CONTRACTUAL AND RELATIONAL FAMILY FIRM GOVERNANCE: SUBSTITUTION OR COMPLEMENTARITY?

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Abstract

In this paper we argue that substantial weaknesses in corporate governance structures may be responsible for the pervasive failure of family firms to survive into the next generation. Aiming to improve extant knowledge on governance of family-owned enterprises that might boost their prosperity and longevity, we advance an integrative conceptual model which builds on boundary theory premises and accounts for the interdependencies among multiple governance arrangements. In particular, we suggest that the choice of an optimal governance configuration is dependent upon the way family firms manage the boundaries between their family and business identities. By combining contractual and relational devices of family firm governance into a single study, our model seeks to contribute to the ongoing debate in the literature regarding the existence of substitution effects and complementarity between alternative governance mechanisms.

Keywords: family businesses, boundary theory, contractual governance, relational governance, complementarity, substitution

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Introduction

Family businesses play a significant role in the development of national economies all over the globe due to their predominance and extraordinary ability to generate wealth (Morck and Yeung, 2004). According to official statistics, more than 75% of organizations worldwide are family controlled and some of the largest international corporations such as L'Oreal, IKEA, McKain Foods, Samsung Group, Wal-Mart and Fiat Group, are owned by well known families (OECD, 2008). Corporate America was mainly built on family businesses where they represent approximately 40% of the Fortune 500 companies and generate over 50% of the United States' private sector workforce (Oswald et al., 2009), while in Western Europe families control about 44% of firms (Faccio and Lang, 2002).

Despite their importance in national wealth creation, the evidence suggests that the prevalent concern for family run organizations relates to the question of survival, sustainability and longevity. Scholars in the field typically show that less than 30% of family firms succeed in passing the business to the second generation and that as little as one out of three companies makes it to the third generation (van der Merwe and Ellis, 2007). Among the most commonly cited reasons for family business failure are intergenerational conflicts, poor interpersonal communication, low levels of process formalization, lack of succession planning, and constant tension between family and business priorities (Blumentritt, 2006; Lambrecht, 2005).

To help family firms improve their survival rate, a longstanding tradition of research has been established aiming at clarifying issues related to conflict resolution, strategic planning and succession

management. Only recently, a new stream in family business literature has emerged suggesting that a major factor in the low survival rate of family-owned enterprises is poor or non-existent governance (Adendorff et al., 2005). Many efforts started to be deployed to identify the most appropriate governance practices that allow family firms to successfully conciliate the complex duality of family emotions and business objectives. Relying on contrasting economic and sociological approaches to organizational theory, researchers have began to emphasize the need for adopting either contractual or relational governance mechanisms with the purpose of securing the long-term success of family businesses. Yet, existing studies in the field have rarely inquired into the existence of complementarity and substitution effects among alternative governance devices operating within the same organizational system (Setia-Atmaja et al., 2009) and their role in alleviating the persistent contradictions between family and business domains. Although during the last decade international scholarship on family firm governance has gained more momentum, still little is known about the effective governance configurations of these firms.

The aim of this paper is to make our contribution to the furthering of extant corporate governance knowledge in the specific context of family businesses. In particular, we advance hereinafter an integrative research framework which builds upon boundary theory premises (Sundaramurthy and Kreiner, 2008) and considers the interdependencies among different governance mechanisms (Rediker and Seth, 1995), while simultaneously conciliating relational and contractual governance and conflicting family and business pressures. We suggest that the choice of an optimal governance configuration depends on the family firm specificities with regard to the way it manages the boundaries between its family and business identities. Thus, our research framework seeks to clarify the complementarity and substitution among multiple governance devices within the family-controlled setting.

Literature review

Economic versus sociological approaches to family firm governance

Despite a long tradition of research established in the family business area, only recently the myriad of questions surrounding family firm governance started to attract scholars' attention giving rise to a new body of literature on the intersection of family enterprises and corporate governance. The interest in governance issues within family firms intensified as many scholars have empirically demonstrated the existence of a positive relationship between good governance practices and organizational survival and profitability (Neubauer and Lank, 1998; Lansberg, 1999). Economic and sociological approaches to studying organizations represent the two contrasting sets of theories that lead current research on family business governance. The economic theory of agency, which stems from the assumption of separation of ownership and control, advances that conflicts of interests between owners and managers arise in situations when managers, seen as utility maximizers, are more interested in their own welfare than that of the owners (Jensen and Meckling, 1976). These conflicts, which generate additional agency costs for the firm, are due to the pursuit of divergent objectives, contrasting levels of effort and risk aversion, differential decision-making time horizons, and the existence of information asymmetries which make it difficult for shareholders to monitor the resource allocation activities of executives (Eisenhardt, 1989). To solve the problems of managerial opportunism and discipline self-interested managers, agency proponents call for the use of formal governance mechanisms such as board monitoring, executive equity ownership, and active markets for corporate control (Walsh and Seward, 1990).

Initially, agency theorists argued that family control would reduce the likelihood of principal-agent conflicts, resulting in low agency costs (Carney, 2005). Yet, since further inquiry uncovered several structural inefficiencies, many problems ensuing from personal rivalries and a variety of incentives for pursuing value-destroying endeavors, agency theory has rapidly become the dominant paradigm in family business research. It was shown that the unification of ownership and control in family firms gives rise to the proliferation of principal-principal type of agency conflicts, whereby majority family owners can use their control rights to expropriate the wealth of minority shareholders (Young et al., 2008). This expropriation may occur when large family owners involve in activities that are detrimental to the interests of other investors, design excessive compensation packages for family managers, and divert many resources from the firm to personal use by family members particularly in situations when family shareholders' control rights significantly outweigh their cash flow rights. Given that external markets for corporate control are essentially inactive for family-controlled enterprises, other contractual governance mechanisms, such as bank ownership and foreign institutional investment, may be used for effectively disciplining family shareholders (Yoshikawa and Rasheed, 2010).

However, the advocates of family involvement in business suggest that in an organizational setting where owners and managers belong to the same family, fruitful and long-lasting networks of social relationships might exist, reducing the potential conflicts of interest between internal and external actors. Sociological approaches to governance, such as stewardship, social capital and social exchange perspectives, adopt an alternative view of human beings portraying them as collectivists, accountable

and trustworthy (Uhlaner et al., 2007). According to stewardship theory, managers are not opportunistic and their need for self-actualization and success drives their efforts towards the maximization of firm performance (Davis et al., 1997). In the particular context of family firms, the individual interests of managers-stewards might well be aligned with corporate goals, while family representatives on the board might be in a better position than outsiders to motivate executives to involve in profitable projects because they have superior access to firm-specific information (Fox and Hamilton, 1994).

Defining social capital as the sum of current and future resources that are incorporated within and can be extracted from the network of relationships possessed by a social unit, Napahiet and Ghoshal (1998) explain how relational resources are created, used, and distributed among different network partners. Social capital residing in strong personal relations and implicit ties among family members is seen as the key feature of the family system that exerts the greatest influence on the effective operation of the firm (Harvey, 1999; Zahra, 2010). More specifically, Arregle et al. (2007) identify two forms of social capital that coexist within family businesses, whereby family social capital influences the development of organizational social capital through isomorphic pressures, organizational identity and rationality, human resource practices, and social network overlaps. Thus, emphasizing the collaboration between firm owners and managers-stewards, these sociological perspectives underline the importance of social controls stemming from relational governance mechanisms based on mutual trust, tempered altruism, shared vision, loyalty and commitment.

Recently, some researchers made explicit attempts to conciliate conflicting sets of theories which allow embracing the simultaneous need for formal control and social collaboration in family firms (Sundaramurthy and Lewis, 2003). According to Le Breton-Miller and Miller (2009), while both economic and psychological approaches are insightful, the key issue for better understanding family-owned enterprises and generating accurate governance predictions is to regard the economic behavior of actors within its broader context of dynamic social relations. Using the social embeddedness view with its structural, cognitive, political and cultural-normative modes, the authors argue that family firm actors are embedded within multiple social systems which exert various degrees of influence and generate different effects. It is thus considered that the extent of owners' and employees' involvement within family and business institutions will determine the type of behavior to be displayed by each firm actor.

We believe that the boundary perspective of individual and organizational identities represents another promising theory for studying governance issues in a family-owned setting but it has received very scant consideration in the current literature. Boundary theory seeks to understand how people manage different roles they are often asked to play and conciliate conflicting demands coming from separate worlds to ensure their performance at work and their personal wellbeing (Ashforth et al., 2000). Acknowledging the multiplicity of individuals' identities and their idiosyncrasies, of particular interest is the question of the nature of interfaces and dynamic interactions between work and non-work domains. To uncover the array of strategies used for successfully navigating across multiple worlds, boundary scholars examine how individuals perceive the boundaries of their personal and professional lives, negotiate complex demands emerging both at home and in the workplace, and make transitions between their identities at individual and organizational levels.

Research conducted to date finds that people differ greatly in the way they approach their work and family roles and erect temporal, spatial and mental fences between them, suggesting that boundary management strategies fall along a segmentation-integration continuum (Kreiner et al., 2006). Segmentation encompasses situations when high barriers are enacted between private and public spaces keeping them separate, whereas integration refers to instances when a significant overlap and blurring is allowed to occur between different domains (Edwards and Rothbard, 2000). Yet, since in real life examples of complete segmentation or integration are quite rare, most boundary strategies tend to be located somewhere between the two opposite edges of the continuum. The cases when borders between bounded realms exhibit various degrees of permeability and individuals flexibly allow some elements from one realm to intrude into the other while keeping the remaining elements outside are referred to as differential permeability.

According to Ashforth et al. (2000), employees' willingness to lean more towards one or the other extreme of the segmentation-integration continuum is explained by their personal needs and specific advantages of each boundary management strategy. Greater segmentation of work and home roles might prevent individuals from paying too much attention to irrelevant distractions, offering them the opportunity to develop themselves more fully and accomplish their duties more effectively within each role. Alternatively, consistent actions and behaviors directed towards greater cross-domain integration might be motivated by people's desire to benefit from flexible arrangements that allow both accommodating family demands in the workplace and relieving professional stress at home, while successfully resolving contradictory tensions stemming from holding multiple identities.

As far as family-owned enterprises are concerned, their very uniqueness resides in the simultaneous amalgamation of dual and frequently

incompatible family and business identities. Hence, boundary perspective provides a rich theoretical grounding for examining family executives' preferences for either contractual or relational modes of governance depending on the dominant strategy put in place to manage the boundaries between family and business domains. To the best of our knowledge, only Sundaramurthy and Kreiner (2008) have explicitly drawn upon both boundary theory and family business literatures to illustrate several governance consequences emerging from each integrated, segmented and differentially permeable identities of family firms. In this paper we conceptualize our model of substitution and complementarity between contractual and relational family firm governance within a boundary theory framework.

Contractual versus relational family firm governance

Based on the theoretical tension between economic and sociological approaches, there appears to be an ongoing disagreement concerning the effectiveness of contractual and relational governance devices in family firms. On the one hand, it is suggested that due to their informality and lack of consistency in day-to-day operations and strategic decision-making, family-owned companies are associated with high costs and inefficiencies. Because of the commonly held belief that the persistent confusion of family and business matters pushes family owners to favor family preferences at the expense of business interests, agency theory proponents believe that formally prescribed contractual means of control are needed to improve the governance practices of these firms. Using a large sample of 2,631 American privately held and publically traded family businesses, Oswald et al. (2009) report a significantly negative correlation between family control and firm performance. Their results indicating that important agency costs are incurred when family representatives control the top executive team are also consistent with earlier evidence provided by Schulze et al. (2001).

Examining the recruitment practices of family enterprises, Berghe and Carchon (2003) maintain that companies which prioritize within-family promotions over more competent candidates available in the labor market, significantly reduce the quality of applicants for their managerial positions and generate important monitoring costs. Non-family employees who receive fewer career advancement opportunities and strongly perceive being treated unfairly as compared to family members employed by the firm have additional incentives to involve in counterproductive and opportunistic behaviors. Lin and Hu (2007) also show that firms with low requirements in managerial skills are more likely to select a Chief Executive Officer (CEO) from the controlling family. Yet, the authors suggest that in situations when the family control is weak and its cash-flow rights are low family firms could gain in performance by recruiting a professional CEO.

In fact, the vast majority of empirical studies conducted to date emphasize the importance of contractual mechanisms in effectively governing family companies. In their study of corporate governance practices of Greek family firms, Spanos et al. (2008) report that these firms are severely undergoverned particularly in terms of board of directors. Among the most important family governance shortcomings they cite the combined functions of CEO and chairman of the board, a low number of and weak external influences from independent non-executive directors, modest scores of establishment of board committees, private and informal discussions among the most influential family directors being held outside the boardroom, lack of formal orientation programs for new directors and a high rate of turnover of non-executive members of the board. The authors conclude that poor corporate governance of family firms in Greece prevents them from building and maintaining potential investors' confidence and reduces their access to local and global capital markets.

Other investigations focus on understanding the relationship between formal planning activities and contractual governance characteristics of family-owned enterprises. Using a sample of 130 American family businesses, Blumentritt (2006) demonstrates that the existence of boards of directors and advisory boards is significantly related to the use of strategic and succession planning activities in family firms. Since boards of directors have the primary role of monitoring the executive team, while advisory boards are the main providers of valuable resources to the firm's management, both types of boards constitute important tools in the governance of family-owned enterprises. In the same vein, Adendorff et al. (2005) show that the use of outside advice and a proper strategic management succession planning are positively associated with the perceived good governance in Greek family businesses located in South Africa. Formal governance structures such as board of directors, family councils and shareholders' assembly are identified as the most influential in ensuring effective governance of these companies.

On the other hand, many scholars believe that the family aspect of business can be a real source of competitive advantage, since the ownership and management of the firm lies in the hands of the same person or different individuals coming from the same family, minimizing the need for monitoring and agency costs (Schulze et al., 2003). The advocates of sociological views to studying organizations who tend to emphasize the multiplicity of family business advantages such as its altruistic behavior, clear identity, shared vision and commitment to mutually beneficial goals, have brought various mechanisms of relational governance under more scrutiny within the particular setting of family-owned enterprises.

Relational mechanisms of control including owner commitment (Uhlaner et al., 2007), parental altruism (Lubatkin et al., 2007), harmonious family relationships (van der Merwe and Ellis, 2007), trust (Sundaramurthy, 2008) and family orientation (Lumpkin et al., 2008) are identified in the literature as critical governance practices for securing family firms' survival, longevity and profitability.

Within this stream, some researchers seek to develop conceptual frameworks for advancing the efficiency of relational governance in family businesses. Building a typology of five archetypes of parental altruism, including principal-based, ideal-typic, family-oriented, paternalistic, and psychosocial altruism, Lubatkin et al. (2007) aim to provide a better explanation of the variance in family firms' ability to capitalize on the positive attributes of their governance system. Similarly, Lumpkin et al. (2008) identify five dimensions of family orientation, such as tradition, stability, loyalty, trust and interdependency, with the purpose of improving our understanding of their aggregate effect on family business outcomes. In her paper, Sundaramurthy (2008) focuses on defining the multidimensional concept of trust, as one of the most critical elements of relational governance, that is composed of interpersonal, competence and systems trust. Since trust in family firms tends to depreciate as the business evolves, the author suggests that it should be sustained over time through active communication, openness to outsiders, and transparent policies and procedures.

Scholars who choose to conduct empirical research on family firm governance provide significant support for the adoption of relational governance mechanisms in businesses originating from a variety of national and regulatory contexts. Drawing upon data from 116 South African family-owned enterprises, van der Merwe and Ellis (2007) demonstrate that family forums and conflict management processes represent effective tools for preserving healthy interpersonal relationships among family members. Analyzing data from 233 completed questionnaires, Uhlaner et al. (2007) report a strong positive association between owner emotional commitment to his business and financial performance of Dutch privately-held family firms. In a recent study of 50 small and 50 large American family companies operating in different manufacturing industries, Zahra (2010) finds that organizational social capital represents an important relational tool for companies seeking to achieve long-term survival and growth. The large stocks of social capital that family firms possess put them in a better position for succeeding in connecting and developing profitable business relationships with new ventures and providing their assistance in governing entrepreneurial ventures' activities.

Substitution versus complementarity of governance mechanisms

Only a decade ago more explicit research efforts started to be deployed for combining contractual and relational governance attributes into a single study and examining their shared role in the context of family-controlled companies (Gubitta and Gianecchini, 2002). Thus, Mustakallio et al. (2002) show that board counsel, board monitoring, and informal social interactions influence positively the quality of decision making in 192 family firms in Finland. Le Breton-Miller and Miller (2006) argue that mixed formal and social governance conditions such as lengthy CEO tenures, concentrated ownership, family and CEO control, profound business expertise of the owner and care for future generations, allow family firms to develop sustainable management capabilities and outperform their competitors. Further, in an attempt to conciliate the conflicting views on family business governance, Lambrecht and Lievens (2008) suggest that 'pruning family tree' represents an alternative path to family harmony and business continuity that allows simplifying the ownership, governance and management structures of family-owned enterprises. Yet despite their contributions, it is worth noting that these recent studies did not consider the interdependencies among relational and contractual governance mechanisms for identifying the optimal level of family firm reliance on different types of governance arrangements.

According to Rediker and Seth (1995), various mechanisms of corporate governance are not independent from each other as they operate within the same system, interact and create complex relationships which affect their own performance and organizational outcomes. However, the extent to which different governance modes increase or decrease the need for each other is subject to a considerable scholarly debate. Some authors demonstrate that multiple governance mechanisms behave as complements, while others provide strong arguments in favor of substitution. Several mechanisms are considered to be complementary when they reinforce each other in a cycle such that existing attributes lead to the adoption of new ones, which in turn enhance the effectiveness of the attributes which are already in place. When a given governance device can successfully replicate the discipline provided by another one, eliminating the need for its further adoption and use, these devices are thought to act as substitutes (Agrawal and Knoeber, 1996).

Both complementarity and substitution effects have already been either theoretically discussed or empirically proven in a number of governance-related investigations, particularly in relation with some mechanisms of executive incentive alignment. On the one hand, employing a sample of 144 large US corporations, Coles et al. (2001) show that CEO

compensation packages can mitigate agency problems stemming from the lack of directors' monitoring in firms where boards are dominated by insiders. Bodolica and Spraggon (2009) also suggest that in the periods preceding and following the conduct of major merger and acquisition activities, long-term incentive plans and compensation protection provisions included in executive pay packages can effectively substitute for each other. On the other hand, Hoskisson et al. (2009) argue that CEO compensation and monitoring intensity are complements and recent increases in executive compensation levels are partly due to tighter corporate monitoring. Considering that under increased monitoring managers bear higher employment and career risk, they require greater compensation to offset this risk. In the same vein, Cheng and Indjejikian (2009) demonstrate the complementarity between active markets for corporate control and executive performance-based incentives for 338 Forbes 500 companies for a period from 1984 to 1991. The authors find that the discipline inherent in takeover markets weakens CEO's ability to bargain for more favorable pay arrangements making it easier for the board of directors to implement effective high-powered internal incentives.

The analysis of complementarity and substitution between contractual and relational mechanisms received little consideration in the family governance literature. Examining the interdependencies between alternative governance devices for a sample of 79 family-controlled firms in Australia, Setia-Atmaja et al. (2009) provide some support for the substitution hypothesis. In particular, their findings suggest that lower levels of board independence in family firms are substituted by higher dividend payouts and higher debt ratios. Due to our relative dearth of knowledge in the area, further clarification of attributes' behavior as complements or substitutes is needed, especially because family firms bear a high cost to the duplication of efforts and inconsistencies resulting from the implementation of mutually incompatible governance arrangements. It is our belief that a thorough understanding of the interrelatedness among alternative mechanisms of corporate governance may help family business researchers design effective governance combinations that may be beyond the reach of studies that focus exclusively on isolated mechanisms.

Research framework and propositions

Our paper seeks to address all these gaps identified in the extant literature by building an integrative research framework that infuses boundary theory insights into the question of interdependency between alternative governance attributes in the context of family-owned enterprises (see Figure 1). The potential advantages of such a framework are threefold. First, adopting a promising but presently underexplored theoretical lens that allows integrating and balancing constant family-business dualities, we can reconcile economic and sociological perspectives to studying governance issues in family-controlled organizations. Second, conceptualizing the simultaneous influence that different governance mechanisms exert on family firm longevity and prosperity, our model helps to identify effective governance configurations that rely on the optimal levels of use of both contractual and relational governance devices. Third, implying that successful family business governance depends on the way the company manages the boundaries between its family and business identities, we aim to contribute to the ongoing debate that animates current research concerning the existence of substitution or complementarity between multiple governance mechanisms.

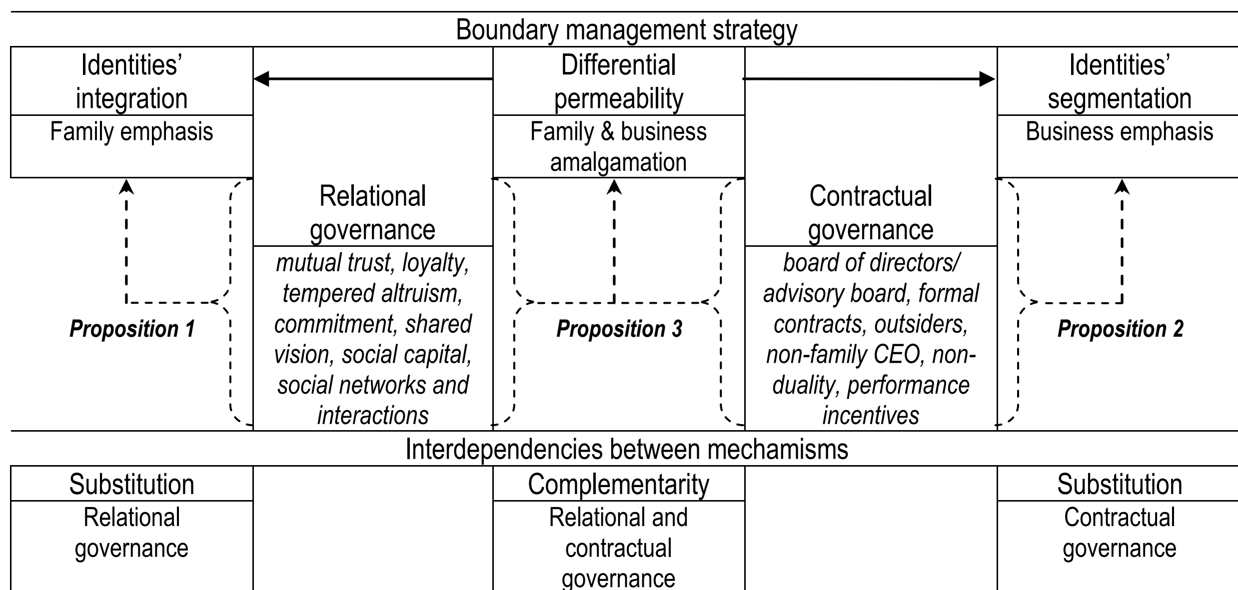
From the boundary theory viewpoint (Ashforth et al., 2000), family businesses are unique in that two different identities (i.e., family and business) interact in the same system often exerting conflicting pressures on the company management. On the one hand, the family universe is suitable for nurturing harmonious relationships among firm members and preserving a strong commitment to family values, but it may lack consistency, objectivity and dedication to long-term financial goals (Schulze et al., 2001). On the other hand, although a formalized business setting may overcome this limitation of the family system by installing objective controls and an appropriate business discipline, it may also annihilate the benefits stemming from a shared family identity and cohesion (Chrisman et al., 2004). When positioning governance preoccupations within the particular framework of family-owned enterprises, the distinctive challenge of family firm governance becomes the need to balance family preferences and business requirements and effectively manage the boundaries between its dual identities in a way that permits the attainment of desired goals and secures organizational prosperity and sustainability.

Based on our extensive review of the literature we suggest that, in order to design an effective governance structure, family businesses can choose between two broad categories of mechanisms – contractual and relational governance – which include several control devices. In the specific family firm setting, contractual governance refers to the monitoring and advising by the board of directors or advisory board and shareholder assembly or family council, hiring of a non-family CEO, existence of and influence from outsiders on the board, avoidance of chairperson/CEO duality situations, usage of formal contracts between company owners and managers disregarding their relatedness to the owning family, and adoption of various performance-based incentives for both family and non-family representatives of the top management team (Gomez-Mejia et al., 2001; Oswald et al., 2009). As far as the relational governance is concerned, it concentrates on social

devices of control including mutual trust between family and non-family employees, loyalty to the firm, tempered altruism, commitment to family business values, shared vision among firm members, development of social capital, and cultivation of a solid network of relationships and interactions within and outside the company (Mustakallio et al., 2002; Uhlaner et al., 2007).

Although previous studies in the field of corporate governance have typically emphasized the efficacy of contractual mechanisms, it is our belief that due to their distinctive and complex feature of family-business duality, relational governance mechanisms are equally important in the context of family-controlled enterprises. To succeed in today's highly competitive business environment, a family firm needs to select among several governance alternatives and create an appropriate mix of mechanisms which will better suit its organizational identity and external conditions in which it operates. The main line of argument inherent in our conceptual model is that family firm's reliance on either contractual or relational type of governance, or a proper combination of the two, depends on the way the company manages the boundaries between its family and business identities. In family-owned enterprises which pursue different boundary management strategies, different types and mixes of mechanisms are more likely to successfully achieve their governance objectives. More specifically, we put forward that the effectiveness of relational and contractual governance and the occurrence of either substitution effects or complementarity among multiple governance devices are greatly determined by whether the family firm is following the identities' integration, identities' segmentation or differential permeability strategy of family-business boundaries' management. As illustrated in Figure 1, we argue that for family firms which are located at the opposite edges of the family-business identities continuum (i.e., either integration or segmentation) relational and contractual governance mechanisms tend to substitute for each other, while for firms positioned somewhere in the middle of this continuum (i.e., differential permeability) these mechanisms are likely to act as complements.

Figure 1. Conceptual framework for family firm governance



Integration of family-business identities

Family firms which are situated at the integration extreme of the family-business identities continuum do not institute any spatial or cognitive boundaries between home and work domains and allow for a large majority of elements from each world to be completely intertwined and diluted in each other. There is no distinction between what belongs to family and what belongs to business and individuals willingly accept holding simultaneously multiple identities to successfully balance conflicting demands stemming from each domain (Edwards and Rothbard, 2000). Business-related tasks can be accomplished while employees are physically located in their family realm and vice-versa, family pressures and requirements can be effectively dealt with while being at work. Integrators tend to promote an informal atmosphere throughout the firm by displaying many family-related artifacts in the workplace that are always reminding them and others about the family dimension of business. In this context, the activities of family firms are mainly driven by a constant desire of its managers to enhance family values and tradition, strengthen family ties, and improve the quality of relationships among different family members.

We posit that this predominant tendency for family-business identities' integration determines the family firm reliance on a combination of various

relational governance devices, substituting the need for implementing contractual mechanisms. In these family-oriented businesses, relational governance is more likely to achieve superior, sought out by family leaders, outcomes in terms of increased family harmony, higher likelihood of business succession within the family, and greater satisfaction of multiple family-related stakeholders. Enterprises that focus on the family dimension of business may find it useful to hire many representatives of the owning family in the top management positions of the firm, have a family member assume a dual role of CEO and chairman of the board, staff their board of directors with family executives and non-executives, encourage significant family stock ownership to maintain control over organizational decision making processes within the family, and compensate family members based on their personal needs rather than their individual or group performance (Sundaramurthy and Kreiner, 2008). In order to compensate for this lack of contractual governance which translates into weak levels of board monitoring, inefficient managerial incentives and dubious performance appraisal systems for family executives, this type of family firm may choose to rely more heavily on different mechanisms of relational governance such as mutual trust, tempered altruism, and social networks. Based on this discussion we formulate the following proposition:

Proposition 1. In family firms with integrated family-business identities, relational governance mechanisms will substitute for contractual governance.

Segmentation of family-business identities

Conversely, other family-owned enterprises prefer to keep family and business realms separated with the purpose of better achieving the performance objectives set out for each world. In family firms located at the segmentation extreme of the family-business identities continuum explicit physical, temporal and mental barriers are installed to protect people from simultaneously dealing with confusing dual demands and prevent the spillover of negative emotions from occurring between the two worlds (Kreiner et al., 2006). The maintenance of clear and unambiguous separation between family and business domains in day-to-day operations of family firms allows employees to reach their highest potential at work notwithstanding the incidence of family problems at home. And vice versa, identities' segmentation allows people to embrace more fully their family role and become accomplished individuals in their personal lives disregarding their suboptimal performance in the workplace. The formalized corporate atmosphere that tends to rein in these types of firms represents a clear indication of the fact that family issues of employees are expected to be dealt with at home, while business requirements – to be successfully completed during the official working hours.

We put forward that in family companies following the boundary management strategy of identities' segmentation contractual governance can effectively substitute for lack of relational mechanisms. Due to a stronger commitment to business values, the implementation of contractual governance devices in these firms is seen as an optimal way for achieving expected corporate outcomes in terms of higher levels of incentive alignment, financial performance and sustainable growth. Family firms with prevailing business-centered targets may consider it less appropriate to rely on social mechanisms of control such as trust, loyalty and social capital. Instead, they may find it more useful to hire a professional non-family CEO, eliminate the dual position of CEO and chairman of the board, design high-powered performance-based compensation system, promote diversified family and non-family stock ownership and control over decision making processes, reduce the employment of family members in the firm, and have extensive non-family representation on the board of directors (Sundaramurthy and Kreiner, 2008). Therefore, segmentators are more likely to put their emphasis on formal governance controls that could be sufficient for successfully attaining pre-established objectives, thus eliminating the need for employing relational devices. The above developed logic suggests the following proposition:

Proposition 2. In family firms with segmented family-business identities, contractual governance mechanisms will substitute for relational governance.

Differential permeability strategy

Finally, family firms which are located somewhere between the two opposite edges of the family-business identities continuum display differential degrees of integration and segmentation. In this case, existing boundaries between family and business realms are viewed as highly permeable, where some aspects of family life can flexibly interfere with business domain while others can be intentionally kept separated (Ashforth et al., 2000). For instance, a family-owned enterprise might seek more integration by promoting a corporate culture substantially based on family values and beliefs, yet simultaneously involve in more segmentation attempts by opening its top executive positions to non-family representatives. The differential permeability boundary management strategy is typically pursued by family firms seeking to grasp the benefits from both family and business worlds. When selected elements from family roles and responsibilities assumed by firm employees are allowed to affect their engagement with work-related tasks and vice-versa, positive spillovers of experiences can occur across domains providing the

needed impetus for them to perform within each domain.

We argue that for these types of family firms an optimal system of corporate governance means a proper equilibrium between family and business requirements, necessitating a combined use of both relational and contractual governance mechanisms. Differential permeability in these companies (Sundaramurthy and Kreiner, 2008) implies that the concurrent pursuit of family and business objectives can be successfully achieved through a variety of mutually reinforcing devices. The adopted social mechanisms of control aimed at attaining family-related targets may call for greater use of formal controls directed towards business-centered outcomes, whereas additional formal governance devices may actually enhance the effectiveness of social mechanisms already in place. Hence, higher family firm reliance on tempered altruism, dedication to family values, and mutual trust between employees may require more detailed employment contracts, explicit appraisal system for both family and non-family firm members, sophisticated performance-based incentives, and non-family non-management representation on the board of directors. Therefore, we posit that family-controlled enterprises with permeable family-business identities may benefit from choosing such a governance configuration that balances and reinforces social controls with formal monitoring, suggesting complementarity between relational and contractual governance. These arguments lead to the formulation of the following proposition:

Proposition 3. In family firms pursuing the differential permeability strategy, relational and contractual governance mechanisms will complement each other.

Conclusion

Family businesses represent the world's most prevalent form of organization, yet the large majority of them fail to survive into the third, or even second, generation (Lambrecht, 2005; Zahra, 2010). Increasing globalization trends and tough economic conditions created by the recent financial downturn have confronted family firms with new challenges imposing them to revise their dominant management models and practices. In today's internationalized and hypercompetitive business environment the design and implementation of an effective governance system might be exactly what family-owned enterprises are lacking in order to strengthen their competitive edge and secure their longevity.

Relying on an extensive review of the literature in the field, in this paper we develop an integrative conceptual model that seeks to identify optimal governance configurations in the context of family businesses. By positioning family firm governance concerns within the broader boundary theory framework, we suggest that the effectiveness of governance choices made by family firms is dependent upon the way they manage the boundaries between their family and business identities. Among the most important contributions of our model is that it offers viable possibilities for effectively overcoming multiple dualities between economic and sociological approaches, contractual and relational governance, and substitution and complementarity between alternative control devices that dominate extant corporate governance research.

From a practical point of view, our paper aims to enhance family leaders' awareness of the dual formal and social governance nature, allowing them to adopt an appropriate system of governance according to their particular identity management needs and desired outcomes. Future studies might focus on validating our conceptual framework by testing the propositions illustrated in Figure 1 on a large set of family-controlled organizations operating in different regulatory environments. Due to the relative scarcity of research in this area, the empirical analysis of interconnections between multiple governance mechanisms will further improve scholars' attempts to theorize about the existence of complementary or substitution effects between contractual and relational governance in the specific context of family firms. On a larger scale, acquiring knowledge about boundary-related antecedents of effective governance structures, family businesses could work more thoroughly on factors that favor not only the adoption but also the sustainability of these structures over time.

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