family dynamics and demographic variables. The top management team (TMT) survey included questions concerning business decision making, TMT dynamics and personal demographics. Family members who work in the family business were asked to fill out both surveys.

1.d. Study Sample

Data was gathered from 175 individuals from 22 families. Families needed to control/own an operating business with second-generation involvement in the business; that is, second-generation family members either own equity in the business or are currently working in the business.

Figure 1.1 depicts the number of generations of family members with equity in the business. For the families in this study the average was 2.27: 1 family had 1 generation, 15 families had 2 generations, 5 families had 3 generations and 1 family had 4 generations.

As indicated in Figure 1.2, the number of family members age 21 or older who had equity in the business varied greatly, from 2 members to 113 members. The median, however, was 4.5 family members, and 77% of the families had 10 or fewer family members with equity.

Figure 1.3 illustrates the revenues of the businesses owned/controlled by families that participated in the study. A total of 17 families (77%) had revenues of less than $500m, one family had revenues between $500m and $1b, and four families had revenues above $1b.

Geographically, 20 family businesses (91%) were US-based, with 2 family businesses from other parts of the world.

The age of family businesses in the study also varied greatly, as shown in Figure 1.4. The median firm age was 16 years, with the youngest firm at less than 10 years and the oldest at over 160 years.

Figure 1.1 - **Number of Generations with Equity**

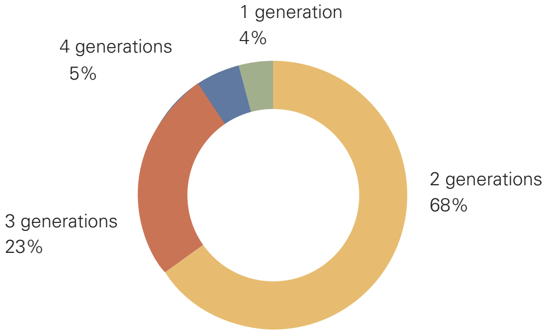


Figure 1.2 - **Number of Family Members with Equity**

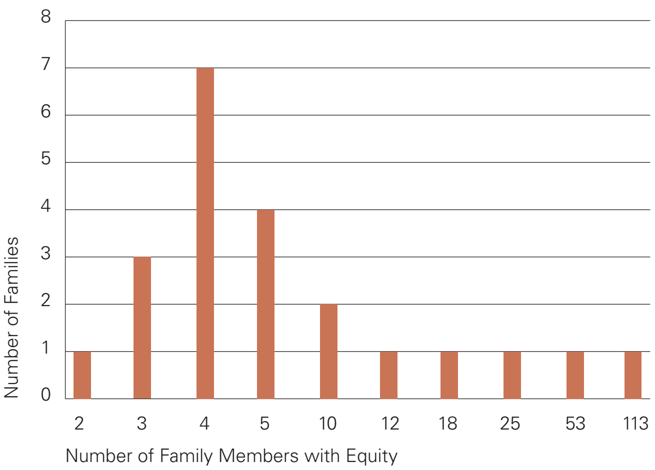


Figure 1.3 - **Revenues of Family Business**

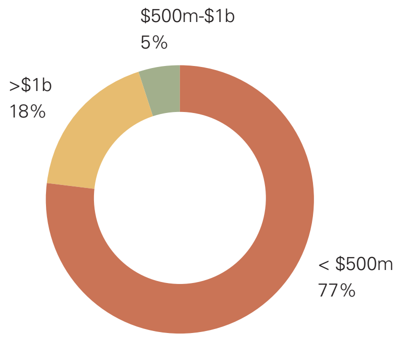
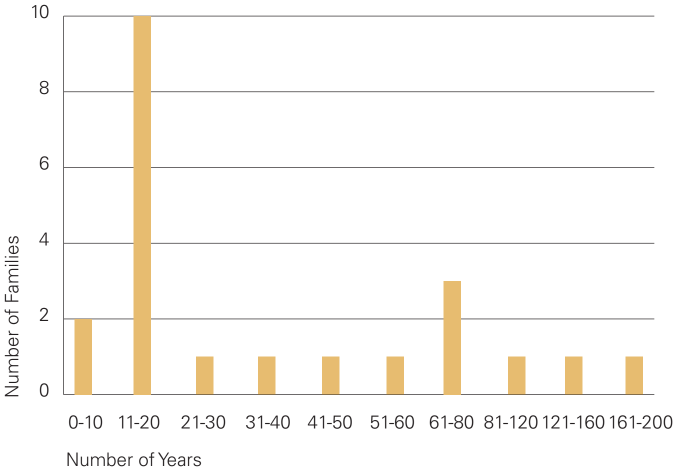


Figure 1.4 - **Firm Age**



Section 2: Family Governance and Family Dynamics

One goal of our study was to examine the effect that family governance institutions have on family dynamics, and in particular, on family conflict.

Families have different forms of governance—that is, different formal and informal rules that structure the decision-making process in the family. Some of the more common institutions, or forms of governance, include family assembly, family council, family charter/constitution and family committees (for definitions of each, see Appendix A). These institutions were also found in the families in our study. Only two families (9%) had no governance institutions, while 55% of the families had two or more family governance institutions. As illustrated in Figure 2.1, the family council and family assembly were the most widely represented institutions: 14 families (64%) had a family council and 12 families (55%) had a family assembly, while 7 families (32%) had a family charter (or constitution) and 5 families (23%) had family committees.

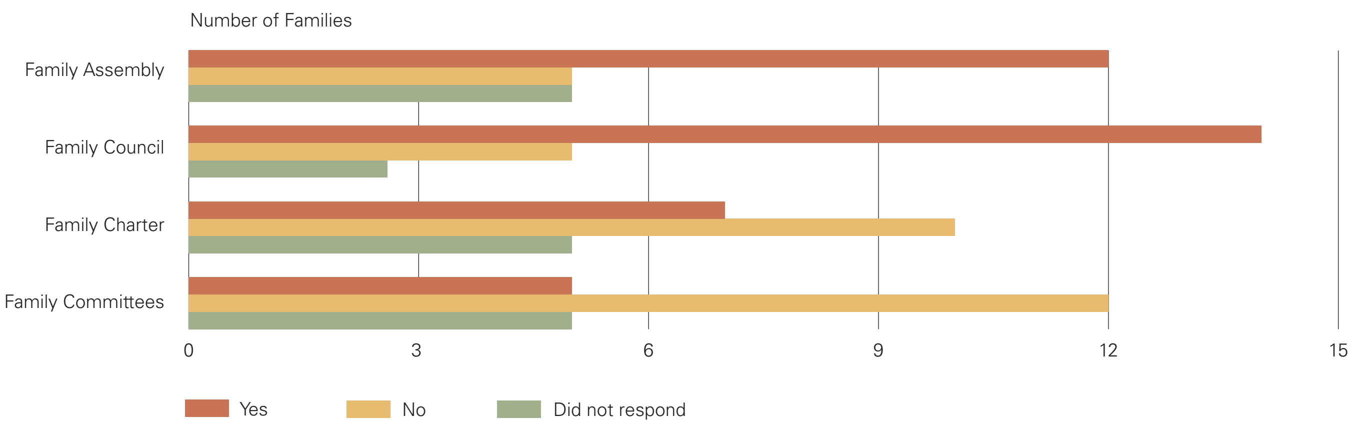
We assessed whether these institutions were related to the following types of family conflict:

Family business conflict: conflict among family members concerning the family business.

Family relationship conflict: personal friction among family members.

Interestingly, the presence of these governance institutions, per se, did *not* correlate to either type of conflict. These results were surprising, as the formation of family governance institutions is considered to be a positive family practice that is supposed to facilitate family unity and to decrease family conflict. Our survey results suggest that the existence of family governance institutions, by itself, is not necessarily beneficial to the family in terms of reducing conflict; closer attention should be given to the processes of developing governance documents and governance institutions, as well as to the content of these documents. Further, our study suggests that merely having developed the governance documents and institutions is not enough to mitigate potential conflict.

Figure 2.1 - **Family Governance Institutions**



It is profoundly important to bring to life the governance structures; namely, convene the institutions periodically and regularly; actively involve family members in family and business issues that emerge; maintain the culture, norms and heritage of the family, and more. Indeed, families may have similar institutions, but the institutions may operate very differently. For example, two families may have a family council; however, the number of family members in this council and the degree to which the council enables family members to participate in decision making may vary to a great extent.

To gain a better understanding of family governance institutions, we asked more specific questions about how family members make decisions concerning the family business. Rather than focusing on what institutions a family has, our goal was to illuminate in more detail the fundamental processes and decision-making structures. We focused on the following variables:

1. **Family business formalization:** the extent to which decision-making processes, rules and institutions concerning the family business are documented in writing and considered "official."

2. **Centrality of decision making concerning the family business:** the extent to which family business leaders let family members participate in the decisions made concerning the family business. When family leaders do not let family members participate in the decision making, the decision-making process becomes more centralized.

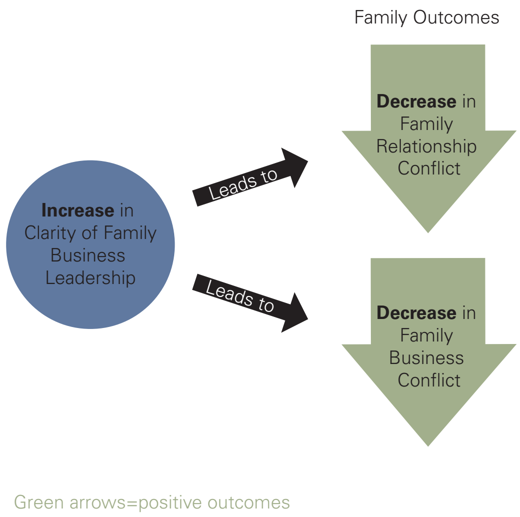
3. **Clarity of family business leadership:** the extent to which it is clear who the family business leaders are.

4. **Number of family business leaders:** the number of family business leaders as identified by family members. We defined family business leader(s) as a family member (or a group of family members) who has authority over decision making concerning the family business.

When we examined the relationship between decision-making structures and family conflict, we found that clarity of family business leadership played an important role. Both family business conflict and family relationship conflict were related to the clarity of the family business leadership. Where there was greater clarity about who the family business leaders were, there was less family business conflict and less family personality conflict (see Figure 2.2).

Based on our survey data the other three variables—formalization, centralization of family business decision making and number of family business leaders—were not related to family conflict.

Figure 2.2 - **Impact of Family Governance on Family Conflict**



Section 3: Family Justice and Family Dynamics

In Section 2, we explored how governance processes and structures relate to family dynamics. In this section we continue to explore the decision-making processes within the family, but focus on family members' perceptions of fairness with regard to two areas: (1) how decisions are made about the family business ("procedural justice") and (2) how resources are distributed among family members ("resource distribution justice"). To what degree does a sense of fairness, or justice, in these important decision-making areas affect the level of family conflict?

To determine the level of procedural justice, we asked family members about their experiences around family decision making concerning the family business. The following questions were asked concerning family decision-making procedures:

1. Have you been able to express your views and feelings during these procedures?
2. Have these procedures been applied consistently?
3. Have these procedures been free of biases?
4. Have these procedures been based on accurate and complete information?
5. Have you been able to appeal the decisions arrived at by these procedures?
6. Have these procedures upheld ethical and moral standards?

Our results confirmed what might be expected: that the higher the "justice perception" among family members, the lower both family business conflict and family relationship conflict. Looking more closely at the two types of conflict, justice perceptions had a stronger impact on family relationship conflict.

The survey also asked about how resources received through the family business were distributed among family members. We asked about the prevalence of three of the following distribution norms:

1. **Need:** the resources each family member receives through the family business depend on how much they need.
2. **Equity:** the resources each family member receives through the family business depend on their actions, input or performance.
3. **Equality:** the resources each family member receives through the family business are equal among family members.

Family members were asked how often resources were distributed in their family according to need, equity and equality on a scale of 1 to 5 (where 1 indicates never and 5 indicates very often). As illustrated in Figure 3.1, the most frequently used norm was equality, with an average of 3.68, followed by equity at 3.14. The need norm, with an average of 2.33, was the least prevalent among families.

Examining the impact on family conflict, we found that both the equity norm and the need norm were related to higher levels of family conflict. When resources were distributed on the basis of equity and need more often, the greater the level of family conflict was, including both business and relationship conflict. The equality norm, which was the most common one cited, was not related to family conflict.

To summarize, as Figure 3.2 depicts, a sense of "justice"—both in terms of decision-making procedures about the family business and in how resources were distributed—had an impact on the level of family business and relationship conflict.

Figure 3.1 - **How Resources Are Distributed among Family Members**

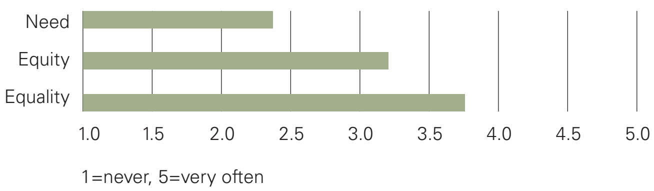
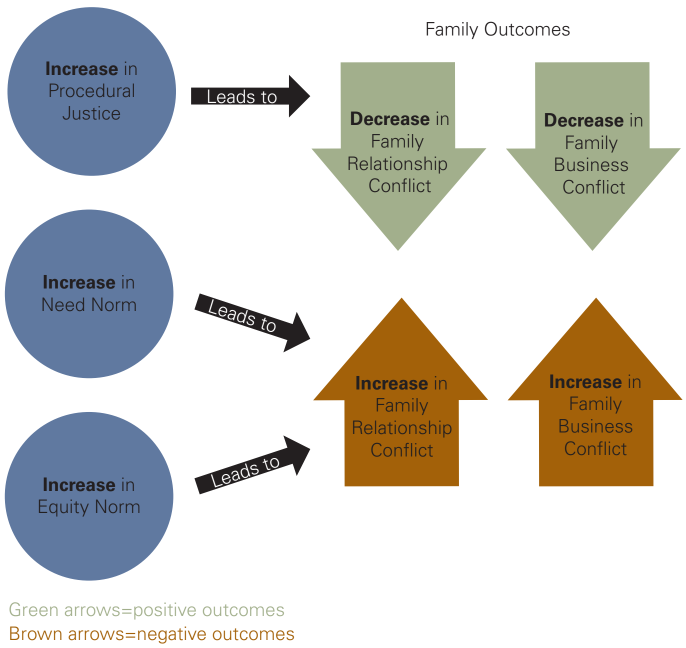


Figure 3.2 - **Impact of "Justice" Perceptions on Family Conflict**



Section 4: Family Conflict and Top Management Team (TMT) Dynamics

To this point, we have discussed the family domain and the relationship family conflict has with family governance and justice perceptions. In this section, we examine how conflict among family members affects the dynamics of the Top Management Team (TMT).

We first looked at how family conflict, both family business conflict and family relationship conflict, relate to TMT conflict. We focused on three different types of TMT conflict:

1. **TMT task conflict:** conflict among TMT members concerning strategic decisions in the business.

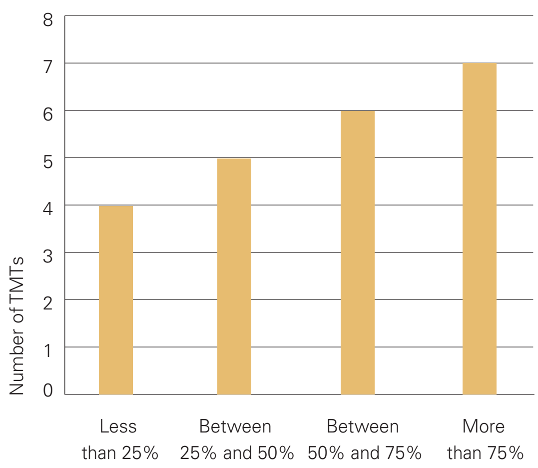
2. **TMT personality conflict:** personal friction among TMT members.

3. **TMT process conflict:** conflict among TMT members concerning the division of responsibilities within the TMT.

Interestingly, there was little relationship between family conflict and TMT conflict. The only relationship that we observed was between family relationship conflict and TMT personality conflict. Higher personality conflict in the family was related to higher personality conflict in the TMT.

The lack of strong correspondence between family conflict and TMT conflict may not be surprising, as the TMT is not comprised solely of family members. In this sample, TMTs were comprised of professional non-family members as well. As illustrated in Figure 4.1, there was a wide range of family member representation in the TMTs: 4 families had 25% or less family members in their TMT, 5 had between 25% and 50% family members, 6 had between 50% and 75% family members, and 7 had more than 75% family members.

Figure 4.1 - **The Proportion of Family Members in the TMT**



Family members affect the TMT not only through their presence in the TMT, but also through their role as owners. For example, conflict among the owners may cause confusion in the TMT and difficulty in the decision-making processes (rather than conflict among the TMT members). Therefore, we examined the relationship between family conflict and other, more general processes within the TMT:

1. **TMT retention:** the average number of years that individual members of the TMT have been a part of the team.

2. **TMT commitment:** TMT members' emotional attachment to, identification with and involvement in the organization.

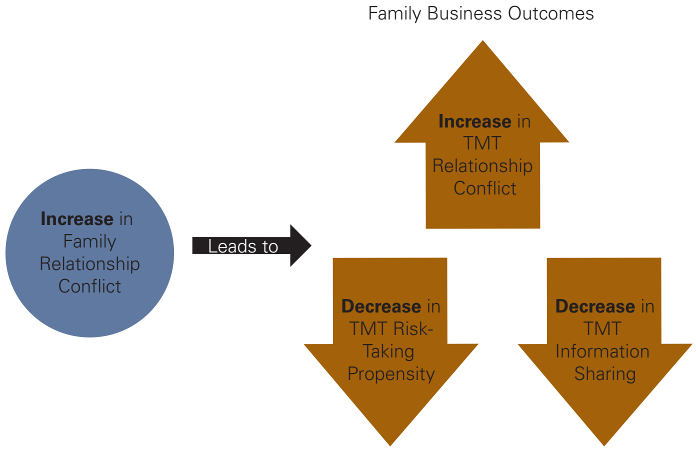
3. **TMT risk-taking propensity:** the tendency of the TMT for high-risk strategic moves.

4. **TMT information sharing:** the degree that information concerning the family business is shared among top managers.

Our results indicated that both family business conflict and family relationship conflict appear to be related to TMT risk-taking propensity and TMT information sharing. The higher the level of family conflict, the less TMT members were willing to take high-risk strategic moves and the less information sharing occurred among the TMT members. TMT commitment was also related to family business conflict (although not family relationship conflict). Higher levels of family business conflict corresponded with lower levels of TMT commitment.

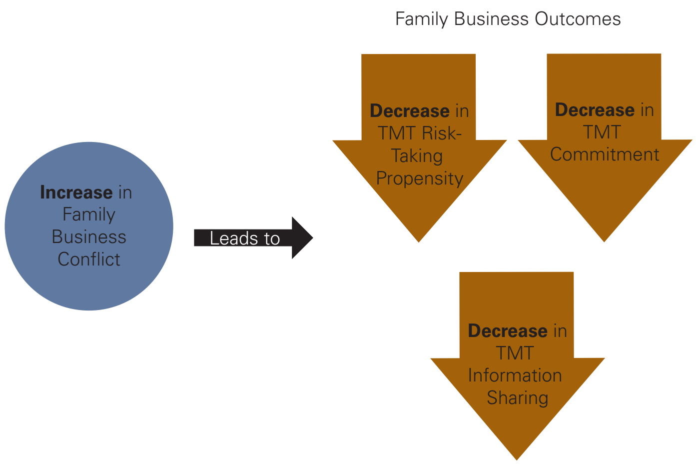
Thus, as illustrated in Figure 4.2, although family conflict did not relate to TMT conflict and TMT retention, it did relate to TMT commitment, TMT risk-taking propensity and TMT information sharing.

Figure 4.2a - **Impact of Family Relationship Conflict on TMT Dynamics**



Brown arrows=negative outcomes

Figure 4.2b - **Impact of Family Business Conflict on TMT Dynamics**



Brown arrows=negative outcomes

Section 5: Summary

The 2012 Family Governance Report is the first publication to focus not only on the family business and its employees, but also on the family itself and all family members that affect the family business. Our sample represented a wide age range among family firms, as well as a wide range in the number of generations and the number of family members with equity in the family business. Despite these differences, we found several significant relationships among various elements of family and TMT dynamics.

Key Findings:

- Interestingly, the presence of four common governance institutions (family assembly, family council, family charter/constitution, family committees), by themselves, did not affect either family business conflict or family relationship conflict. This suggests that merely having governance institutions in place does not guarantee that they will help to reduce conflict. Careful attention needs to be given to the processes of developing the governance institutions and documents. As well, the way governance structures are implemented plays a key role in their effectiveness as conflict-reducing mechanisms.

- The three factors that exhibited a significant relationship to family conflict were: clarity of business leadership, a sense of "procedural justice" in making decisions about the business, and the distribution of resources from the family business to family members.

  » Where there was greater clarity about who the family business leaders were, there was less family business conflict and less family relationship conflict. Other similar variables—including the extent to which decision-making processes and rules were "formalized," and whether the decision making was highly centralized or more participatory—did not show a correlation with family conflict.

  » When family members believed that the procedures for making decisions about the family business were fair (procedural justice), there was lower family conflict.

  » Among three common norms used to distribute the family business resources—need, equity and equality—distribution on the basis of need and equity (or performance contribution) were both associated with higher levels of family conflict. Distributing resources equally among family members, which was the most frequently used norm, was not associated with either higher or lower conflict.

- Moving from the family domain to the Top Management Team (TMT), we were interested to find little relationship between the level of family conflict and the level of TMT conflict as reflected in task, personality and process conflict.

- Family conflict does, however, appear to be related to other important aspects of the TMT. Higher levels of family business and relationship conflict were associated with lower levels of risk taking (i.e., the willingness of the TMT to take high-risk strategic moves) and with less information sharing among TMT members. Higher levels of family business conflict also corresponded with lower TMT commitment.

The results of this study stress the deep connection between the family and its business, and the importance of understanding family processes as a key step in understanding the family business.

Wharton GFA is committed to continuing its study of families and their businesses with the goal of contributing to the ability of families to preserve the family itself and all forms of family wealth. For information on this and other reports—or if you are interested in participating with us in future surveys—please email *wgfa@wharton.upenn.edu.*

Appendix: Definitions

Family and Governance

Family: We refer to family as those individuals related by blood, marriage or adoption who have, or will have, a claim to the family business. This definition includes members from multiple generations and multiple branches of the family—whether or not they work in the family business.

Family assembly: a forum for all family members dedicated to information sharing and discussion of family related issues such as family business, family life and family wealth management.

Family business: We refer to family business as a business that is owned or controlled by a group of people related by blood, marriage or adoption. When a family owns or controls several lines of business, we use the term family business more generally, i.e., to refer to the family enterprise.

Family charter/family constitution: a document stating the family's formal rules and regulations.

Family committees: groups of family members responsible for various aspects of family life, such as an education committee, family governance committee and/or social committee.

Family council: a formal group of family members responsible for day-to-day family-related decisions and their implementation.

Family governance: We refer to family governance as the formal and informal rules and institutions that structure the decision-making processes.

Family Conflict

Family business conflict: conflict among family members concerning the family business.

Family relationship conflict: personal friction among family members.

Family Decision-Making Processes and Leadership

Centrality of decision making concerning the family business: the extent to which family business leaders let family members participate in the decisions made concerning the family business. When family leaders let family members participate in the decision making less often, the decision-making process becomes more centralized.

Clarity of family business leadership: the extent to which it is clear who the family business leaders are.

Family business formalization: the extent to which decision-making processes, rules and institutions concerning the family business are documented in writing and considered "official."

Number of family business leaders: the number of family business leaders as identified by family members. We defined family business leader(s) as a family member (or a group of family members) who has the authority over decision making concerning the family business.

Family Resource Distribution Norms

Equality: the resources each family member receives through the family business are equal among family members.

Equity: the resources each family member receives through the family business depend on their actions, input or performance.

Need: the resources each family member receives through the family business depend on how much they need.

Top Management Team (TMT) Conflict

TMT personality conflict: personal friction among TMT members.

TMT process conflict: conflict among TMT members concerning division of responsibilities within the TMT.

TMT task conflict: conflict among TMT members concerning strategic decisions in the business.

Other TMT Variables

TMT commitment: TMT members' emotional attachment to, identification with and involvement in the organization.

TMT information sharing: the degree to which information concerning the family business is shared among top managers.

TMT retention: the average number of years that individual members of the TMT have been a part of the team.

TMT risk-taking propensity: the tendency of the TMT for high-risk strategic moves.

Notes

Wharton Global Family Alliance

Prof. Raphael Amit
amit@wharton.upenn.edu

PhD Candidate Rachel Perl
rperl@wharton.upenn.edu

The Wharton School
University of Pennsylvania
Vance Hall, 4th Floor
3733 Spruce Street
Philadelphia, PA 19104-6374
+1 215.898.4470 phone
+1 215.898.1905 fax
wgfa@wharton.upenn.edu