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When does the Affiliate Director Matter More for Family Firms?

Irfan Siddique[1]*, Irfan Saleem[2], Aqeel Ahmed[3]
University of Central Punjab, Lahore[123]
***Corresponding Author Email:** irfans@ucp.edu.pk

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With increasing competition, diversity, and dynamic market environment, family firms need better entrepreneurial mind-sets to tackle all catastrophic situations. The requirement for family firms' survival and growth ends to business diversification. Much has been discussed about the pros and cons of family control and family identity. However, the literature is naive in probing the combined effect of family control, family identity, and a moderating effect of affiliate directors on the firm's diversification. Using a socioemotional wealth perspective, our study examines diversification decisions, the one considered as a major decision in making firms as corporate entrepreneurial under family firms. The data is collected from Pakistani family firms operating in the manufacturing sector. The results prove that family control has a direct effect on a firm's diversification and the presence of affiliate directors moderate the relationship between family control, family identity, and a firms' diversification. Our study has recommended future research avenues for family-owned enterprises.

Keywords: Family firms, Diversification, Family control, and Family Identity

INTRODUCTION

Much has been studied about family firms' characteristics (Chua, Chrisman, & Sharma, 1999). A few studies were conducted to differentiate family firms from non-family firms, while evaluating them on diversification strategies (Gomez-Mejia, Makri, & Kintana, 2010). Within the diversification area of family firms, even a few studies probed characteristics of family firms that helped family firms to diversify neglecting the dimensions of restrictions under the riskier decisions. Along the importance of many other factors there has also been a little empirical research conducted on the combined variables of family control and influence and family identity in relationship to diversification decisions though few studies have highlighted the influence of family control on strategy and firm performance (Zellweger, Kellermanns, Chrisman, & Chua, 2012; Van Essen, Carney, Gedajlovic, & Heugens, 2015). Out of four basic themes of corporate entrepreneurship (Burns, 2012), diversification falls under the corporate venture theme and has been recently addressed on-farm diversification in UK (Yoshida, Yagi, & Garrod, 2019). However, literature does not examine diversification under family control and family identity with a moderating effect of affiliate directors.

This study tries to fill the literature gap as the effect of family control and family identity on diversification with a moderating role of affiliate directors. Moreover, the family firms are risk-averse (Alessandri, Mammen, & Eddleston, 2018) and the main source of their risk aversion is referred by Gomez-Mejia et al., (2007) as Socioemotional Wealth (SEW). Considering the two aspects of SEW that is family control and influence, and family identity the conceptual framework will relate the role of affiliate directors as the main source of their dilution for taking diversification decisions (Munoz-Bullon, Sanchez-Bueno, & Suarez-Gonzalez, 2018) that appeared as riskier decisions.

The study is based on the work of Gomez-Mejia et al., (2007), who argue that family has some specific traits that they want to enjoy for a longer period of time but are very critical to maintaining and called it as SEW. Family firms are loss averse for both financial wealth and SEW. Any of the activities that bring fear to some negative effect on SEW would make the family firm more conscious and would work in that direction that protects SEW (Gomez-Mejia, Patel, & Zellweger, 2018). Therefore, the family firm has to make a choice either to enhance and protect SEW or to make such decisions that may bring gain to firm but will not be shockers for family control and their identity (Ponomareva, Nordqvist, & Umans, 2019). The study will help the family firm's decision makers to look again about their control systems and the way they influence their firms and what will be the value of their identity. Further, the study will pave the path for the decision makers to understand the importance of affiliate directors in their board.

Diversification is one of the competitive strategies to formulate a competitive edge (Barney, 2001) that firms adopt and is considered as a major area of corporate entrepreneurship for high performances (Burns, 2012). Family firms especially need some sustainable competitive advantage (Stadler, Mayer, Hautz, & Matzler, 2018) as their organizational lifetime is very critical and can be challenged at any stage of their life cycles. Therefore, family firms need some bold steps to follow their dynasty and one of the competitive strategies is to diversify (Gomez-Mejia, Makri & Kintana, 2010). However, diversification may appear as a threat to SEW and the family firm would prefer to avoid such diversifications. According to Gomez-Mejia et al., (2010) family firms are fixed in two opposite directions when they are to take the diversification decisions. If family firms opt for diversification i.e. increasing diversification may be lowering down the SEW and vice versa. Related to the same concept is the effect of debt on the family firm's control. As the diversification is not only the theoretical concept, it is more practical and requires more capital. In such situation family firms require more debt that may solve the financial misery while on the other hand there will be less control by the family and the identity of the firm can also be shared as the investors have to take part in the decision making to save their invested portions (Gomez- Mejia et al., 2010). This highlights that the family firms are less willing to diversify, as they are not accustomed to the outsider's views (Schulze et al., 2003).

Based on the arguments by Gomez Mejia et al., (2010) we further validate the four hypotheses in our study. We hypothesize that family firms are more averse to diversification in case of losing their control and identity. Further, they prefer diversification, when affiliate directors play a moderating role in diversification (Jones, Makri, & Gomez-Mejia, 2008).

Besides conceptual studies, there is a dearth of empirical studies on the diversification of family firms. Our study addresses this gap and moves to the basic research questions that how do family control and identity in firms are linked to diversification decisions? And does affiliate director play any significant role in strengthen stated relationships in Pakistani family firms?

Subsequently, there are two key objectives of the research study.

a) To explain the relationship between family controls, family identity with the firm's diversification decision.
b) To test the moderating role of the affiliate directors in stated relationships.

LITERATURE REVIEW

In a traditional agency theory, the firms that are undiversified increases the level of risk and encourages decision-makers to dilute the risk by taking diversification decisions (Eisenmann, 2002). Contrary to this, the behavioral agency model (BAM) (Wiseman & Gomez- Mejia, 1998) challenges the assumption of consistent risk preferences and proposes that decision-makers have contingency views that are calculated under the different risks and their outcomes (Gomez- Mejia et al., 2010). The risk-seeking behaviors depend upon the frame of problems that can be gauged by the reference point to compare (Gomez-Mejia et al., 2007). Depending upon the nature of the prospects the decision-makers act as risk-averse for positively framed prospects and risk seeker for negatively framed prospects and is referred to as loss averse (Gomez- Mejia et al., 2010).

Therefore, the importance of any decision is not the risk aversion rather it is loss aversion. Firms may take a decision that is high risk in nature but high in a loss. When it comes to family firms Gomez-Mejia et al. (2007) argue that, it is the socio-emotional endowment that is being used as the reference point for any decision. The socioemotional endowment is a value that a family derives from its controlling position (Chirico, Gomez-Mejia, Hellerstedt, Withers, & Nordqvist, 2019; Berrone, Cruz & Gomez-Mejia., 2012) and makes decisions for their firms to merge sell or liquidate and gives an impression of their responsibility in the society (Cruz, Larraza–Kintana, Garces–Galdeano, & Berrone, 2014).

Diversification and Family Firm's Decisions

Family firms are considered as risk-averse firms (Gomez-Mejia, Neacsu, & Martin, 2019). One of the reasons may they invest all of its wealth in one venture i.e. having an undiversified business. Another reason may be their control over the firm and their family repute as their family identity that they may perceive to lose while taking any risky decisions (Gomez-Mejia et al., 2019). Family firms also try to avoid debt financing as it may also hurt family control and may lose their family identity because they may face issues of foreign interference and power of delegation. To remain entrepreneurial, family firms seek internal resources for their growth goals (Zahra, 2018) and also become one of the significant barriers for diversification (Gomez- Mejia et al., 2010).

When we investigate the pool of family firms it appears that they have limited knowledge and managerial expertise and diversification increase the complexity which results in hiring the professionals from outside of the family (Gomez- Mejia et al., 2010). Such hiring requires to give up some of the control to those professionals and should follow the directions given by them. Subsequently, the result will be of less control and identity issues and family firms are less likely to incorporate outsiders' perspectives and opinions in their decision making especially in SMEs owned by family firms (Maseda, Iturralde, & Arosa, 2015). Public related family firms do have different nature although the same preservation attitude about control and identity has been evidenced in them (Dyer & Whetten, 2006). Therefore, we formulate our first hypothesis as

H1: Family firms are reluctant to diversify if it implies to less family control & influence.

The key reason behind diversification in family firms is to mitigate risk (Delbufalo, Poggesi, & Borra, 2016) but that may result in control loss on different points of the firm. As discussed previously that diversification requires more capital in the form of debt and professionals to carry the business that may result in interference and authority delegation. Since authority delegation and foreign interference of any kind is a peril to the family endowment, therefore family firms are unwilling to diversify (Gomez- Mejia et al., 2010).

If family firms are willing to take a high business risk in terms of diversification, then they may be trading for high external elements that eventually results in less family control & influence. However, family firms are evaluating performances in comparison to their previous performances and if there is a decline in it then the decision-makers take it more sensitively. Gomez- Mejia et al. (2007) referred to this performance risk as to performance hazard. Family firms may opt for higher risks and may diversify. If firms fail to diversify in high-performance hazards, then that may also be a complete loss to their control and influence because the family control & influence exist by the existence of their firm. A lower performance hazard means fewer chances to diversify as family firms perceive high family control & influence. Therefore, perception of lower risk to family business means the preservation of family control and it can be created by a previous employee who is an expert and is working at the director's position (Jones et al., 2008). Further, the dominant coalition of the family firm has settled a way to decide about the business decisions and normally be controlled by the family principal. When some proposals may come from the independent board member that may hurt the control system or identity of the family firm (Jones et al., 2008). Therefore, the dominant coalition restricts to support such decisions even assumed for financial wealth in the form of diversification (Munoz-Bullon et al., 2018). When the affiliate directors become part of the same board that will uncover the potential of the existing board and may support the existing hegemony of the family firms. Therefore, family firms are reluctant to independent board member's advice (Munoz-Bullon et al., 2018) and supported to affiliate director's advice (Jones et al., 2008). Thus we frame our second hypothesis is as under

H2: Family firms decide to diversify at the expense of the firm's control and influence when affiliate directors moderate it.

Organizational identification is the attachment of individuals that associate them with the organization and perceive the values of that organization as his/her own (Ashforth, Harrison, & Corley, 2008). Deephouse and Jaskiewicz (2013) in their research related a social identity theory (Tajfel, Turner, Austin, & Worchel, 1979) and organizational identification with family firm's decision-making, having an impact on firm's reputation. Individuals in family firms take their organization with a deep relation (Deephouse & Jaskiewicz, 2013) and feel respect and admiration with the firm (Gomez- Mejia et al., 2018). For instance, a firm reputation is one of the key indicators for family identification (Zellweger, Sieger, & Halter, 2011).

Applying the same concept of organizational identification where family members have developed their own businesses may have high involvement at all organizational levels. Even the family members have not participated actively in family firms consider themselves as part of the family firm because they have grown up with it. The firm became their integral part of personality and identity (Zellweger et al., 2011). Social identification necessitates awareness, values and emotional attachment (Dentoni, Pascucci, Poldner, & Gartner, 2018; Ashforth et al., 2008) to the firm. Family members see the businesses as part and extension of their family and try to make their business goals aligned with family goals. They have their intentions to reflect family values, norms and beliefs in their businesses (Neckebrouck, Manigart, & Meuleman, 2016; Dentoni et al., 2018). Not only influenced by their economic goals, family members also weight high to psychic incomes (Gomez-Mejia et al., 2007; Gomez-Mejia, Cruz, Berrone, & De Castro, 2011) and their decisions may sometimes influence by family priorities rather business priorities (Zellweger, Nason, Nordqvist, & Brush, 2013). However, the case in a family business for organizational identification may vary from family to family. There are family-owned firms where family members do not relate themselves with their business, in comparison to other family members having less ownership, nonetheless imply strong family identification (Zellweger et al., 2013). Any member of the family who enjoys such a reputation is not of his/her own rather it is the reputation of the firm. Firm's reputation is the reflection of a family members' reputation and they either want to conceive it or try to make it to the next upper level. To protect that repute, family members do not take risky decisions. Fading reputation means the deterioration of their family repute. Whereas diversification involves risk and may take away the already build repute of the firm, therefore we frame our second hypothesis as

H3: Family identification with firm influences diversification in family firms.

This is not always the case and previous research has discussed different dimensions to mitigate risk. In family firms, the top positions often held by family members. A recent study by Hoskisson, Chirico, Zyung, and Gambeta (2017) refutes that risky strategic decisions under uncertain environments, do have to follow more certain outcomes. CEOs or top managers whenever take risky decisions they have their reference point to follow and in family firms, economic goals are determined as top manager's point of reference that make them loss averse (Wiseman & Gomez Mejia, 1998) not risk-averse. Gomez-Mejia et al., (2018) find that family firms go less for acquisition and diversification, the situation quite changes when organizational slack increases (Nohria & Gulati, 1996). Such an increase in slack become the main source of unrelated acquisitions (Gomez- Mejia, et al., 2018). Family firms require many resources for diversification and if they probe their firms, they may find large slack in their premises and employees who are reliable and worked for the past many years in their organizations can also be treated as a slack resource. Therefore, when an affiliate director works in the family firm it makes the situation change and comfort is being appeared to diversify based on his/her knowledge and network. Utilization of such resources paves the path for diversification therefore, we can propose

H4: Family firms decide to diversify at the expense of the firm's identity when affiliate directors moderate it.

METHODOLOGY

Family firms are neither in cluster nor in any specific industrial sector. Moreover, they have their roots in every trade, service or manufacturing area. In order to understand the limitation of our study, we have limited our research data to only manufacturing family firms. As there is no any specific population data available on the family firms, therefore we adopted non-probability sampling technique. Following the convenience sampling method for this study to investigate perception about family control and influence and family identity were asked from the respondents. The sampling unit was the family firms and the respondents were owners or any family member having a role in decision making or any key managerial position in their family business. The data was collected from the industrial areas in the peripheries of Lahore i.e. Quadi-e-Azam industrial state and Sunder industrial estate.

Previous researchers collected data by mail surveys and referred it as the most common method used in obtaining data for family firms (Chrisman, Chua & Litz, 2004; Chrisman, Gatewood, & Donlevy 2002) through the mail surveys in our country has least response rate therefore we opted the self-administrative method for data collection (Siddique, Saleem, & Abbas, 2016). The survey is scheduled with 105 owners or their members belonging to the family having a decision making a role in the family business. Out of 105 scheduled meetings, only 82 of the owners or family members of the business allowed and given time to record their responses. Whereas 78 responses are found correct making the response rate to 74.2%.

The questionnaire was divided into two parts where part one involved demographics of participants and part two consists of questions related to independent variables and dependent variables. The questionnaire was based on a five-point Likert scale was used in the questionnaire having a spread from strongly disagree (1) to strongly disagree (5). We have taken diversification as our dependent variable. Diversification, in our case, is taken under corporate venturing for corporate entrepreneurship and is a strategic choice by top managers or CEOs (Hoskisson et al., 2017). Independent variables are family firm's control & influence and family identity whereas a moderating variable is taken as affiliate director. Regression analysis is used by opting the SPSS software 21.0 for our variables. The conceptual framework is as under:

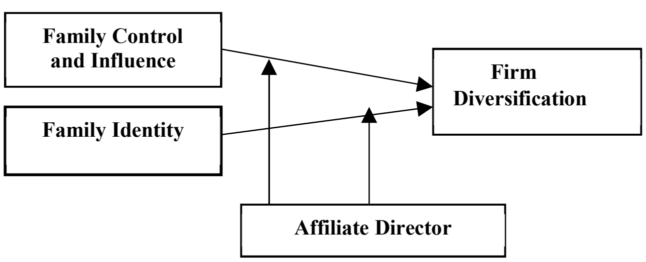

Figure: 1 Conceptual Framework

Firm's Diversification = b0 + b1 (FCI) + b2 (FI) + b3 (AFDir) + b4 (FC **x** AFD) + b5 (FI **x** AFD) + error

Instrumentation

Literature has defined differently to family firms where as per our study we are following the definition for family business as taken in the study of Kellermanns and Eddleston (2006) where a family business is a business owned by a single family and at least two members of the family should be working at some key positions in the firm.

Firm's Diversification. We have taken diversification as the subset of corporate entrepreneurship and the nature of our study matches with the scale used by Kellermanns and Eddleston (2006) where diversification decisions are counted under corporate entrepreneurship and we adopted the same measure with 7 items.

Affiliate Directors. We took affiliate directors by using Hillman et al., (2000) taxonomy as business experts or support specialists or have some previous affiliation with the focal firm either as a former manager or as the director of the related firm having their stake in the focal firm. To test the affiliate director's influence, we will follow the same method as described by Cennamo (2012) by taking the ratio of affiliate directors to board.

Family Control and Influence. For family control & influence we studied different scales (Klein, Astrachan, & Smyrnios, 2005; Lee & Rogoff, 1996; Debicki et al., 2016) and finally adopted the scale as proposed by Berrone et al., (2012). The construct was made up of 6 items.

Family Identity. For family identity, the same procedure of family control & influence been adopted and the relevant literature for the identity scales were studied (Klien et al., 2005; Carlock & Ward, 2001; Debicki et al., 2016). We took our scale by taking items from Berrone et al., (2012). The construct was of also 6 items.

Results and Data Analysis

Reliability Analysis: The coefficients of Cronbach's alpha were used to check the reliability of the stated items. As given in table 1 the items are reliable and accepted as in other studies with their alpha values above 0.7 (Amjad, & Mahmood, 2018).

Table 1. Coefficients of Cronbach's Alpha

Construct	Cronbach's alpha
Family Control and Influence	0.761
Family Identity	0.712
Diversification	0.850

Content Validity. The selected items of the scale sent to eight different experts five from each academia and industry. To validate, we selected five respondents having PhDs and are qualified from the top universities of the world having an entrepreneurship degree or teaching any of the subjects on entrepreneurship. As our study is based on family business, therefore, we also tried to scrutinize the relation of respondents to the family business. However, their relationship with family business serves the purpose of our study irrespective of their operational or managerial duties through the family business affiliation is considered as one of the family members who are active in taking the business decisions. The remaining three were CEOs of the family firms.

Initially, to address the issue of validity, we incorporated 13 items for family control and influence, 10 items for family identity and 7 items for firm diversification from the different studies. The draft questionnaire was having 30 items in total and was sent to 8 relevant experts of the filed. The draft questionnaire was sent by email to their respective addresses and after a weeks' time, a reminder email was also sent. A second reminder was given after 15 days of the first email. In response, we got 4 replies that make 50 % response rate. The final questionnaire remained with 6 family control items and 6 family identity items and 7 diversification items that make the questionnaire with 20 items.

Characteristics of Sample. As per the descriptive analysis, a large number of family firms' respondents (91.5%) are male. There are 59% of family firms having less than 50 employees, whereas 19.2% have 51-100 employees and 5.1 5 falls in the range of 101-150 employees and 1.3 % have 151-200 employees and 15.4% of firms in our sample have more than

200 employees. Interestingly the majority of the family firms' age i.e. 30.8% fall under 5 years of age. 25.6% of the firms fall in the age bracket of 05-10 years, whereas 12.8 % of the family firms fall in the age range of 11-20 years and also in the age range of 21-30 years separately. The remaining 10.3 % of the firms have the age of 31-40 years and only 7.7 % of the firms have the age of more than 40 years in our sample set. Most of the family firms have their family CEOs that count the figure to 96.15% and only 3.85% of family firms have non- family CEO. The data revealed that there are 64.1 % of the family firms in our data set having three (3) board members and 21.8 % of family firms have four (4) board members. Remaining 9% of the firms have five (5) board members 2.6% of the firms have six (6). Finally, 61.5% of family members have 76-100% board representation, whereas 20.5% have 51-75% and remaining 9% have a representation of 26-50% further 9% have an only representation of up to 25%.

Table 2. Sample Characteristics

Variable		Frequency	Percentage
Firm Size	1-50	46	59.0
Firm Age	>40	6	7.7
CEO	Family CEO	75	96.15
BOD	3	50	64.1
FBRATIO	25%	7	9.0
Gender	Female	08	10.3

Further, we run a direct effect of two independent variables by making them standardized and we saw that the model is significant but neither of the two variables is independently significant. Further, we standardized the variables and we took the interactive terms and we investigated that the model is significant with $p<0.05$.

Table 3. Regression Analysis

Model	Variables	β	SE	T- stat	Sig
Model:1	FCI	.025	.196	.125	.901
	FI	.422	.221	1.908	.049
Model:2	FI	.252	.197	1.278	.005
	FCI	.297	.221	.441	.001
	FCIxAFD	.175	.121	1.446	.042
	FI x AFD	.077	.120	.640	.024

Note: Independents= FC: Family Control & Influence; FI: family Identity; Moderator= AFD: Affiliate Director; Dependent Variable =CE: Corporate Entrepreneurship; CE is being used as proxy for Firm's Diversification.

Direct effects and Moderation. Refer to above Table 3, regression analysis is used among the independents (FI and FC), moderator (AFD) and Dependent (Family diversification) variables. Later we computed interactions terms. Refer to model 1, regression analysis shows that one variable i.e. FI is statistically significant, while FC is insignificant. The First hypothesis is rejected as standardized $\beta =0.025$ $p = .901$ is statistically insignificant. Therefore, family control does not influence the firm's diversification. The second hypothesis is accepted as standardized $\beta = 0.175$ $p = 0.042$ that is statistically significant. Thus we can say that having affiliate directors at corporate board moderates the relationship between FCI and the firm's diversification. The third hypothesis is also accepted as standardized $\beta = .422$ $p = 0.049$ is statistically significant. Thus it is assumed that the family identifies positively influence the firm's diversification. The fourth hypothesis is also accepted as standardized $\beta = .077$ $p = 0.024$ is statistically significant. Thus affiliated director's presence at the corporate board positively modifies the relationship between FI and Firm's diversification.

Table 4. Results

Hypotheses	Description	Result
Hypothesis No.1	Family firms are reluctant to diversify if it implies less family control and influence.	Rejected
Hypothesis No.2	Family firms decide to diversify at the expense of the firm's control and influence when affiliate directors moderate it.	Accepted
Hypothesis No.3	Family identification influences a firm's diversification in family firms.	Accepted
Hypothesis No.4	Family firms decide to diversify at the expense of the firm's identity when affiliate directors moderate it.	Accepted

DISCUSSION AND CONCLUSION

This study highlights the theoretical arguments and empirical evidence to justify that family firms have a unique nature and differs from non-family firms in their decision making specifically while taking the decision for diversification. Family firms differ while deciding diversification from the non-family firms as they have to take care of their socioemotional wealth. Diversification is taken as a corporate entrepreneurship activity and family firms are reluctant to make decisions for it.

The result of our first hypothesis is inconsistent with the result of previous studies (Gomez- Mejia et al., 2010). That could be the reason that in our culture of family firms the decision-makers have very firmly believe in their control system and if there is an option to expand their business they will do that irrespective of losing their control. Our third hypothesis is accepted and is consistent with the result of the previous studies (Neckebrouck et al., 2016; Zelleweger et al., 2013). As of the other parts of the world, the family firms are reputational conscious and do not want to lose their reputation for any of the new test cases that may even appear as diversification. Further, we also conclude that the role of affiliate directors plays a great role in helping family firms to take such important decisions of diversifications. The results are consistent with the study of Gomez-Mejia et al. (2007) where the firms were reluctant to become the part of co-operatives even they were getting more financial benefits but they preferred to preserve their family control and influence. In another study by Berrone et al. (2012) where family firms were polluting less just to save their reputation is also consistent with our results. As protecting repute is also considered to save family identity. In the Pakistani context, the family owners do not consider any of the threat to their control and influence and whenever they see an opportunity they go for it that can be in the shape of diversification. However, when affiliated directors come they may more support to take any of the risky decisions that may also be of any diversification. The result of hypothesis 2 and hypothesis 4 are also consistent with the previous study of Jones et al., (2008).

Limitations and Future Research

Our study is based on the two very important aspects of socioemotional wealth that is, family control and influence and family identity. Family firms are reluctant to become corporate entrepreneurial as they have a risk of loss in their control and identity. To limit the dimensions of corporate entrepreneurship we only studied its dimension of diversification while for future research the area of corporate venturing, intrapreneurship and entrepreneurial transformation can also be studied. Moreover, the researchers can also check the other five dimensions of SEW and can probe their different matches either independently or taking as a cumulative construct. The moderating effect is also having its limitations to affiliate directors i.e. any previous employee currently working as a director, or any business expert or any supporting expert as lawyer or banker. However, for future studies, the new moderators can be explored as the employees having long term relationships with the firms and are considered as loyal employees that can understand the culture of the family firms and can easily mitigate the expected risks.

With given dimensions of socioemotional wealth, our study restricts our scope to two major characteristics of the family firm i.e. family control & influence and family identity. We have come up with the results that family firms diversify less or are more reluctant to diversify because of the risk of loss on their family control and family identity.

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