

BOARD OF DIRECTORS AND FIRM PERFORMANCE IN SPANISH NON-LISTED FAMILY FIRMS¹

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Abstract:

The aim of the study is to analyze the effect of the presence of outsiders (affiliated and independents) on the board of directors on firm performance in family SMEs, also considering the generational effect. To test our hypotheses that outside directors act as agents or stewards, we examined the relation between firm performance and the proportion of affiliated and independent directors on the board, using data from non-listed family firms in Spain.

Our findings show the existence of a positive impact of affiliated directors on firm performance in family firms. It is also important to note the different behaviour between family firms run by the first generation and those run by subsequent generations. In this case, the presence of independents on the board has a positive effect on performance when the firm is run by the first generation. When the firm is run by second and subsequent generations, the presence of independents has no effect on performance.

Key words: Affiliated directors, independent directors, generation, non-listed firms, family firms

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1.- INTRODUCTION

Within the management research area, corporate governance is one of the topics receiving increased attention. Specifically, corporate board structure and its impact on firm behaviour is one of the most debated issues in literature today. There are many studies that analyse the board of directors from different perspectives. Some of them analyse the determinants of board composition (Fiegener et al., 2000; Voordeckers et al., 2007; Jaskiewicz and Klein, 2007; Bammens et al., 2008). Minichilli et al. (2009) studied the antecedents of board tasks performance, developing and empirically testing a theoretical model on the impact of board characteristics on board task performance for a sample of 2000 largest Italian industrial companies. Other studies analyse the effect of board composition on firm performance but, in general, the empirical evidence is not conclusive. Some empirical findings regarding board composition towards performance finds that outside directors could improve board effectiveness and firm performance. For instance, Weisbach (1988), McKnight and Mira (2003) and Anderson and Reeb (2004) find a positive and significant relationship between outsiders' proportion and firm value. However, others like Baysinger and Butler (1985), Hermalin and Weisbach (1991), and Agrawal and Knoeber (1996) find a negative relationship between the proportion of outside directors and firm performance. Dalton et al. (1998), De Andres et al. (2005) and Jackling and Johl (2009) find no relation between the two variables. Differences in findings have in part been attributable to the differences in the theoretical bases of investigation and different measure of firm performance (Jackling and Johl, 2009).

However there is little research on the effect of the role of outside directors on firm performance in family SMEs and those who do have often uncritically adapted concepts and theories developed for large corporations without adjusting the situation to differences in for example ownership involvement, and the general lack of internal resources that often characterize these ventures (Huse, 2000; Daily et al, 2002). There consequently seems to be deficiencies in our knowledge of the role and contribution of outside directors in SMEs (Gabrielson and Huse, 2005).

Boards of directors are a central institution in the internal governance of a company. In addition to strategic direction, they provide a key monitoring function in dealing with agency problems in the firm (Fama, 1980; Jensen, 1993). In a diffuse ownership context, the monitoring function must focus on reducing the agency problem between disperse shareholders and management (Hermalin and Weisbach, 2001). In the context

of companies with high ownership concentration, the agency conflict in the firm is between controlling shareholders and minority shareholders (Lefort and Urzua, 2008). However there is some debate about the usefulness of agency theory in a family firm context (Westhead and Howorth, 2006), since agency theory may provide only a partial explanation of private family firms (Howorth et al. 2004).

Stewardship theory, in contrast with agency theory (Davis et al. 1997), defines situations in which managers and employers are not motivated by individual goals, but instead behave as stewards whose motives are aligned with objectives of the organization. The typical ownership pattern of small and medium sized family firms (Forbes and Milliken 1999) reduces the need for the board's control role so, the appearance of outside directors will reflect the service and advice needs of the CEO rather than the control role (Fiegener et al., 2000).

The board's primary role is to service and advise, rather than to discipline and monitor as agency theory prescribes (Hillman and Dalziel, 2003).

The aim of the study is to analyze the effect of the presence of outsiders on the board of directors on firm performance in family SMEs, also considering the generational effect. While most studies have treated outsiders as an indistinguishable group of nonexecutive directors, we classified them in two groups, affiliates and independents. Affiliate directors are those with existing or potential business ties to the firm and independent directors those whose only tie to the firm is their directorship.

To test our hypotheses that outside directors act as agents or stewards, we examined the relation between firm performance and the proportion of affiliated and independent directors on the board.

Our findings show the existence of a positive impact of affiliated directors on firm performance in family firms. It is also important to note the different behaviour between family firms run by the first generation and those that are run by subsequent generations. In this case, the presence of independents and the affiliates on the board has a positive effect on performance when the firm is run by the first generation. These results indicate that outsiders perform as stewards in family firms in this generation.

This study makes several contributions to the literature on the impact of board composition on firm performance. First, our findings provide a new perspective on the role that outside directors (affiliated and independents) play in corporate governance of family firms, considering both the monitoring and advising role. Second, our study is one of the first to examine the distinction among outside directors in family firms. The

role of affiliate directors has generally been overlooked in corporate governance research, and, typically, affiliate directors have been lumped in the overall category of outside directors. Third, previous studies focus on relatively large publicly-traded family firms (S&P 500). Nevertheless we focus on SMEs non-listed family firms because their findings may not extend to smaller ones.

In that context, the rest of the paper is organised as follows. Section 2 describes the theoretical basis and the hypotheses to examine. Section 3 sets out the data and procedures for analysis used in undertaking this empirical study. The main results of the investigation are presented in Sections 4. The next section presents and discusses the results. We conclude the paper in Section 6 with some conclusions and implications for management theory and practice, and indicate paths for further investigation. The paper ends with a list of bibliographical references.

2. BOARD OF DIRECTORS AND FIRM PERFORMANCE: THEORETICAL BACKGROUND AND HYPOTHESES

Corporate board structure and its impact on firm behaviour is one of the most debated issues in literature today. In recent years, the discussion has focused on the structure of the board of directors, the most outstanding governance mechanism of the internal control systems (Jensen, 1993). Researchers studying corporate governance have used a diverse set of theoretical perspectives to understand the characteristics, roles and effects of board of directors (Corbetta and Salvato, 2004). Although agency theoretic arguments represent one explanation in describing the relation between founding families and boards of directors, stewardship theory provides an alternative explanation (Anderson and Reeb, 2004). It is not necessary to choose one theoretical perspective over another. Indeed, one can obtain a better understanding of family business board by trying to integrate different theoretical perspectives (Corbetta and Salvato, 2004; Minichilli et al., 2009).

Board structure has relied heavily on agency theory concepts, focusing on the control function of the board. Agency theory treats the company as a nexus of contracts through which various participants transact with each other (Jensen and Meckling 1976). Since assets are the property of the shareholders, a principal-agent problem may arise because managers have to make decisions concerning the productive use of these assets. Installing a board of directors can be an effective instrument for monitoring top managers and coping with this problem and to reduce agency costs (Fama and Jensen 1983). Thus, agency theory is used to examine the role that the board of directors may

play in contributing to the performance of the organizations they govern (Jackling and Johl, 2009). However, the agency problem seems less important in the context of family firms with high ownership concentration, given that the controlling shareholders have sufficient incentives, power and information to control top managers (Jensen and Meckling, 1976). High ownership concentration can trigger other problems with corporate governance and other types of cost. The asymmetric altruism, free rider problem and the family members entrenchment could cancel or even exceed the benefits derived from the agency agreement between owners and managers (Chua et al., 2009; Oswald et al., 2009; Schulze et al., 2001, 2003). If there are controlling shareholders, they are more likely to be able to use their power to undertake activities intended to obtain private profit to the detriment of minority shareholders' wealth (La Porta et al., 1999; Villalonga and Amit, 2006). The main contribution of independent directors according to agency theory is consequently their ability to be independent when oversee operating matters, protecting the assets of the firm, and holding managers accountable to the firm's various key stakeholders to ensure the future survival and success of the enterprise (Gabrielson and Huse, 2005).

Stewardship theory, in contrast with agency theory (Davis et al. 1997), defines situations in which managers and employers are not motivated by individual goals, but instead behave as stewards whose motives are aligned with objectives of the organization, that is, people are not inclined to opportunism, and managers want to sincerely pursue shareholders' interests (Davis et al. 1997). Arrègle et al. (2007, p. 84) maintain that: "Family members are concerned about the firm because it is part of their collective patrimony and is often the main asset of the family." Family owners' and managers' stewardship stems from their socio-emotional attachment to the business, which can be very high since the company can serve to satisfy needs for security, social contribution, belonging, and family standing (Ashforth and Mael 1989; Gomez-Mejia et al. 2007; Lansberg 1999). The results of stewardship conduct, generous investment in capabilities, people, and long-term relationships, may be sustainable business value. The expectation is that businesses will build competitive advantages and thereby outperform their peers in growth, returns, and market valuations (Le Breton-Miller and Miller, 2009). Recent research employing a stewardship perspective has shown that effective family relationships and processes contribute to firm performance (Eddleston & Kellermanns, 2007; Eddleston et al., 2008).

In this view, boards of directors are groups of competent people that help managers to enhance their decision-making process, e.g. contributing to the boardroom debate through their experiences, competences and different viewpoints (Minichilli et al, 2009). In other words, board members provide advice and support to top managers, and thus represent a valuable resource for corporate boards (Donaldson and Davis, 1991). Organizations might require less control from a board when goal alignment between owners and managers is high (Davis et al., 1997; Luoma and Goodstein, 1999; Muth and Donaldson, 1998; Sundaramurthy and Lewis, 2003).

Stewardship theory suggests that the main role of the board of directors is to advise and support management rather than to discipline and monitor as agency theory prescribes (Corbetta and Salvato, 2004b; Daily et al., 2003; Gubitta and Gianecchini, 2002; Hillman and Dalziel, 2003, Brunninge et al., 2007)

Acting as stewards, families may place outside directors (independent and affiliate) on the board to provide industry specific expertise, objective advice, or generally act as advocates for corporate health and viability. They can play an important role in the development of strategic change processes in family businesses (Brunninge et al., 2007, Fiegenger et al., 2000; Voordeckers et al., 2007).

Stewardship theory as such, potentially offers an alternative explanation for observing a relation between outside directors and firm performance (Anderson and Reeb, 2004). Consequently, a relation potentially exists between board independence and firm performance because of the counsel and advice that outside directors offer, as opposed to their monitoring and control activities (Anderson and Reeb, 2004).

Agency theory and stewardship theory indicate that independent directors exhibit a positive relation to firm performance, but the role of the board of directors is different in each theory. Under agency, independent directors monitor and control insiders and/or the family. Under stewardship, independent directors provide valuable outside advice and counsel to the firm.

In this context, the first hypothesis proposes that a higher proportion of independent directors on the board will be associated with a positive impact on performance due to the role, monitor or advisor, which these directors play in firms.

Accordingly the following hypothesis is presented:

H₁: The proportion of board independent directors of non-listed family firms is positively associated with firm performance

Agency and Stewardship theory offers an alternative explanation for observing a relation between board independence and firm performance as outlined under our first hypothesis. To provide insights into which of these competing theories better explain the role of boards in family firms, we analyze, as Anderson and Reeb (2004), the role of affiliate directors.

Affiliate directors are non-employee board members with existing or potential business ties to the firm (Daily et al., 1998) and may play an important role in any firm, and in the case of family firms their influence is likely to be greater given the more permanent and personal relationship with firm's management (Jones et al., 2008).

An agency perspective suggests affiliate directors, in seeking to protect or enhance their business relationship with the firm, are less objective and less effective monitors of the family. Affiliate directors often have conflicts of interests due to their current and expected future business relationship with the firm, thereby impairing their ability to monitor and discipline (Baysinger and Butler, 1985; Daily et al., 1998). However, stewardship theory suggests a different perspective on the role that affiliate directors play in family firms. Families, acting as stewards of firm value, may not differentiate directors based on their affiliation with, or independence from, the family. Directors classified as affiliates often maintain skills in knowledge based fields such as law, finance, accounting, and consulting; suggesting that families seek these directors for their value-adding advice and counsel as opposed to affiliate directors' abilities in monitoring and controlling family activities.

In sum, agency theory indicates that affiliate directors are less effective monitors, while stewardship theory indicates that affiliate directors are placed on the board to provide alternative perspectives and expertise, similar to independent directors. Thus, stewardship and agency theory lend different perspectives on the role affiliate directors play on the board and in the firm.

Therefore, we propose competing hypothesis:

Under stewardship theory:

H_{2a} The proportion of affiliated directors on the board of non-listed family firms is positively associated with firm performance

In contrast, under agency theory:

H_{2b} The proportion of affiliated directors on the board of non-listed family firms is negatively associated with firm performance

According to Schulze et al. (2001), whereas the main source of agency problems is the separation between ownership and monitoring, such problems do not exist in first-generation family firms because the same person is responsible for making management and supervision decisions. Reductions in agency costs may be achieved by entirely eliminating the separation between owners and management. In such cases, the interests of principal and agent are aligned and it is assured that the management will not expropriate the shareholders' wealth (Miller and Le-Breton Miller, 2006).

As a family firm prepares to incorporate later generations, priorities and problems change (Gersick et al., 1997). The family property is shared by an increasingly large number of family members, conflicts may start to arise when the interests of the family members are not aligned, and the agency relations between the various participants in the firm are conducted on the basis of economic and non-economic preferences (Chrisman et al, 2005; Sharma et al., 2007). When more family members are active in the firm, the likelihood of opposite opinions and objectives increases, thereby increasing the need for outside arbitration (Voordeckers et al. 2007). Schulze and colleagues (2001) argued that family relationships tend to generate agency problems, mainly because control over firm resources enables owner/managers to be generous to their descendents and other relatives. Parental altruism is a trait that positively links the controlling owner's welfare to that of other family members. Over time, however, the economic incentive to do what maximizes personal utility can blur the controlling owner's perception of what is best for the firm or family (Schulze et al., 2003).

Conflicts between family members generate the need for board control to ensure that the management team considers the preferences and interests of all family owners (Bammens et al. 2008).

The generational phase will influence on the need for board control. Therefore, independent directors may play a vital role as arbitrator in the case of conflict between family members. So, we propose that a higher proportion of independent directors on the board will be associated with a positive impact on performance.

Accordingly the following hypothesis is presented:

H3: The relationship between the proportion of board independent directors of non-listed family firms and firm performance is bigger in family firms run by subsequent generations

3. - EMPIRICAL RESEARCH: METHOD, DATA AND ANALYSIS

3.1. – Population and sample

We conducted this study on Spanish firms included in the SABI (Iberian Balance Sheet Analysis System) database for 2006. We imposed certain restrictions on this group of companies in order to reach a representative set of the population. First, we eliminated companies affected by special situations such as insolvency, winding-up, liquidation or zero activity. Second, restrictions concerning the legal form of companies were imposed: we focused on limited companies and private limited companies as they have a legal obligation to establish boards of directors. Third, we eliminated listed companies. Fourth, we studied only Spanish firms with more than 50 employees, i.e. companies large enough to ensure the existence of a suitable management team and a controlling board to monitor their performance. Finally, companies were required to have provided financial information in 2006.

There is no official database of family firms, so there is no way of directly identifying family firms. Moreover, the lack of an agreed definition of family firm leads to the use of samples of convenience, or to firms being identified as family firms after the sample has been preselected (Daily and Dollinger, 1993; Schulze et al. 2001, 2003; Chua et al., 2003). Given these limitations, a detailed analysis of the information in databases and a survey are the only way of identifying family and non-family non-listed firms. This study has chosen a combination of these two methods of identification.

In this study, a family firm is taken to mean a firm that meets two conditions: a) a substantial common stock is held by the founder or family members, allowing them to exercise control over the firm, and also b) they participate actively in monitoring it. We established 50% as the minimum percentage of a firm's equity considered as a controlling interest (Voordeckers et al., 2007; Westhead and Howorth, 2006). To find compliance with these two conditions, we conducted an exhaustive review of shareholding structures (percentage of common stock) and composition (name and surnames of shareholders), and also examined the composition of the board of directors of each selected companies in the database.

We accordingly classify a firm as a family firm if the main shareholder is a person or a family with a minimum of 50% of firm equity and there are family relationships between this shareholder and directors, based on coincidence of surnames. The composition of the management was also reviewed in search of family relationships between shareholders and managers.

The original sample used in this study is a 2958 firm random sample. After sending a reminder or contacting the firm by phone, 369 family firms responded the questionnaire

for which there were data on ownership structures, accounting variables and boards of directors.

3.2. – Data

Data were collected by means of telephone interviews, a method that ensures a high response rate, and financial reporting information was obtained from the SABI database. To guarantee the highest possible number of replies, managers were made aware of the study in advance by means of a letter indicating the purpose and importance of the research. In cases where they were reluctant to reply or made excuses, a date and time were arranged in advance for the telephone interview. The final response rate was approximately 12.47%, and the interviewees were persons responsible for management at the firms (financial managers in 56.48% of the cases, the CEO in 31.06%, the president in 1.54% of the cases, and others in 10.92%).

The questionnaire collects information on the variables required for the study that could not be obtained from the SABI database and which it was considered would be more reliably collected through a survey; in particular, information regarding the ownership structure and composition of the board and company management.

Table. 1 - Definition and calculation of variables

PANEL A	
VARIABLES OBTAINED FROM THE QUESTIONNAIRE	
VARIABLE	DEFINITION
Generation managing the firm (GEN)	Dummy variable that takes the value of 1 if the company is headed by the first generation and 0 otherwise.
Presence of affiliated directors in the Board (AFFILLITED)	Percentage of affiliated directors on the total number of directors
Presence of independent directors in the Board (INDEPENDENT)	Percentage of independent directors on the total number of directors
Board of Director's Size (BOARDSIZE)	Ln Total members on the board of directors.
Insider ownership (INSOWN)	Percentage of ownership of insider directors and chief executive officer
Family Dummy (FD)	Dummy variable that takes the value 1 if the company complies with the definition adopted and 0 otherwise
PANEL B	
VARIABLES OBTAINED FROM FINANCIAL STATEMENTS	
Firm performance, measured by firm profitability (ROA)	$EBIT / TA$, where $EBIT = \text{earnings} + \text{financial expenses} + \text{tax benefit}$, and $TA = \text{Total Assets}$
Growth opportunity (GROWTHOP)	$Sales_0 / Sales_{-1}$
Debt (LEV)	Total Debt / Total Assets.
Firm's size (SIZE)	Ln Total Assets.

Firm's age (AGE)	Ln number of years since the establishment of the company.
SECT	Dummy variables to control for sector

4.- RESULTS

Table 2 presents descriptive statistics for the variables in the analysis. We show mean values for family firms in the sample. These firms show a significant diversification, with nearly 64% reporting only one line of business. It should be noted the significant proportion of independent directors in family firms boards of directors. These boards have a composition which, at first sight, seems efficient in order to maintain family firm interests represented and separated. The evolution of this composition tends to reduce the presence of insider directors in favour of affiliated, maintaining also a significant presence of independent directors, regardless of which generation manages the firm. It is therefore necessary to determine the possible effect the presence of different type of directors might have on firm performance due to the greater monitoring or counselling capacity. In relation to *control variables*, it can be highlighted the high insider ownership, due to the CEO's percentage of ownership, which is, on average, 20%. It is also noteworthy that family firms have an average age of 40 years, suggesting that our firms are well established.

Table. 2 – Descriptive statistics of sample firms: Mean values for variable measures

	Family Firms		
Number of observations	369		
Number of business segments	2.47		
Fraction of single-segment firms	63.60		
Board of Director's composition (Outsiders %)	37.48		
	1st Gen	2nd Gen	3rd Gen
% insiders	74.39	68.58	51.99
% affiliated	16.48	17.89	33.65
% independent	9.13	13.53	14.37
<i>Control variables</i>			
Insider ownership (%)	50.17		
Board of Director's size (Number of directors)	5		
Return on Assets (%)	6.42		
Growth opportunity (Sales ₀ /Sales ₋₁)	1.14		
Leverage (Total Debt / Total Assets)	61.98		
Firm's size (Total Assets)	27309.48		
Firm's age (years)	40		

As shown in Table 3, the correlation coefficients are weak and do not violate the assumption of independence between the variables. To test for multicollinearity, the VIF was calculated for each independent variable. Myers (1990) suggests that a VIF

value of 10 and above is cause for concern. The results (not shown in this paper) indicate that all the independent variables had VIF values of less than 10.

Table 3 - Correlation Data

Variables	1	2	3	4	5	6	7	8	9
1 Independent	1								
2 Affiliated	0.88***	1							
3 Insider ownership	-0.06	-0.07	1						
4 Board size	0.01	0.02	-0.20***	1					
5 ROA	-0.05	0.09	0.03	0.20	1				
6 Growth opportunity	-0.05	-0.01	-0.00	0.06	0.24***	1			
7 Leverage	-0.03	-0.03	0.12**	-0.11	-0.29***	-0.24***	1		
8 Firm's size	0.03	-0.01	-0.08	0.18***	-0.02	-0.05	0.13**	1	
9 Firm's age	-0.04	-0.01	-0.11**	0.16***	-0.01	-0.01	0.3	0.01	1

*** Correlation is significant at the 0.01 level

Table 4 sets out the results of our linear regression evaluating the influence of board composition on business performance for family firms.

Table 4.- Relationship between board composition and firm performance

	ROA					
	I	II	III	IV	V	VI
Constante	0.112	0.142	0.186	0.150**	0.144**	0.143**
INDEPENDENT	-0.022		-0.040	-0.025		-0.019
INDEPENDENT*GEN				0.089**		0.081**
AFFILIATED		0.070*	0.089*		-0.004	-0.003
AFFILIATED*GEN					0.072***	0.067***
INSOWN	0.029	0.028	0.022	0.010	0.003	0.011
BOARDSIZE	0.002	0.002	0.002	0.002	0.006	0.003
GROWTHOP	0.273	0.385	0.444*	0.335***	0.327***	0.327***
LEV	-0.105**	-0.109*	-0.112**	-0.113***	-0.103***	-0.106***
SIZE	-0.001	-0.002	-0.003	0.001	0.001	0.001
AGE	0.009	0.008	0.009	0.002	0.004	0.003
F value	2.15	2.17	2.3	4.28	4.61	4.30
R ²	0.18	0.19	0.20	0.22	0.25	0.26

***, ** and * indicate significance at 1%, 5% and 10%.

In our first and third regressions we examined the influence of independent directors on firm performance (Table 4, column I and III). Our results show a nonsignificant relationship ($\beta_1 = -0.022$ and -0.040) between independents and firm performance. Thus, firm performance seems to be insensitive to the presence of independent directors in the board. Hypothesis 1 was not supported. These results show that monitoring and counselling by independents does not necessarily imply efficiency improvements for family firms.

The Hypothesis 2a predicted that the greater the fraction of affiliated directors in family firms, the better the performance of the firm and Hypothesis 2b predicted a negative effect. The coefficient (β_1 in column II) is positive and significant, so there is a positive

effect between the presence of affiliated directors on board and firm performance. The results (β_2 in column III) are similar if we include independent and affiliated directors in the same regression. The results support the hypothesis 2a.

Columns IV, V and VI show the effect of board composition considering which generation is running the firm. When the family firm is run by subsequent generations to the first, the results are not expected. The coefficient β_1 (column IV) is no significant, so we can not confirm the relationship between the presence of independent directors in the board and firm performance. However, the coefficient for the interaction between the percentage of independents on the board and the dummy corresponding to the first generation (β_2) is positive (0.089) and significant. We may therefore conclude that when the family firm is run by the first generation, the presence of independents on the board improves business performance.

The results are similar for affiliated directors. The coefficient β_1 (column V) is no significant, so we can not confirm the relationship between the presence of affiliated in the board and firm performance for firms run by subsequent generations. For first generation family firms the coefficient (β_2) is positive (0.072) and significant. The presence of affiliated directors, as independent ones, improves firm performance.

We may conclude from the results that Hypothesis 3 is not accepted. The finding show a bigger relationship between the percentage of outsiders on the board (independents and affiliated) and firm performance in family firms run by the first generation.

The result shows a clear difference in behaviour between family firms run by the first generation and those run by subsequent generations.

5.- DISCUSSION

We do not find any robust relationship between independent directors and firm performance, thus, Hypothesis 1 was not supported. These results are partially consistent with those obtained for other types of firms by authors such as Baysinger and Butler (1985), Hermalin and Weisbach (1991); Mehran (1995), Klein (1998), Baghat and Black (2000), De Andrés et al (2005) and Jackling and Johl (2009), who find no evidence relating the proportion of outsiders on the board and different measures of business performance or market value. However, we have advanced further than these authors, since we have differentiated between the independent and affiliated directors.

These results do not support the assumption that independent directors have an important controlling and advising function and in contrast can justify the presence of affiliated and insider directors in family firms.

The reasons put forward to explain the inexistence of a relationship between the presence of independent directors and performance vary. Hermalin and Weisbach (1991) suggest that both insider and outsider directors may fail to perform their job of representing shareholders' interests properly, i.e., it cannot be concluded that outsiders perform their activity better than insiders. Likewise, Mace (1986) and Vancil (1987) argue that inside directors facilitate the process of succession in the firm, offering advice and conveying knowledge to the CEO on the firm's day-to-day operations. The presence of insiders on the board makes it easier for the other directors to view them as potential top executives, since they can assess their skills more simply from seeing them act on the board itself (Bhagat and Black, 2000). Maug (1997) demonstrates that for firms with important information asymmetries –and this is the case of family firms– it is not optimal to increase monitoring through the incorporation of independents, since transferring specific knowledge about the firm to independents can prove costly. On the other hand, the CEO and management are characterised by their high level of commitment to the organisation and by sharing its values. It also needs to be said that each type of director has a specific role on the board (Baysinger and Butler, 1985). Inside directors have a greater knowledge of the firm than outsiders (Raheja, 2005), who are often unfamiliar with the working of the firm.

Nevertheless, the results show a clear difference in the behaviour of first-generation family firms and those run by subsequent generations. When the family firm is run by the first generation, having independent directors on the board improves firm performance, implying that independent directors potentially play an influential role in moderating family power and alleviating conflicts amongst shareholder groups as well as being advisors. These findings are consistent with both theory perspectives. Specifically, families acting to protect and promote corporate welfare could select directors based on their expertise and decision-making abilities rather than the independence or lack of independence from the family.

To differentiate between agency and stewardship based explanations of our results, we conducted additional tests to examine the interplay of family influence and board structure. We examined another group of outside directors; affiliate directors.

According to affiliated directors, our findings support the stewardship predictions, confirming the positive relationship between the proportion of affiliated directors on the board of non-listed family firms and performance. In non-listed family SMEs, affiliated act as stewards of firm value, promoting corporate health and firm performance. Directors classified as affiliates often can maintain skills in knowledge based fields such as law, finance, accounting, and consulting; suggesting that families seek these directors for their value-adding advice and counsel (Anderson and Reeb, 2004). In sum, these results are consistent with the stewardship explanation on the role of outside director, but are inconsistent with the monitoring or agency hypothesis.

Taking into account the clearly differentiated behaviour of first-generation family firms and those run by subsequent generations, the reason may be that in the case of first generation firms, independent directors really are more involved in their work on the board and perform their function effectively. First-generation family firms have a smaller proportion of independent directors than family firms run by subsequent generations. Although they have a smaller presence, this may be the right composition for the first phase in the life of a family firm, when the insider directors' knowledge of the firm's strategic planning is needed given the long-term perspective of these firms. In this way, independent directors monitor insiders and/or family members and also offer important and helpful advice and counsel.

Outsiders (independents and affiliated) have a more moderate presence during this first phase of the firm's life, which is unsurprising, given that the company equity is in hands of a small number of people, who are properly represented on the board. It therefore appears that the outsiders have been selected appropriately for performing their function, perhaps prevailing the advice and counsel roles.

When the firm is run by second and subsequent generations, the presence of outsiders (affiliated and independents) do not have any effects on performance. This might seem surprising, given that as the various generations succeed and the share base becomes more diverse, the presence of independent directors may become more necessary to ensure that the interests of the different shareholders are properly represented and that no decisions are taken that are detrimental to the interests of minority shareholders, since independent directors may play a vital role as arbitrator in the case of conflict between family members.

The results, however, suggest that in such cases independents are probably not acting in this way. If we analyse the board composition in firms run by second and subsequent

generations, we see that they have an ever greater presence but their monitoring role has no effect on firm performance.

It would be interesting to examine the degree of independence and specific expertise held by the outside directors on the board. Perhaps, the criteria for choosing directors also can vary, and personal friendship could play a relevant role. One might therefore consider that independents may not be acting objectively, given their many overlapping interests with the firm. Brunninge et al. (2007) indicate that one might suspect that outside directors often have close relations to the SME manager and owner based on friendship or professional ties. This may result in lack of real power and potential to contribute more extensively to the firm's strategy. This may explain why their presence on the board results in a drop in performance.

Moreover, a higher generation can be a proxy for a well-developed internal knowledge base in the firm. Higher generation successors are often better educated than the first generation owner manager. Therefore, the need for external advice and counsel decreases.

6.- CONCLUSION

Our aim is to analyze the effect of the presence of outsiders (affiliated and independents) on the board of directors on firm performance in family SMEs, also considering the generational effect. To test our hypotheses that outside directors act as agents or stewards, we examined the relationship between firm performance and the proportion of affiliated and independent directors on the board. Moreover, contrary to most previous studies, we did not focus on large listed companies but adopted a sample that includes mainly SMEs, none of which is listed. In an ownership concentration context, we used a sample of 369 family firms.

Our findings show the existence of a positive impact of affiliated directors on firm performance in family firms. The presence of independent directors can be said not to have resulted in improved firm performance. The firms in the sample showed a significant presence of affiliated directors, an aspect that may be related to their greater knowledge of the firm, with a subsequently positive effect on strategic planning decisions. This type of director provides alternative perspectives and expertise, playing an advising and counselling role.

It is also important to note the different behaviour between family firms run by the first generation and those run by subsequent generations. In this case, the presence of independents and affiliates on the board has a positive effect on performance when the

firm is run by the first generation. In this context, the predictions of stewardship theory are fulfilled, and outside directors act as stewards. When the firm is run by second and subsequent generations, the presence of independents has no effect on performance. Thus, one might therefore wonder how independent they really are.

The results of this study contribute to knowledge concerning agency and stewardship relationships in family firms. First, our findings provide a new perspective on the role that outside directors play in corporate governance of family firms, differentiating between affiliated and independent directors. Besides examining the board's role in controlling the conflicts between shareholder groups, we also consider the advising and counselling role of the board. Second, our study is one of the first to examine the distinction among outside directors in family firms. The role of affiliate directors has generally been overlooked in corporate governance research, and, typically, affiliate directors have been lumped in the overall category of outside directors. Third, the bulk of empirical research on the role and effect of outside directors on firm performance has however mostly been conducted on large publicly held companies (Anderson and Reeb, 2004; Daily et al, 1998). There are consequently very few studies that have explored the role and contribution of outside directors in the context of SMEs family firms, and those who do have often uncritically adapted concepts and theories developed for large firms. There consequently seems to be deficiencies in our knowledge of the role and contribution of outside directors in SMEs. We focus on non-listed family SMEs because the findings of large firms may not extend to smaller ones. Following Howorth and colleagues (2004) agency theory may provide only a partial explanation of private family firms.

Our research has some implications for family business owners and all those consultants. In family firms run by the first generation, the presence of outside (affiliated and independent) directors has a positive effect on firm performance, while in family firms run by subsequent generations there is no effect. These results suggest that first generation firms' outside directors' influence is an important element in monitoring and advising family activity. These directors certainly can add value to the firm through advice and arbitration in, for example, succession issues. However, when the firm is managed by subsequent generations, there is no such oversight, so we think that the problem can be the criteria for choosing directors. Personal friendship could play a very relevant role and it might therefore consider that outsiders, and in particular independents, may not be acting objectively, given their many overlapping interests

with the firm. Therefore, outside directors are to be selected carefully in order to be adequately qualified to carry out the responsibilities, general knowledge about business management and its environment and knowledge of the peculiarities of the family firms. It is also interesting that the consultants recommend firms to have a well-balanced equilibrium between outside and inside directors because of the important and concrete role they play on it, exercising a more effective function on the board, leading to better performance. It is the balance between monitoring and collaboration among governance actors that allows for an effective governance system.

This research has to deal with some limitations. First, the great difficulty to obtain non-listed firms database, and this is even more difficult in the case of family firms. Second, our data are cross-sectional in nature and therefore, we can not clearly infer on causality. Only a panel data sample will allow testing and complementing our findings. Third, data were collected exclusively in Spain, therefore limiting the possibility of generalizing our findings. Fourth, our analysis focuses solely on the formal independence of the board and ignores the social and psychological factors that may exist between the family and directors.

To conclude, some ideas about future research are pertinent. First, a research design based on longitudinal data would be more suitable for this kind of study in order to increase the reliability of causality directions. Second, we also want to consider the effect of CEO duality in conjunction with founding family ownership and the effect of the size of board of directors in monitoring and control activity. Third, a similar study could be conducted in countries other than Spain in order to increase the validity of our result.

7. - KEY REFERENCES

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