

# Peculiarities Of Financial Management In Family Firms

Martin R. W. Hiebl, Johannes Kepler University, Austria

## ABSTRACT

*The majority of firms in market-oriented countries are family-owned. Despite their significant economic importance for these countries, research focusing on family firms is a rather young field within business research, having intensified starting only in the late 1980s. Research regarding the peculiarities of financial management in family firms is especially scarce. Hence, this paper seeks to synthesize existing research and to theoretically analyze the finance and accounting practices and resources of, as well as the role of financial managers in family firms. Using agency theory, stewardship theory, and the resource-based view of the firm, this paper suggests that finance and accounting practices should be adapted to the controlling family's needs. The paper further suggests that family firms are likely to use fewer short-term-oriented financial-management practices than non-family firms. Moreover, compared to non-family firms, financial managers should play a more traditional role in family firms, focusing on core financial management tasks and on advising the controlling family, while not themselves holding strategic decision-making power. The paper concludes with concrete avenues for further research.*

**Keywords:** Financial Management; Finance; Accounting; Management Accounting; Family Firms; Agency Theory; Stewardship Theory; Resource-Based View of the Firm

## INTRODUCTION

Family firms are acknowledged to form the majority of firms in most market-oriented economies worldwide (e.g., Joyce, 2007). The high share of family firms amongst the total number of firms also represents the family firms' enormous economic importance, as usually more than half of a western country's GDP and more than half of such a country's employment are generated in family firms (IFERA, 2003). Despite their economic importance, research regarding family firms is a relatively young area of business research, having intensified starting only in the late 1980s (Bird et al., 2002). Since then, academic journals entirely concerned with the specifics of family firms have been established. In 1988, the first edition of *Family Business Review* was published. In 2010, the *Journal of Family Business Strategy* was established, followed by the *Journal of Family Business Management* in 2011.

Although research regarding family firms has seen increased activity recently, the existing literature has mostly focused on a rather small set of issues. These include business succession, special resources and challenges of family firms, family-firm governance, and the economic performance of family firms (Schulze and Gedajlovic, 2010). Meanwhile, the particular organization of financial management (finance and accounting) in family firms has thus far received limited attention (Filbeck and Lee, 2000; Salvato and Moores, 2010). This lack of attention is regrettable, because there is evidence that these functions are crucial to a family firm's survivability and economic success; also, as a result of insufficient financial management know-how, only one-third of family firms successfully manages to transfer the business to the second generation, and only roughly 10% survive the third generation (Paisner, 2000). Accounting and management accounting techniques can help the family firm to mitigate typical business-succession hurdles. For instance, by using strategic management accounting tools such as a balanced scorecard, formerly informal knowledge can be codified and thus transferred to succeeding generations or to external managers with greater ease (Giovannini, 2010). At the same time, there is evidence that family firms differ from non-family firms in their use of finance and accounting practices and in the institutionalization of these functions (Gallo and Vilaseca, 1998; Filbeck and Lee, 2000; García Pérez de Lema and Duréndez, 2007; Duller et

al., 2011; Speckbacher and Wentges, 2012; Hiebl et al., forthcoming). Thus, this paper seeks to provide an overview of currently existing literature on financial management, financial accounting, and management accounting in family firms. It further seeks to theoretically analyze aspects of finance and accounting in family firms, which have not yet been examined. To do so, agency theory, stewardship theory, and the resource-based view of the firm (RBV) are employed as a theoretical background. Specifically, the use of finance and accounting practices, the existing finance and accounting resources, and the roles of finance and accounting managers are analyzed, each with a focus on a comparison between family and non-family firms. The final section of this paper provides avenues for further research.

## **LITERATURE REVIEW**

A number of empirical studies investigating the organization of financial management in family firms have focused on the adoption of specific practices or techniques. In comparison to non-family firms, family firms were often found to use less and less sophisticated finance and management accounting practices (Filbeck and Lee, 2000; García Pérez de Lema and Duréndez, 2007; Lutz et al., 2010; Hiebl et al., 2011a; Di Giuli et al., 2011; Speckbacher and Wentges, 2012). However, some contextual factors relativize these findings based on a dichotomous differentiation between family and non-family firms. For instance, the existence of non-family managers, such as a non-family Chief Financial Officer (CFO), on a family firm's executive board reduces the differences between family and non-family firms regarding the use of finance and management accounting practices (Filbeck and Lee, 2000; Caselli and Di Giuli, 2010; Lutz et al., 2010; Di Giuli et al., 2011). Moreover, differences between family and non-family firms also diminish along with greater firm size; large family firms were found not to differ substantially from non-family firms regarding their use of finance and accounting techniques (Hiebl et al., 2011a; Speckbacher and Wentges, 2012). In contrast, there is no such linear relationship for the contextual factor of family-firm generation, as Duller et al. (2011) argue that there is instead a U-shaped dissemination of management accounting practices along the generational lifecycle. This finding is contradictory to the results presented by Moores and Mula, 2000, who found that in later lifecycle stages, family firms also adopt more bureaucratic mechanisms such as profit or cost centers and budgeting. However, Moores and Mula (2000) have focused on the family firm's lifecycle, not on the generation of the controlling family by which the family firm is led, which might explain their discrepancy with the study by Duller et al. (2011).

Concerning financial accounting, empirical studies have mainly investigated earnings quality and earnings management in family firms (Salvato and Moores, 2010). In this regard, family ownership was found to positively influence the informativeness of a firm's reported earnings (e.g., Wang, 2006; Chen et al., 2008). This relationship is mostly explained by the observation that there is usually a lower incentive for managers of family firms to perform active earnings management, as these managers are often also the main owners of the firm. However, this finding mainly holds for countries with higher ownership dispersion, such as the UK or the United States. In contrast, in countries with rather concentrated ownership, controlling families could try to expropriate minority shareholders by performing earnings management in their favor (Salvato and Moores, 2010). For regions such as continental Europe and Asia, there is empirical evidence supporting this notion (e.g., Yeo et al., 2002; Beuselinck and Manigart, 2007). Regarding voluntary disclosure, theory would suggest that because of their long-term orientation and family participation in management, family firms should attach less value to voluntary disclosure. However, empirical results on this issue are mixed, providing evidence that family firms engage in both more and less voluntary disclosure than non-family firms (e.g., Ali et al., 2007).

Regarding the resources used in family firms and the role of financial managers in family firms, existing literature is very scarce. There is only evidence that family firms establish discrete management accounting departments to a lower extent than non-family firms (Hiebl et al., 2011b; Hiebl et al., 2011a), which can be viewed as evidence that family firms rely less on finance and accounting resources than non-family firms. Concerning special roles for financial executives in family firms, there are some findings regarding the role of non-family CFOs in family firms. Because of the specific knowledge needed in the CFO role, the position was found to be the first for which the controlling family employs non-family managers (Filbeck and Lee, 2000). Empirical results also indicate that non-family CFOs foster the professionalization of family firms, the introduction of more sophisticated financial management techniques, and also potentially a reduction in a family firm's financial risk (Filbeck and Lee, 2000; Lutz et al., 2010). However, family members in the CFO position should still be more powerful than non-family

members, as the controlling family tends to not delegate much decision-making power to non-family members (Gallo and Vilaseca, 1998). Still, there exists evidence that non-family CFOs very well complement family CEOs, as family firms with this management configuration show superior performance (Caselli and Di Giuli, 2010).

## **THEORETICAL BACKGROUND**

Because the involvement of a controlling family forms the main difference between family firms and non-family firms, research regarding family firms has widely used agency and stewardship theories as a foundation (Chrisman et al., 2010; Siebels and zu Knyphausen-Aufseß, forthcoming). These theories are useful in family-firms research, as both theories examine the relationship between a firm's owners (whether family or non-family) and its managers (also family or non-family). Furthermore, the RBV has been utilized in family-firms research to analyze the advantages and disadvantages of family firms due to their specific resources (Siebels and zu Knyphausen-Aufseß, forthcoming). Finance and accounting practices and personnel can serve both as a resource to the firm (Sirmon and Hitt, 2003; Songini, 2006) and as a mechanism to support alignment of owners' and managers' interests (Bushman and Smith, 2001; Johanson, 2008). Thus, in this paper, these three theories are applied as the theoretical background. Their main ideas are briefly discussed upfront.

Agency theory predicts that agents (the firm's management), who operate with the principals' (the firm's owners') resources, do not automatically act in line with the principals' goals, but also pursue self-serving goals (Jensen and Meckling, 1976). To make the agents act in the principals' interest, principals introduce mechanisms to align the agents' interests with their own (Fama and Jensen, 1983). Business owners might set up control mechanisms or establish incentive-compensation schemes to make their managers act according to their goals (Chua et al., 2009). Costs arising as a result of actions that seek to align the principals' and the agents' goals are referred to as agency costs (Fama and Jensen, 1983). Because family firms often involve a personal union of owner and manager (known as family managers), there should be a lower need for goal alignment, which should reduce the agency costs compared to non-family firms (Ali et al., 2007; Bammens et al., 2011). However, there can arise specific agency costs when a family firm relies on family managers. For example, family managers may exhibit below-average management performance, thereby creating disadvantages for the family firm (Schulze et al., 2001; Keleş et al., 2011). Family managers could also pursue the goals of the controlling family instead of the goals of the firm, harming the family firm in so doing (Davis et al., 2010).

Stewardship theory offers another approach for analyzing the principal-agent relationship. Managers acting in line with this model are not self-serving, aiming not to optimize personal income. Instead, they are intrinsically motivated and behave in order to encompass the well being of the firm (Davis et al., 1997). Family-firms scholars have mainly used stewardship theory to analyze family members' behavior in the context of family firms, widely assuming that the goals of the family firm and the family manager are identical (Corbetta and Salvato, 2004). Family firms should thus have a culture of mutual trust, a lower need for the institutionalization of monitoring mechanisms or incentive schemes, and generally a lower need for goal alignment. However, under certain circumstances, non-family managers can and also do act according to the stewardship model. For instance, Vallejo (2009) has shown that the level of commitment of non-family managers positively influences family-firm performance and survivability. He ascribes this finding to the notion that non-family members can also act as stewards to the family firm.

Finance and accounting information may be a resource for the firm, which can influence the firm's future competitiveness and long-term survivability (Sirmon and Hitt, 2003; Di Giuli et al., 2011). Thus, in this paper, finance and accounting resources and practices are seen as potential comparative resources; therefore, this paper also draws on the RBV as a theoretical framework to assess the utility of a firm's resources. The RBV generally assumes that a firm's competitive advantages are based on the resources available to the firm and the management of these resources (Wernerfeldt, 1984; Mahoney, 1995). Family firms usually enjoy special resources, but they also have to face special challenges (Habbershon and Williams, 1999). On the one hand, family firms have more patient shareholders, show pronounced survivability, and have more flexible organizational structures. However, family firms often struggle when trying to overcome hurdles specific to family firms, such as mastering business succession or attracting highly qualified employees (Neubauer, 2003; Sirmon and Hitt, 2003; Chrisman et al., 2010).

## **USE OF FINANCE AND ACCOUNTING PRACTICES IN FAMILY FIRMS**

As predicted by stewardship theory, family firms often enjoy a specific culture, characterized by mutual trust and high commitment of the executives to the family firm's overall success (Davis et al., 1997; Corbetta and Salvato, 2004; Davis et al., 2010). This culture has been observed both for family firms that rely on family managers and those that employ non-family managers (Vallejo, 2009). The resulting lower need for goal alignment also affects the use of finance and accounting practices, especially financial and managerial accounting techniques, which can increase the transparency of the impact of a manager's actions and performance (Merchant and van der Stede, 2007). For instance, the use of the balanced scorecard can create transparency of a manager's success in reaching strategic goals (Moores and Craig, 2006). If there is a reduced need for goal alignment, finance and accounting techniques should also be of lower value. Thus, from a theoretical standpoint, it can be expected that family firms employ fewer financial management practices. As pointed out in the Introduction, prior research partly supports this notion. Furthermore, it can also be expected that finance and accounting practices in family firms are less formalized, because, as a result of mutual trust, commitments and arrangements are more often made orally, or on an ad-hoc basis, than in a written form (Duller et al., 2011; Feldbauer-Durstmüller et al., forthcoming).

Not only should a reduced need for goal alignment between owners and managers have an impact on the use of financial management techniques, but so also should the typical long-term orientation of family firms (Habbershon and Williams, 1999; Joyce, 2007). Many controlling families aim to keep the family firm in the hands of the family (Chua et al., 1999). Thus, business succession and a long-term orientation become important goals for family firms. From another perspective, this also means that family firms attach less value to short-term performance variations and the reporting of short-term results (Chrisman et al., 2005; Chua et al., 2009). Therefore, compared to non-family firms, family firms should rely less on short-term and reporting-oriented financial management techniques, relying more on strategic instruments that could foster the long-term well being of the family firm.

Because of the typically high influence and importance of the controlling family in the family firm, it can be expected that financial management techniques will be adapted to the family's needs. Finance and accounting practices should therefore also include a more pronounced owner dimension in family firms compared to non-family firms, which are often widely held. Again, one example could be found in the introduction of a balanced scorecard in family firms, which often features a family dimension in addition to the classical four balanced-scorecard dimensions (Moores and Craig, 2006). On the other hand, as a result of the common personal union of owner and manager in family firms, it can be expected in such firms that the spheres of ownership and business would be heavily intertwined (Gersick et al., 1997). This could also result in mixing the family's sphere of personal wealth with the firm's wealth management. Thus, financial managers in family firms are also likely to need (at least partly) to deal with personal wealth-management practices, as it seems probable that when the controlling family has put its trust in a financial manager for their firm, it might also place their personal wealth management in his hands, or at least partly.

## **FINANCE AND ACCOUNTING RESOURCES IN FAMILY FIRMS**

The above-described reduced expected usage of financial management practices in family firms should also result in fewer resources allocated towards finance and accounting in family firms: if there be less need for such practices, fewer financial management personnel are needed. This notion receives further support from findings based on the RBV. As family firms usually show pronounced market orientation (Tokarczyk et al., 2007), they tend to allocate available resources more to business areas that promise market success or immediate returns, such as marketing and sales efforts or product development. In contrast, finance and accounting are supporting functions that might thus not enjoy the same attention or resource allocation in family-owned firms. A reduced endowment of financial-management resources in family firms should result in reduced relative finance and accounting headcount and less-separated organizational units, such as discrete financial-accounting or management-accounting departments (Hiebl et al., 2011b).

In general, family firms were found to attach less value to the academic training of their employees (Fiegener et al., 1996; García Pérez de Lema and Duréndez, 2007; Hiebl et al., 2011a). Thus, it can also be expected

that finance and accounting personnel in family firms would hold academic degrees to a lesser extent than in non-family firms. This expectation receives also support from an agency perspective. On the one hand, because of the limited wealth transfer in family firms (usually, there are no stock options or possibility to gain partial ownership of the firm), academically educated financial and accounting personnel might rather avoid employment at family firms (Sirmon and Hitt, 2003). On the other hand, patriarchal family firm owners might not welcome potentially better-educated financial management employees who might want to challenge the patriarch's decisions (Schulze et al., 2003)

The family firm's configuration of corporate governance can be expected to moderate the endowment of finance and accounting resources at such firms. The introduction of non-family directors or managers, especially, should lead to intensified usage of finance and accounting practices and thus to the establishment of resources in these fields. First, this reasoning is supported by the idea that non-family directors and managers are often required to professionalize family firms; the establishment of finance and accounting resources is usually seen as one aspect of professionalization (Songini, 2006). Second, non-family managers might just be used to fact-based decision-making relying heavily on financial and accounting information. In contrast, family members often show deep, firm- and market-specific knowledge, relying to a lesser extent on formalized finance and accounting systems (Sirmon and Hitt, 2003). Hence, from this standpoint, family firms that solely rely on family management can be expected to use fewer financial-management resources than non-family firms.

## **ROLES OF FINANCE AND ACCOUNTING MANAGERS IN FAMILY FIRMS**

Recent literature suggests that finance and accounting personnel, such as CFOs or management accountants, have emerged into a more strategic role instead of dealing only with traditional, more transaction-based tasks (e.g., Granlund and Lukka, 1998; Baxter and Chua, 2008). As of yet, there are no empirical findings regarding this possibly increased role of financial managers in family firms specifically. However, there is evidence that non-family financial managers in family firms enjoy less strategic decision-making power than their family peers (Gallo and Vilaseca, 1998). Moreover, family firms tend only to employ non-family financial managers when they cannot provide sufficient financial-management knowledge from their own ranks and when they are looking for financial-management specialists (Lutz et al., 2010; Hiebl and Feldbauer-Durstmüller, forthcoming). Thus, it seems likely that non-family financial managers should rather play a more traditional role in family firms, mainly focusing on core financial-management tasks and not on the strategic management of the firm.

Reconsidering the reduced reliance of family firms on short-term reporting, it can further be expected that, in general, financial-management personnel should not play such a prominent role in family firms as that proposed for large, widely-held corporations (e.g., Zorn, 2004). Again, the family can be expected to retain most strategic decision-making power for themselves; they might not want to share this power with non-family financial managers (Barnett et al., 2009). However, non-family financial managers can add value to a family firm in the role of financial advisers to the controlling family (Caselli and Di Giuli, 2010). Thus, it seems likely that the role of non-family financial and accounting managers in family firms can be depicted as centering on core finance and accounting tasks and less on strategy, on advising the controlling family in the decision-making process while not themselves enjoying much (strategic) decision-making power. In this way, financial managers could well fit into the stewardship model as they try to realize the long-term well-being of the family firm by advising the controlling family and by trying to reduce the financial risk associated with the controlling family's decisions.

## **CONCLUSION AND AVENUES FOR FURTHER RESEARCH**

This paper has aimed to analyze the peculiarities of financial management in family firms from the standpoint of agency theory, stewardship theory, and the RBV. The theoretical analysis revealed that, compared to non-family firms, family firms can be expected to use fewer finance and accounting practices, that these practices should be less short-term-oriented, and that they should be adapted to the controlling family's needs. This should lead to a reduced endowment of finance and accounting resources in family firms and to a reduced reliance on academically trained financial-management personnel. Moreover, the financial managers in family firms can be expected to play a more traditional role than in non-family firms, focusing on core finance and accounting tasks and on advising the controlling family.

The field of financial management in family firms offers a vast array of further research opportunities. First and foremost, it would be valuable to test empirically the relationships and assumptions drawn in this paper. Both quantitative and qualitative research methods should offer worthwhile approaches to do so. For instance, it would be interesting to further investigate the differing roles of CFOs, management accountants, financial accountants, and treasurers in family firms and non-family firms. Besides an initial, general description of the peculiarities of these roles in family firms, a more detailed analysis would be worthwhile, examining how these roles at family firms change in relationship to certain contextual factors. Research questions might include: How does the role of financial managers in family firms change in relationship to the firm's life-cycle stage, the level of family influence, the existence of outside investors, or a change in the firm's predominant strategy? Furthermore, it would be interesting to further investigate the specific needs of family firms for adapted finance and accounting practices. So far, there is only very limited insight regarding how family firms alter standard finance and accounting techniques to their needs (e.g., Moores and Craig, 2006).

Following these potential research agendas should offer important insights to both theory and practice; theory could then create more precise recommendations for family firms in different situations. Practice, in turn, could be informed by research findings, allowing firms to adapt and change their use of financial-management techniques and resources. By exploring the special needs of family firms, theory should strive for more suitable financial-management solutions for family firms.

#### **AUTHOR INFORMATION**

**Martin R. W. Hiebl** is a Research Assistant at the Institute for Controlling and Consulting at the Johannes Kepler University Linz and a Management Consultant at McKinsey & Company, Inc. in Vienna, Austria. His main areas of research include the role of the Chief Financial Officer and the organization of management accounting in family firms. E-mail: martin.hiebl@jku.at.

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