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Abstract

This paper examines the relationship between the evolutionary stages of family governance and the rate of return required by family businesses' shareholders (k_e), building on an institutional and relational governance lens. We distinguish between the informal stage, the family council stage, and the family constitution stage. Findings from a sample of Spanish private family firms reveal that family firms in the family constitution stage have a lower k_e than family firms in the family council stage and the informal stage. Surprisingly, family firms in the family council stage seem to have a higher k_e than those in the informal stage, which points to ceremonial adoption effects and a potential mismatch between governance needs and practices in the family council stage. We also find that the effect of different family governance stages on k_e is conditional on the number of family shareholders.

Keywords: rate of return, family governance, privately held family businesses, family council, family constitution.

1. Introduction

Family firms are generally defined by a family's involvement in ownership, management, governance, a transgenerational vision (Chua et al., 1999), and a perceived family firm identity (Salvato et al., 2019; Zellweger et al., 2010). However, family firms are not a homogenous population. Therefore, the last decade has witnessed a burgeoning interest in the degree of *heterogeneity* among family firms (e.g., Neubaum et al., 2019; Daspit et al., 2021) and its impact on strategic decision-making (e.g., Santulli et al., 2019; Sciascia et al., 2013), investment choices (e.g., Matzler et al., 2015), organizational effectiveness and financial value creation (for an overview see Pindado & Requejo, 2015). Unfortunately, extant family business research has largely ignored the variations in *family governance* - defined as "voluntary mechanisms [such as a family council or constitution] established by the business family with the primary aim of governing and strengthening relations between the family and the business, as well as the relationship between the members of the business family itself" (Suess, 2014, p. 139) - as a source of family business heterogeneity and its impact on value creation in family firms. This is a remarkable omission, as the primary goal of family governance is to ensure the efficient involvement of the family in the firm to create financial value with a long-term perspective (Kammerlander et al., 2015). This study takes initial steps to fill this void.

Financial value creation in a firm can be realized by improving the key value drivers, such as boosting future free cash flows or decreasing the minimum rate of return. In this paper, we focus on the minimum rate of return required by investors (hereafter k_e) in private family firms for two reasons[1]. First, it is widely acknowledged that k_e plays a

[1] An additional and more practical reason is that k_e is more easily observable than future cash flow streams and the value of private family firms, which can by definition not be observed by external researchers.

critical role in the valuation of a firm's equity[2] (as a discount factor in a Discounted Cash Flow valuation analysis) and in the evaluation of long-term investment projects (as a benchmark to which the rate of return of a project is compared) (e.g., Boubakri et al., 2010; Cooper & Priestley, 2016; Jagannathan et al., 2016). More specifically, a lower k_e will allow family firms to execute unique value-enhancing investment strategies and projects, leading to a competitive advantage (Brigham et al., 2014; Zellweger, 2007). Second, k_e is a pivotal value driver which finds its roots in the family subsystem, i.e., family members have to determine their collective aspiration levels regarding k_e, reflecting the long-term interests of the family firm (e.g., Adams et al., 2004; Mustakallio et al., 2002; Zellweger, 2007). As emphasized in the relational governance literature, a shared family vision on essential business issues, such as k_e, is accomplished by social interactions among family members (Mustakallio et al., 2002), coordinated decision-making in systematic communication forums (Arteaga & Escribá-Esteve, 2020) and the crafting of transparent policies and protocols (Sundaramurthy, 2008), which are known to be the elementary ingredients of effective family governance (de Groot et al., 2022; Suess, 2014).

The arguments above suggest that family governance plays a crucial role as an antecedent of k_e in private family firms. Unfortunately, empirical research on how family governance affects k_e is missing so far. Therefore, we investigate in this study the relationship between Family Governance Practices (hereafter FGP) and private family firms' k_e from an evolutionary stages lens, building on arguments from the relational governance (Mustakallio et al., 2002; Poppo & Zenger, 2002; Sundaramurthy, 2008) and institutional perspectives (Melin & Nordqvist, 2007; Parada et al., 2020; Scott, 2001).

[2] A lower k_e means a higher equity value: $Value\ of\ Equity = \sum_{t=1}^{t=\infty} \frac{E\ (Cash\ Flow\ to\ Equity_t)}{(1+k_e)^t}$

FGP exist as a range of distinct practices (Suess, 2014), such as informal family meetings (Bloemen-Bekx et al., 2021), formal family councils - defined as "a forum where the owner-family's relations to and issues with the business should be discussed" (Melin & Nordqvist, 2007, p. 325) - and family constitutions - defined as "a document that articulates the family policies that guide the relationships between family, ownership, and business roles in a family firm" (Botero et al., 2015, p. 219). Recent developments in the field suggested that implementing FGP follows a specific evolutionary *sequence or pattern* (Leach, 2012; Parada et al., 2020). We build further on these ideas and propose that family governance broadly follows three evolutionary stages of development in their FGP, of which the early stage is characterized by no or only informal family meetings (Bloemen-Bekx et al., 2021), the second stage comprises the formation of a formal family council (Leach, 2012), and finally, family firms will enter the third stage in which the family council has developed a family constitution (Parada et al., 2020; Suáre & Santana-Martín, 2004). Therefore, we will theorize and test the effect of different *FGP stages* and contrast their effectiveness, i.e., their lowering effect on k_e.

This article contributes to the family business literature in several ways. First, we introduce the evolutionary sequences in FGP – the three proposed family governance stages - as a new antecedent of k_e. In doing so, we add to the family business heterogeneity debate by investigating a largely ignored source of heterogeneity in the family subsystem, namely family governance. Second, we blend theoretical arguments of the relational governance literature with arguments from the institutional perspective. As specified above, the relational governance perspective (Poppo & Zenger, 2002) advances that the elementary components of effective family governance consist of social interactions and processes, formal communications forums, and a formal protocol (Mustakallio et al., 2002; Sundaramurthy, 2008; Villalonga et al., 2015). However, recent research building on the institutional perspective pointed to the potential ceremonial adoption of family councils, which may drive a wedge between the implementation and their functionality/effectiveness (Parada et al., 2020). Prior family business research already revealed the existence of conformity pressures in listed family firms (Miller et al., 2013). We add to this emerging literature stream by proposing and finding evidence that – in contrast to common perceptions – also decision-making in *private* family firms may be driven by normative and mimicking pressures in the *family system,* such as the ceremonial adoption of a family council, which may have a negative impact on its effectiveness. Third, building on the idea that the effectiveness of governance mechanisms is conditional in nature (Chi & Lee, 2010), we show that the relationship between the different FGP stages and k_e depends on the family governance needs of a family firm, measured by the number of family owners. Indeed, a higher number of family owners increases family complexity (Arteaga & Escribá-Esteve, 2020; Suess, 2014) and the potential for agency problems (Arteaga & Menéndez-Requejo, 2017), which enhances the need for a further developed family governance system to address these challenges.

The remainder of this article is organized as follows. First, we review the previous relevant literature on k_e and FGP. The next section will establish the theoretical relationship between the different FGP stages and k_e and hypotheses are formulated. Subsequently, the methodology is explained. Then, section 5 presents the findings. Finally, the last sections offer the discussion and conclusions.

2. Literature review

2.1. The minimum rate of return required by family shareholders

As we focus on privately held family businesses in this study, we considered family firms when they meet the following requirements: (1) family members own at least

50% of the shares, (2) at least one of the family members is actively involved in the corporate governance and/or in the business management (Chua et al., 1999), which is a commonly accepted definition. In the context of privately held family businesses, k_e is primarily determined by the family and not by the capital market (Zellweger, 2006, 2017). Thus, family business shareholders can determine the k_e levels based on their preferences, aspiration levels, and subjective needs (Adams et al., 2004; Findlay et al., 1983; Zellweger, 2007). Prior research on the determinants of k_e in family firms is scant and found that (the objective of) family control is associated with an increase in k_e (Boubakri et al., 2010; Martínez-Romero & Rojo-Ramírez, 2017) whereas a stronger emotional endowment (Martínez-Romero & Rojo-Ramírez, 2017) and a higher degree of family involvement will lead to a lower k_e (Rojo-Ramírez & Martínez-Romero, 2018).

Despite the lack of empirical research, family business scholars provided interesting *theoretical* arguments that could serve as starting points in the search for new unexplored antecedents. First, there is ample evidence that distinctive family firm characteristics such as dynastic succession intentions (Berrone et al., 2012), patient family shareholders (Sirmon & Hitt, 2003) and a family firm culture (Zahra et al., 2004) are all related to a long-term vision and an extended time horizon (Brigham et al., 2014; Zellweger, 2007), which will influence the risk appetite of investors as the marginal riskiness of an investment project declines over time (Zellweger, 2007). Given that k_e is the investors' compensation for the risk they take, the declining marginal risk when taking a longer time horizon has, by consequence, a lowering effect on k_e (Zellweger, 2007). Furthermore, due to the vocation of continuity in time and their emotional endowment, family firms are willing to accept a lower required return, taking into account transgenerational motives, which are a core component of the socioemotional wealth of family firms (Berrone et al., 2012; Martínez-Romero & Rojo-Ramírez, 2017). Indeed, Chrisman and Patel (2012, p. 979) maintain that "as evaluation periods lengthen, the "socioemotional discount rate" by which long-term financial investments are judged should be lower". Consequently, the theoretical prediction following the arguments above is that family firms, which are able to establish and maintain a long-term vision on the firm, will invest in more projects and realize a larger diversification, leading to a competitive advantage and value creation in the long run (Zellweger, 2007).

2.2. Family Governance Practices

A central assumption underlying the theoretical arguments above is that a shared long-term vision is a dominant logic resulting from a *collective mind-set* concerning the temporal orientation of the family firm's dominant coalition. However, establishing and maintaining a *shared* vision among family shareholders is challenging and requires the development of formal systems and processes supporting the dominant logic (Brigham et al., 2014; Suess, 2014). For example, when a family firm evolves over time, and the complexity within the family system increases, strong disagreements about the free cash spending between active (who may prefer *long-term* value-enhancing investments) and passive family shareholders (who may prefer a *short-term* dividend policy) may occur which has an impact on the temporal orientation of the family firm. This type of challenge requires adopting formal governance mechanisms in the family subsystem, labelled "family governance practices" (Neubauer & Lank, 1998; Suess, 2014). FGP contribute positively to firm outcomes because they improve the monitoring of management, encourage a better alignment of interests among owners, and enhance communication and transparency within the organization (Arteaga & Menéndez-Requejo, 2017; Michiels et al., 2015; Suess, 2014). In addition, FGP generally stimulate an open dialogue among family members, which cultivates family unity, a team spirit, and a shared vision (Berent-Braun & Uhlaner, 2012; Botero et al., 2015; Mustakallio et al., 2002). Consequently, FGP mitigate agency problems (Arteaga & Menéndez-Requejo, 2017) and help to avoid perceptions of unfairness (Botero et al., 2015).

Different types of FGP exist, but family councils and family constitutions are found to be the most common formal FGP (Suess, 2014). Although different purposes have been attributed to family councils (e.g., decisions about dividend policy, chairing family meetings, among others), their main objectives are to promote communication and socialization among family shareholders (Brenes et al., 2011; Scholes et al., 2021) and to define the rules of the game for the family (Calabrò, et al., 2021; Kets de Vries, 1993). Family constitutions, also labeled as family charters or family protocols, address issues regarding elementary family governance (Botero et al., 2015; Suáre & Santana-Martín, 2004) and include guidelines and principles regarding the family-business relationships (Matias & Franco, 2020; Michiels et al., 2015). The family constitution expresses "what the family stands for, its expectations and its fundamental values" (Neubauer & Lank, 1998, p. 89) concerning the business (Arteaga & Menéndez-Requejo, 2017; Suess, 2014).

Although FGP have received increasing attention during the last decade, empirical research on the consequences of FGP remains relatively scant and provided equivocal evidence (e.g., Arteaga & Menéndez-Requejo, 2017; Berent-Braun & Uhlaner, 2012; Blanco-Mazagatos et al., 2016). One reason for these inconclusive findings may be found in the fact that most prior studies used an aggregate FGP measure (e.g., Berent-Braun & Uhlaner, 2012; Blanco-Mazagatos et al., 2016; Michiels et al., 2014). However, recent studies pointed to specific patterns and sequences in implementing family governance structures (Leach, 2012; Parada et al., 2020). We build on these new insights and propose that the family governance system broadly evolves through three evolutionary stages. In the first stage ("the informal stage"), there are no formal FGP and communication about business-related issues takes place in informal family meetings (Bloemen-Bekx et al., 2021). The second stage in the evolutionary sequence is the creation of a formal 'family council', which we label "the family council stage" (Leach, 2012; Parada et al., 2020; Suáre & Santana-Martín, 2004). Entering this stage will be especially beneficial when the challenges in the family system are mounting, i.e., as the number of family members and owners increases (Sundaramurthy, 2008). The next step in the pattern is what we label as "the family constitution stage" when the family has developed a family constitution, usually within their family council (Leach, 2012; Parada et al., 2020). Entering this third stage is expected to be especially beneficial for family firms that face complex family and ownership structures (e.g., increasing number of family owners) and related agency problems (Arteaga & Menéndez-Requejo, 2017).

3. Theory and Hypothesis Development: The relationship between the different Family Governance stages and k_e.

3.1 Family governance effectiveness: a relational governance perspective

Establishing a relationship between the FGP stages and k_e raises the question about the governance effectiveness of each stage. A first answer to this question can be found in the *relational governance perspective* (Gnan et al., 2015; Mustakallio et al., 2002; Poppo & Zenger, 2002). Indeed, a distinctive feature of family firms is the unique nature of the social relationships among key (family) actors in ownership and management (Mustakallio et al., 2002), making the relational governance perspective a highly relevant lens. The relational governance perspective proposes that governance occurs from values and mutually accepted processes embedded in social relationships (Poppo & Zenger, 2002). The enforcement of promises and expectations emerges through social interactions and processes. These social processes encourage flexibility, solidarity (commitment to joint problem-solving), and information sharing. Trust becomes a central feature embedded in a relationship (Sundaramurthy, 2008). While the original proponents in this perspective have mainly focused on inter-organizational exchanges (e.g., Poppo & Zenger, 2002), the family business literature has extended these ideas by taking an intra-organizational family point of view. As explained above, the objective of family governance is to strengthen and govern relationships between family members and between the family and the business (Suess, 2014). Thus, FGP serve as relational mechanisms that manage expectations and stimulate dialogue, transparency and trust (Bloemen-Bekx et al., 2021), leading to greater family cohesion and a shared vision on important business issues (Mustakallio et al., 2002). Prior family governance studies building on this relational perspective pointed to three essential ingredients for family governance to be effective (for an overview, see Suess, 2014). First, as family governance is considered a relational governance mechanism, social *interactions* and behavioral *processes* among family members are, consequently, the first central element in reaching governance effectiveness (Mustakallio et al., 2002). Second, although informal social interactions can be, to a certain extent effective, depending on the specific family objective (for example, in nurturing the affective commitment of offspring in the pre-entry stage of succession (Bloemen-Bekx et al. 2021)), reaching a shared vision on important family business issues, such as risk-taking and investment behavior, requires formal coordinated decision making in systematic communication forums and governance *structures* such as a family council (Scholes et al., 2021; Villalonga et al., 2015). Hence, effective formal communication structures are unveiled as a second crucial factor in reaching a shared understanding and vision of the business among family members (Sundaramurthy, 2008). Finally, transparent policies and *protocols* written down in a document (the family constitution) are a third crucial factor in reaching family governance effectiveness as it is “central to producing the reliability fundamental for trust in a system" (Sundaramurthy, 2008, p. 96) and enable an adequate functioning of family governance structures such as the family council (González-Cruz et al., 2021).

3.2 Family governance effectiveness: an institutional perspective

The arguments above suggest that governance effectiveness increases across the three stages: the family council stage is expected to be more effective than the informal stage, while the family constitution stage is likely more effective than the other two stages. This is because the family constitution stage generally fulfills the three essential effectiveness requirements while firms in the family council stage do not fulfill the protocol requirement, and firms in the informal stage do not fulfill the structure requirement.

Anecdotal evidence (Melin & Nordqvist, 2007) and recent empirical results (Parada et al., 2020) tells another story, building on arguments from the institutional perspective. The institutional perspective proposes that external stakeholders' greater quests for social legitimacy will result in conformity in organizational practices and strategic behavior reflecting the institutional environment's dominant template (DiMaggio & Powell, 1983; Meyer & Rowan, 1977). The relevance of the institutional pressures in understanding family business behavior and outcomes has been demonstrated before by Miller et al. (2013) in the context of listed family firms. Miller and colleagues indeed found that family involvement will lead to greater strategic conformity in listed firms.

The common idea concerning institutional dynamics in *private* family firms is that they experience fewer conformity pressures than their listed counterparts. However, conformity pressures are not unique in the context of listed firms. Howorth & Kemp (2019) reported that since 2003, many countries have developed governance codes and national best practice guidance for private firms containing voluntary recommendations for family and corporate governance, such as the adoption of a family council. Melin & Nordqvist (2007) argue that such initiatives may lead to normative and mimetic pressures, pushing family firms to adopt strategic and organizational practices legitimized by the institutional environment. These authors also added that these legitimized practices could not be appropriate for all family firms and argued that family firms often decide to adopt a family council due to institutionalization processes as these firms are highly influenced by social norms and rules. Consequently, they tend to follow similar conventions than their peers (Scott, 2001) and the adoption of a family council may thus be often considered ceremonial (Parada et al., 2020). In addition, Parada et al. (2010) put forward that mimetic and normative institutional pressures exerted through professional family firm associations might shape and change firms' values. The societal expectations, which define socially acceptable rules, cause firms to exhibit similar practices, such as, for example, establishing a family council as the main family governance structure, but without the implementation of appropriate practices and processes serving the specific family governance needs (Melin & Nordqvist, 2007; Parada et al., 2010; Howorth & Kemp, 2019).

These findings have important implications for understanding the governance effectiveness of the family governance stages. Blending the insights of the relational governance perspective with the arguments of the institutional perspective raises some important questions concerning the governance effectiveness of the family council as the sole FGP in the family council stage. Indeed, although family councils can be obviously categorized as formal family governance *structures*, recent findings that many of these councils are the result of ceremonial adoptions (Parada et al., 2020) suggest that relational dynamics and *processes* are less present or even completely missing which questions the common idea that being in the family council stage is more effective than in the informal stage. Therefore, establishing a family council without appropriate internal processes and the establishment of a formal protocol may be insufficient to reach a higher governance effectiveness than the informal approach.

These counteracting institutional dynamics are less of a problem for governance effectiveness in the family constitution stage, even in the case that ceremonial motives originally inspired the start of the development process of the constitution. In this stage, the family council and constitution *interact* and *complement* each other as essential building blocks of a well-designed family governance system (Leach, 2012). Indeed, one of the main functions of the family council is to develop and revise the family constitution. Furthermore, a family constitution is not a template document "that can be used with minimal alterations for multiple family firms" (Botero et al., 2015, p. 225) or can be bought from a consultant. Family constitutions are tailor-made protocols resulting from an intense process of discussing and consensus building within a family council (Matias & Franco, 2020; Neubauer & Lank, 1998) for which the *development process* is "more important than the document itself" (Botero et al., 2015, p. 225). Moreover, to create an effective family constitution, family members must trust one another and communicate openly (Suess, 2014). The implementation process requires a great deal of effort by all family members involved. Long conversations, intensive dialogue, and many hours are needed to implement a family constitution. Therefore, the development of a family constitution serves as an important communication process tool (Botero et al., 2015; Sundaramurthy, 2008) that may enhance trust, cohesiveness, and the quality of relationships among family owners (Berent-Braun & Uhlaner, 2012). Thus, developing and implementing a family constitution involves a long-term process with many social interactions and relational dynamics (Brenes et al., 2011; Matias & Franco, 2020). Accordingly, when developed properly, family constitutions will lead to enhanced trust and a shared vision among family members (Suess, 2014) and will establish the necessary conditions for a sustainable future of the family firm.

Once the family constitution is ready, the protocol document usually determines the roles of the family council within the broader governance system. It helps the council manage complex issues when they appear (Leach, 2012). The reciprocal relationship between the family council and constitution creates a strong and well-balanced family governance system in the "family constitution stage", which is therefore expected to be more effective in reaching a shared vision concerning risk-taking behaviour and k_e in a long-term perspective than the other two family governance stages. Therefore, we postulate:

***H1**: Family firms in the "Family constitution stage" will have a lower k_e than **(a)** family firms in the "Family council stage" and **(b)** family firms that are in the "Informal stage".*

3.3 The moderating effect of the number of family shareholders

While the extant family governance literature often proposes that having some formal FGP will have positive outcomes versus having no formal FGP (Suess, 2014), we argue that this is not necessarily always the case but will depend on the *specific family governance needs* of the family firm. The general corporate governance literature acknowledges that corporate governance mechanisms are not a "one size fits all phenomenon" and that their added value is conditional in nature (Chi & Lee, 2010; Corbetta & Salvato, 2004). These ideas are equally relevant for the governance of the family subsystem (Arteaga & Escribá-Esteve, 2020). Family firms are dynamic systems in which agency problems and trust evolve as a result of changing contingencies in the family and business systems of which the dispersion of ownership among family members ranks ahead as a pivotal context factor (Botero et al., 2015; de Groot et al., 2022). The involvement of more family members who will become shareholders increases the likelihood that there will be substantial differences in financial and nonfinancial objectives among family members, leading to typical principal-principal agency problems (Arteaga & Menendez-Requejo, 2017; Rodríguez-García & Menéndez-Requejo, 2023). For example, when family ownership disperses, family shareholders will face a difficult situation in which the long-term benefits from cooperation in the family firm will conflict with the short-term demands of the own nuclear family (Lubatkin et al., 2005). This kind of unsolved agency problem can pose a severe threat on the long-term vision, risk-taking, investment policy and thus, k_e of the family firm. As a consequence, constructive debate and open communication among family members, as well as unambiguous guidelines and rules concerning potential conflict areas, will be more beneficial for the family firm when the number of family owners is higher (Botero et al., 2015; Rodríguez-García & Menéndez-Requejo, 2023). Indeed, more communication and dialogue in the family system will lead to a stronger alignment of preferences concerning growth and risk-taking, serving the long-term prospects of the family firm (Lubatkin et al., 2005).

In sum, family firms will benefit from effective FGP when the number of family owners - and thus family governance needs - are higher. Thus, in the context of this study, the difference in k_e between being in the “Family constitution stage”, the “Family council stage” and the “Informal stage” is not expected to be large when the number of family owners is small (i.e., low family governance needs). But this difference will increase when the number of family owners is higher, i.e., family firms that invest in formal FGP are expected to keep their k_e lower than family firms that have no or informal FGP when family ownership disperses.

A logical inference from the arguments above is that family firms that invest in FGP but face *low* family governance needs will not experience many beneficial effects. We argue that the truth may be even worse for firms in the "Family council stage" for two reasons. First, prior research documented that the effectiveness of a team or governance body will depend on the levels of goal clarity among members (e.g., Ferreira et al., 2015). When family firms create a family council because of ceremonial motives, it is highly questionable that there will be goal clarity among family members concerning the real purpose of the family council and its added value for the company. This lack of a shared purpose will increase the risk that individual family members will use the family council for (individual) purposes for which it is not intended. This behaviour might be counterproductive and increases agency problems instead of mitigating them (e.g., agency problems related to parental altruism) (Lubatkin et al., 2005; van Aaken et al., 2017). Second, when corporate governance bodies are underdeveloped or non-existent (e.g., a rubber-stamp or paper board of directors), family councils (and especially when they are created without a clear family governance purpose) may start to be a substitute for these formal governance mechanisms (Gnan et al., 2015). These dynamics may further increase several types of agency problems "by formalizing and legitimizing policies that may benefit family outsiders at the expense of the firm and its shareholders" (Villalonga et al., 2015, p. 649). In addition, the family council may be used as a formal governance body to take over the role of the shareholders' meetings and even the monitoring role of the board of directors (Gnan et al., 2015) which may imply a refocus of roles away from the typical roles attributed to a family council. We expect these negative effects to be stronger for family firms in the "Family council stage". In contrast, family firms in the family constitution stage have developed a protocol and are less likely to face these detrimental effects. This is because agreements regarding ownership and governance are usually essential components of a family constitution (Arteaga & Menendez-Requejo, 2017), which will create role clarity among governance bodies of the family firm. Thus, having a family council when it is not needed may be even worse than not having any formal FGP. We infer from this reasoning that the k_e of family firms in the "Family council stage" will be generally higher than the k_e of family firms in the other two family governance stages when the number of family owners is low.

H2: *Family firms in the "Family council stage" will have a higher* k_e *than* ***(a)*** *family firms in the "Family constitution stage" and* ***(b)*** *family firms in the "Informal stage" when the number of family owners is low.*

When the number of family owners becomes higher (and thus, the family governance needs are mounting), the difference in k_e between the three FGP stages will change. First, and in line with the reasoning above, the difference between the k_e of family firms in the "Family constitution stage" (k_e will remain low) and family firms in the "Informal stage" (k_e will increase) will become by definition larger when the number of family owners is higher. Second, the difference in k_e between family firms in the "Family council stage" vis-à-vis the other two FGP stages will become smaller. This is because when family ownership disperses, a family council will start to play a central role in the management of intra-family conflicts and the communication of the family's values, opinions, and attitudes toward the top management team (Eckrich & McClure, 2012; van Aaken et al., 2017). In addition, when some family shareholders are not involved anymore in the day-to-day management of the family firm, a family council provides "a forum for educating the family about their investment, business strategy, or the need for shareholder alignment and support for competitive business positions" (Eckrich & McClure, 2012, p. 15). Accordingly, it can be expected that when there is a family council, family members will start *using* it for the purpose for which it was initially intended, i.e., to address the increasing family governance needs, making it more effective. Hence, we expect that the k_e of family firms in the family council stage is lower than in the informal stage when the number of family owners is higher. Nevertheless, the governance effectiveness of a family council will still be less effective than when the family developed a family constitution due to the lack of a formal protocol, which was previously argued to be an essential component of family governance effectiveness.

In summary, when the number of family owners is higher, the k_e of family firms in the "family constitution stage" will stay low - at least lower than the other two stages -the k_e of family firms in the "family council stage" is expected to decline (the council will be an answer to governance needs) and the k_e of family firms in the "informal stage" will increase (due to unfulfilled family governance needs). This pattern suggests that the number of family owners will moderate the relationship between the different family governance stages and k_e in such a way that:

H3: *The difference in k_e between family firms in the "Family council stage" versus* ***(a)*** *family firms in the "Family constitution stage" and* ***(b)*** *family firms in the "Informal stage" will be lower when the number of family owners is higher.*

H4: *The difference in k_e between family firms in the "Family constitution stage" versus family firms in the "Informal stage" will be larger when the number of family owners is higher.*

4. Methods

4.1. Sample

Two different data sources were employed in our study: the SABI database from Bureau Van Dijk and a cross-sectional questionnaire.

The SABI database includes financial information and accounting statements of Spanish and Portuguese businesses. First, we randomly selected 4,000 firms representative of the Spanish population from SABI that met the following requirements: privately held, independent, employing at least three full-time employees, and with a minimum turnover of 12,000 euros. These prerequisites were to ensure the selection of active businesses. Then, a questionnaire was mailed to the CEOs of those 4,000 firms between May and December of 2014. The questionnaire explored general firm characteristics regarding ownership and control structures, management, professionalization, and corporate governance issues. Therefore, financial reporting information was derived from SABI, while the remaining data was obtained from the questionnaire. The questionnaire collects information on the variables that are not available in secondary data sources. When we sent the questionnaire, we received responses from 462 businesses, representing a final response rate of 11.55%. Although our response rate is not high, it is in line with prior studies in the upper echelon and private family business field that asked for CEO participation in their surveys (e.g., Vandekerkhof et al., 2015; Cruz et al., 2010). Of those responding firms, and for the aim of the present study, we wanted to focus exclusively on family firms. This is why, following prior research (e.g., Arzubiaga et al., 2018; Vandekerkhof et al., 2015, 2018), we identified family firms according to two conditions: (1) family members own at least 50% of the shares and (2) at least one of the family members is actively involved in the corporate governance and/or in the business management (Chua et al., 1999). Thus, this process leads to a sample of 359 family firms. Moreover, to ensure that the sampled firms were family firms, we added an additional question in which we asked the CEOs directly whether they identify themselves as family firms (Westhead & Cowling, 1998; Zellweger et al., 2011). This criterion reduced the sample to 338 family firms. After removing cases with missing values regarding economic and financial data, we obtained a final sample of 299 privately held family businesses. We tested for nonresponse bias by using Kruskal-

Wallis and X^2 tests, which compare the main firm characteristics in this study (e.g., firm size and firm age) between the sample and the population. No statistically significant differences were found for these variables, so the sample is supposed to be representative for the population.

The use of two different sources of data mitigates the risk of common method bias, to the extent that the dependent variable (k_e) and multiple control variables (i.e., firm age, firm size, leverage, and industry) stem from a database external to the survey.

4.2 Variables

Dependent Variable

The Capital Asset Pricing Model (CAPM) (Black, 1972; Sharpe, 1964) has traditionally been the model par excellence to calculate k_e. This model considers the existence of a positive linear relationship between the expected return of securities and their market betas (Fama & French, 2004), explained by their mean-variance. Nevertheless, the CAPM presents some limitations to determine k_e of privately held family businesses (Copeland et al., 2000). Consequently, different authors (e.g., Abudy et al., 2016; Cotner & Fletcher, 2000; Kerins et al., 2004) have proposed alternative models to estimate the k_e of private firms, mostly using accounting variables (e.g., Sarmiento-Sabogal & Sadeghi, 2015).

Because of the characteristics of the firms in our sample (i.e., private firms), we first decided to calculate the minimum rate of return required by family shareholders (k_e) following the proposal of Kerins et al. (2004). These authors suggest a formula to estimate the k_e of entrepreneurs who make *a full commitment* to a venture in contrast to investing in a diversified portfolio. This full commitment can be described as "a prospective entrepreneur who must choose between committing all financial and human capital irrevocably to a venture or, alternatively, holding all wealth in a market portfolio" (Kerins et al. 2004, p. 392). As family shareholders are usually *undiversified* entrepreneurs who invest all or most of their resources in the family business, without a well-known diversification policy and, simultaneously, lacking liquidity (Martínez-Romero & Rojo-Ramírez, 2017), the proposal of Kerins et al. (2004) to calculate k_e fits the context of privately held family businesses very well. The model, which is based on the Capital Market Line that underlies the CAPM, is formulated as follows:

$$k_e = R_f + \left(\frac{\sigma_e}{\sigma_M}\right) P_M$$

where R_f is the risk-free interest rate, σ_e and σ_M are the standard deviations of the firm financial profitability and the market profitability for the analyzed period, respectively, and P_M is the market risk premium, that is, the historical differential return of the stock market over treasuries (Damodaran, 2021; Fernández et al., 2020). Note that this model resembles the approach of the standard CAPM model under the assumption that the correlation between the asset and the market is equal to 1, and thus, the entrepreneur's cost of capital is affected by *total risk*. The difference with the Kerins et al. (2004) approach (which uses market data) is that we have to use accounting profitability because we focus on private firms. More specifically, we estimate an accounting beta based on a profitability ratio (EBITDA less interest expenses and taxes to equity). We chose this profitability ratio to calculate the accounting beta as prior research showed that accounting betas tend to overestimate market betas, but this difference is lessened by using equity as denominator (Sarmiento-Sabogal & Sadeghi, 2015).

Accordingly, the risk-free rate (R_f), whose value in 2014 was 3.1%, was obtained from the Spanish public treasury web page (https://www.tesoro.es). The market risk premium (P_M), 4.5%, was taken in accordance with Garrido & García (2010). To calculate the standard deviation of the firm financial profitability (σ_e), we used data from the SABI database for the period of 2010-2014. And, for the standard deviation of the market profitability (σ_M), data from the Madrid Stock Exchange during the 2010-2014 period were used.

Independent Variables

The evolutionary stages of the development of family firms' FGP could be categorized as follows. First, the "informal stage," in which no formal FGP exists, or only informal family meetings are held (Bloemen-Bekx et al., 2021). Second, the "family council stage", characterized by the existence of a formal family council (Leach, 2012). And, third, the "family constitution stage" when the family council has developed a family constitution (Suáre & Santana-Martín, 2004; Parada et al., 2020). To define each of these FGP evolutionary stages, we used two questions from the survey, asking (1) whether the firm has a family council and (2) whether it has a family constitution. With a yes/no answer, family firms indicate whether or not they have implemented each of the family governance mechanisms. Next, we defined the three evolutionary stages, i.e., *Informal stage, FamCouncil stage,* and *FamConstitution stage* based on these two questions. Thus, firms in the *Informal stage* answered both questions with no, firms in the *FamCouncil stage* answered yes on council and no on constitution, and firms in the *FamConstitution stage* answered both questions with yes[3].

Moderating variable

We use the number of family owners as a proxy for family complexity (*FamShareholders*). This variable is a better proxy than a more crude variable as the generation (Lubatkin et al., 2005). Indeed, family firms in later generations can still be

[3] There are five firms that indicate that they have a constitution but no council. These firms could not be classified directly with the criteria above. However, these firms developed their constitution in an ad hoc task force. As this ad hoc task force is also a systematic communication forum like a council (Villalonga et al., 2015), we decided to classify these firms as being in the family constitution stage. We also executed some robustness checks by removing these five cases from the sample. The results stay the same.

led by one family owner-manager with 100% ownership. Therefore, the number of family owners is a much better and more direct proxy for family firm complexity and the related family governance needs. Because of the skewness in the distribution of this variable, we apply the natural logarithm.

Control Variables

We also controlled for several business characteristics that might affect k_e. First, as family divergences regarding required returns may exacerbate as families age (Schulze et al., 2003), we controlled for firm age (*Firm Age*), measured as the natural logarithm of years since the firm's inception (Martínez-Romero et al., 2023). Moreover, as risks tend to decrease with firm size (Zellweger & Dehlen, 2012), the number of employees was included as a proxy of firm size (*Firm Size*) (Cruz et al., 2012). We also controlled for firm performance because family shareholders' requirements regarding minimum returns might vary depending on firms' profitability. If profitability increases, family owners would demand a higher rate of return. Thus, the variable Return on Investment Capital (*ROIC*), measured as net income divided by invested capital, controls for firms' profitability (Rojo-Ramírez et al., 2022). The model also controls for firm leverage (*Leverage*), measured as financial debt over equity, inasmuch as leverage has a positive effect on equity returns (López-Delgado & Diéguez-Soto, 2015). Moreover, the generational phase of a family firm has implications on goal setting because intra-family conflicts are exacerbated as firms evolve from first to subsequent generations (Schulze et al., 2003). Consequently, the dummy variable *Generation* is included, which equals one for first-generation family firms and zero for later-generation family firms. Moreover, we controlled for the presence of non-family shareholders because of their possible influence on the firm's return policy and their potential threat to family control (Michiels et al., 2015). Thus, we included the dummy variable *NonfamShareholders*, which equals one when the firm has active non-family shareholders and zero otherwise. We also control for passive shareholders because they may have different interests than active family shareholders (Bartholomeusz & Tanewski, 2006; Siebels & zu Knyphausen-Aufseß, 2012), and in turn, have an incentive to monitor them closely (Blanco-Mazagatos et al., 2016). In this regard, *PassiveShareholders* report the percentage of passive family shareholders within the firm, measured as the number of passive family shareholders divided by the total number of family shareholders. Finally, we also included two dummy variables to control for the effect of industry affiliation on k_e (active in construction (*Construction*), wholesale and retail (*Wholesale&Retail*), or other sectors of the economy (reference category)).

4.3 Analysis

In this paper, we investigate the effect of a multicategorical antecedent variable (with the three FGP stages *Informal stage*, *FamCouncil stage*, *FamConstitution stage* as three different groups) on k_e. As our multicategorical independent variable consists of three groups, it can be included in the regression model using a coding system based on two variables representing the three groups, with the group that is left out as the reference group (Hayes, 2017). We use indicator (dummy) coding concerning the three FGP described above, which allows us to quantify differences between pairs of means of the dependent variable (Hayes, 2017). For example, a firm in the family constitution stage will be coded 1 for *FamConstitution* stage and 0 for *Informal stage* and *FamCouncil stage.* A firm in the family council stage will be coded 1 for *FamCouncil stage* and 0 for *Informal stage* and *FamConstitution stage.* When *Informal stage* is chosen as the reference category in the regression model, the regression results show the difference in the dependent variable of (1) *FamCouncil stage* versus *Informal stage* (=β_1) and (2)

FamConstitution stage versus *Informal stage* (=β_2) The regression model can be written as (in which X is the vector of control variables):

$$k_e = \beta_0 + \beta_1 \, FamCouncil\ stage + \beta_2 \, FamConstitution\ stage + \gamma' X + \varepsilon \qquad (1)$$

To test our moderation hypotheses, we also estimate a moderation model in which we add the number of family shareholders (*FamShareholders*) as a continuous moderator.

The regression model can be written as:

$$k_e = \beta_0 + \beta_1 * FamCouncil\ stage + \beta_2 * FamConstitution\ stage + \beta_3 * FamShareholders + \beta_4 * FamCouncil\ stage * FamShareholders + \beta_5 * FamConstitution\ stage * FamShareholders + \gamma' X \qquad (2)$$

A moderation effect is found when *the difference (gap) between the estimated conditional means* in k_e of the three FGP stages is significantly different for different values of the moderator (Hayes, 2017). For example, the relative conditional effect (conditional on *FamShareholders*) of the difference between the FamCouncil stage versus the Informal Stage can be written as ($\beta_1 + \beta_4$*FamShareholders*) (see regression model (2)).

5. Results

5.1. Descriptive statistics

Table 1 reports the average characteristics of the sample firms. The mean k_e by family businesses' owners is 12%. This rate ranges from 5% to 44%[4]. On average, the sample firms are 24.26 years old and have 23 employees. Firm age ranges from 7.85 to 85.04 years old, while firm size varies between 3 and 1,103 employees, and about 45% of the firms are second- and later-generation firms. The average value of *ROIC* is 5% and the average value of leverage is 3.12. About 11% of the sample firms have non-family

[4] Because of the skewness of this variable, we also re-estimated all our regression models with the natural log of k_e as a robustness check. All our findings were confirmed in these models. These unreported results are available from the authors.

shareholders. Moreover, the sample firms have on average 27% of passive family shareholders. The average number of family shareholders is 3.47. Finally, 28% of the firms belong to the "family council stage" and 12% to the "family constitution stage".

(Insert Table 1 here)

Table 1 also reports the correlations among the variables of interest in this study. The dependent variable, k_e, is significantly and negatively correlated with *Firm Age, and ROIC*, and, significantly and positively correlated with *Leverage* and *FamCouncil stage.* Table 2 shows no indications of multicollinearity as its magnitudes are modest with most of the correlation values below 0.297. Additionally, to ensure that multicollinearity is not a problem in this study, we calculated Variance Inflation Factors (VIF) in all regressions. We found that the VIF values do not exceed 2.668 in any regressions, which is well below the threshold of 10 (Belsley et al., 1980).

5.2. Main results

Model 1 in table 2 only contains the control variables and shows that k_e is negatively and significantly related to *Firm age* and *NonfamShareholders,* and positively and significantly related to *Leverage*. Next, we executed a direct test of H1 in models 2 and 3 in which we tested for significant differences of k_e between the three FGP evolutionary stages. Model 2 indicates that both businesses in the *FamCouncil stage* and in the *Informal stage* have a higher k_e (β =0.024; $p < 0.01$; β =0.012; $p < 0.1$, respectively) than those in the *FamConstitution stage*, supporting H1. Similarly, model 3 provides additional information of the lower ke for businesses in the FamConstitution stage (β = -0.024; $p < 0.01$) compared with the *FamCouncil stage.*

(Insert Table 2 & Table 3 here)

As a first step in testing H2, H3, and H4, we calculated the conditional means for different values of the moderator (*FamShareholders)*. We found that for low values (16th

percentile) of the moderator, the conditional mean of k_e was 9.12% for *Informal stage*, 10.97% for *FamCouncil stage* and 7.87% for *FamConstitution stage.* For moderate values of the moderator (50th percentile), we found a conditional mean for k_e of 9.21% for *Informal stage*, 10.28% for *FamCouncil stage* and 7.90% for *FamConstitution stage.* Finally, for high values of the moderator (84th percentile), we found a k_e of 9.33% for *Informal stage*, 9.41% for *FamCouncil stage,* and 7.94% for *FamConstitution stage.* These figures provide support for the hypothesized patterns leading to H2, H3, and H4.

To statistically test H2, we estimated a moderation model with a multicategorical independent variable using the SPSS PROCESSv3.0 code (Hayes, 2017). We mean-centered the continuous interaction variable (*FamShareholders*) to avoid multicollinearity problems. The PROCESS code calculates relative conditional effects for low (16th percentile), moderate (50th percentile) and high (84th percentile) values of the moderator (*FamShareholders*). By examining the differences in the gap between the conditional means of k_e for the three stages (*Informal stage* vs. *FamConstitution stage* vs. *FamCouncil stage*), we can formally test H2, H3, and H4 (Table 3). Panel (a) in table 3 shows that family firms in the *FamCouncil stage* indeed have a higher k_e than family firms in the *Informal stage* (model 1, $\beta = 0.019$; $p < 0.05$) and family firms in the *FamConstitution stage* (model 2, $\beta = 0.031$; $p < 0.001$) when the number of family shareholders is low. These findings lend support to H2.

H3 proposes that the differences in k_e found concerning H2 will become smaller when the number of family owners increases. The interaction coefficients (*FamCouncil stage* * *FamShareholders* vs. *Informal stage* * *FamShareholders* in model 1, $\beta = -0.019$; $p < 0.05$; *FamCouncil stage* * *FamShareholders* vs. *FamConstitution stage* * *FamShareholders* in model 2, $\beta = -0.018$; $p < 0.1$) show indeed the proposed negative effects which provides support to H3. Further analysis of the relative conditional effects in Panels (a), (b), and (c) in Table 3 provides additional insights about the statistical significance of the differences in k_e for different values of the moderator. The comparison of *FamCouncil stage* vs. *Informal stage* can be found in model 1 of table 3. We found that the effect was significant (panel (a), $\beta = 0.019$; $p < 0.05$). When the number of family shareholders is moderate (panel (b)) or high (panel (c)), family firms in the *FamCouncil stage* will have no significant different k_e than family firms in the *Informal stage* (panel (b), $\beta = 0.011$, $p > 0.1$; panel (c), $\beta = 0.001$, $p > 0.1$). This finding suggests that the governance effectiveness of family councils indeed increases (and thus will lower k_e) as hypothesized, but is still not statistically significant different than in the informal stage, even when the family governance needs of the firm are high, which is an important new insight.

The comparison of *FamCouncil stage* vs. *FamConstitution stage* for several values of the moderator can be found in model 2. The difference in k_e stays significant for moderate (panel (b), $\beta = 0.024$; $p < 0.01$) and high values (panel (c), $\beta = 0.015$; $p < 0.05$) of the moderator, although less significant for the latter category of the moderator.

Finally, the interaction coefficient of *FamConstitution stage*FamShareholders* vs. *Informal stage*FamShareholders* in model 1 of table 3 ($\beta = -0.001$; $p > 0.1$) is not significant and does not seem to provide support for H4 in which we predicted that the difference in k_e between these two categories will *enlarge* when the number of family owners increases. Further analysis of the relative conditional effects in panels (a), (b), and (c) of model 1 shows that the difference in k_e stays significant when the number of family owners is low (panel (a), $\beta = -0.013$; $p < 0.05$), when the number of family owners is moderate (panel (b), $\beta = -0.013$; $p < 0.05$) and when the number of family owners is high (panel (c), $\beta =- 0.014$; $p < 0.1$).

5.3. Post hoc analysis

We developed hypotheses in which we propose a moderating effect of the number of family owners. An alternative relationship between our variables of interest may be assumed in which increasing family complexity – and thus mounting family governance needs – are an antecedent of FGP, therefore assuming a mediation model. To test this alternative hypothesis, we recoded the family governance stages into an ordinal variable reflecting the proposed evolutionary sequence (*Informal stage* = 1, *FamCouncil stage* = 2, *FamConstitution stage* = 3) and estimated an ordered probit model with all control variables and the original moderator as an independent variable which is the first step in a mediation model. The number of family shareholders has no significant effect on the 5% level (p=0.081) in this model. Next, we estimated a multinomial logit model with the three dummies representing the family governance stages as the dependent variable. In these models, the number of family shareholders is not even significant at the 10% level. Furthermore, none of the other included variables significantly determine the step towards a family council, which suggests that, generally, entering the family council stage is rather ceremonial in nature and not directly driven by the typical family governance needs. The situation is slightly different for entering the family constitution stage: firm size is found to be a significant determinant at the 1% level. This finding suggests that the growing complexity on the firm level (as a result of leading a larger firm) triggers the development of a shared protocol concerning business matters (the constitution). Overall, these tests do not support the alternative hypothesis but support our choice of a moderation model and also provide some support for the ceremonial motive argument in the adoption of a family council.

6. Discussion

The minimum required rate of return by the shareholders or k_e is an important financial variable as it is one of the key variables in calculating a firm's equity value in a discounted cash flow model and serves as a benchmark when evaluating investment projects (Boubakri et al., 2010). Furthermore, the k_e that family owners require is a variable more directly related to goal setting concerning the business, which is one of the pivotal roles attributed to FGP (Neubauer & Lank, 1998). Notwithstanding the salience of k_e as a financial variable, we still have a limited understanding of the antecedents of k_e in private family firms, which are the most common type of business worldwide. Therefore, we contribute to this literature by proposing that FGP are an important overlooked antecedent of k_e in family firms building on the premise that the adoption of FGP will nurture a shared vision about the future sustainability of the business among family members and will lead to a lower k_e (Suess, 2014). Indeed, prior literature found that family shareholders are a distinct class of ownership with unique characteristics, such as a long-term temporal vision, which has a theoretically established lowering influence on k_e (Zellweger, 2007). In contrast to prior FGP literature, we investigate the effect of FGP on k_e from an *evolutionary stage perspective* (Parada et al., 2020), proposing three distinct stages: the informal stage, the family council stage, and the family constitution stage. Family firms in the family constitution stage conform to the essential elements of an effective governance mechanism, which include structures, trust-enhancing processes, and a protocol. Family firms in the other two evolutionary FGP stages do not conform to these essential conditions and especially the lack of a protocol (the family constitution) as a complement to the structures (the family council) seems to be an important constraint in reaching governance effectiveness (González-Cruz et al., 2021).

Our findings indicate that family firms in the family constitution stage have a lower k_e than family firms in the family council stage which is in support of our first hypothesis. In addition, we proposed that these findings are conditional on the governance needs of the family firm (as a result of family ownership dispersion and higher family complexity). Therefore, we tested the moderating effect of the number of family owners on the FGP stages - k_e relationship and found that family firms in the family constitution stage will have a lower k_e than the other two FGP stages under each family complexity condition (low vs. moderate vs. a high number of family owners). Furthermore, family firms in the family council stage will have the highest k_e across the whole range of the moderator, which questions the governance effectiveness of family councils as standalone FGP, especially when the family governance needs are low (low family complexity).

6.1. Theoretical contributions

These results have important implications for k_e and governance research in family firms. First, prior research primarily investigated firm variables and family control (e.g., Boubakri et al., 2010) as antecedents of k_e. Recently, scholars have started to investigate idiosyncratic family business antecedents originating from the family subsystem, such as the different dimensions of SEW (Martínez-Romero & Rojo-Ramírez, 2017). By examining the distinctive influence of FGP evolutionary stages, we extend the scant literature on antecedents of k_e in private family firms. We show that the heterogeneity in the governance system of the family may have an important influence on k_e in family firms, which embodies a new family subsystem antecedent. In addition, we contribute to the family firm heterogeneity debate (Daspit et al., 2021) as we distinguish between different evolutionary FGP stages, a largely overlooked family business heterogeneity facet. In so doing, we provide a salient novelty in addition to previous research that analysed the aggregate FGP effect or the effect of a single FGP on firm performance (e.g., Blanco-Mazagatos et al., 2016; Tower et al., 2007). Thus, our findings reveal that it is important to differentiate between the different stages of FGP, which sheds another light on prior equivocal results. While family councils do not necessarily improve businesses' outcomes, complementing the family council with a family constitution will keep the k_e lower, even in challenging complexity conditions for the family subsystem.

Second, extant research found that corporate governance is conditional in nature (e.g., Chi & Lee, 2010). We apply these ideas to the field of family governance and find that k_e differences between the three FGP stages depend on the family governance needs measured by the number of family owners. Two observations need to be highlighted. The first one is that creating a family council shows no lower k_e versus the other two FGP categories under no particular condition, which is even worse than we would have expected. This observation supports our theoretical argument that when there are no clear family governance needs, having a family council may entail the risk of creating agency problems instead of solving them. This is because without clarity about its boundaries, a family council may be used for what it is not intended, such as developing into a "Family Court" in which family members criticize each other, especially when they feel they are not heard (Eckrich & McClure, 2012), or becoming a substitute for the board of directors or the shareholders meeting (Gnan et al., 2015). Therefore, it is important that starting a family council is accompanied by the creation of a family constitution in which the essential elements of the functioning and roles of the family council are established (Eckrich & McClure, 2012; González-Cruz et al., 2021). A second observation is that family constitutions complementing family councils will indeed lead to a lower k_e than only having a family council or no formal FGP when the number of family owners is high. However, the effect is less significant than expected. This finding suggests that a family constitution is only one part of fulfilling mounting family governance needs. We speculate that the creation of a shareholder agreement (Arteaga & Menendez-Requejo, 2017) or the establishment of a family assembly in which the broader family will meet (Flamini et al., 2022; Gónzalez-Cruz et al., 2021) can be equally important. Future research should investigate these potential explanations further.

FGP are often cited as pivotal in maintaining trust, family unity, and a longer temporal orientation (Berent-Braun & Uhlaner, 2012; Suess, 2014; Sundaramurthy, 2008). However, what was missing so far in the debate is a critical analysis of whether distinct FGP, such as a family council and a family constitution, conform to the essential conditions of an effective family governance system (Calabrò et al., 2021). The relational governance perspective (e.g., Poppo & Zenger, 2002; Sundaramurthy, 2008) proposes that effective FGP comprises three indispensable attributes, i.e., coordinated decision-making in a systematic governance forum (Villalonga et al., 2015; Suess, 2014), social interaction and relational dynamics (Mustakallio et al., 2002) and the development of transparent policies and protocols (Sundaramurthy, 2008; Botero et al., 2015; Neubauer & Lank, 1998). Our analysis shows that only having a family council does not meet these essential conditions. An important addition in understanding why the family council stage may not be effective for many family firms comes from institutional theory. Indeed, prior literature (Melin & Nordqvist, 2007; Parada et al., 2020) pointed to normative and mimetic pressures on family firms to adopt a family council as a legitimized structure but without seeing them taking the next "behavioural processes" step towards the development of a formal written protocol, i.e., the family constitution. As a consequence, the creation of the family council can be ceremonial (Parada et al., 2020) and when it happens, will not be effective in coping with the family governance challenges associated with the increasing family complexity, creating a misfit between the governance system and the governance needs (González-Cruz, et al., 2021). Our study's results provide some evidence supporting this institutional pressure argument.

6.2. Practical Implications

Our results also have important practical implications. During the last decade, practitioners and policy makers have spent much time and effort initiating governance recommendations and codes for family firms worldwide. However, family firms also have a family subsystem that requires idiosyncratic governance practices. Therefore, family firm governance codes often recommend the implementation of FGP, such as a family council and a family constitution (Fleischer, 2023; Rodríguez-García & Menéndez-Requejo, 2023). However, governance codes often tend to encourage a box-ticking approach. For instance, family owners could get the impression from these codes that merely installing a family council will be the answer to the governance needs of their family subsystem. Our results show that creating a family council will be insufficient and that a more nuanced recommendation is warranted, i.e., preparing a family constitution in the council will better align with the requirements of an effective family governance system, especially when the governance needs of the family system are increasing.

6.3. Limitations and Future research avenues

This study has some limitations that could provide interesting opportunities for future research. First, measuring k_e in private firms is a real challenge, and academic research has not provided many solutions. Although we use an accounting-based proxy that is not perfect (Sarmiento-Sabogal & Sadeghi, 2015), it serves the purpose of this study which is to investigate *differences* in k_e, not make point estimates of k_e. Future research should develop more sophisticated approaches to measure the k_e of private firms. Second, we use cross-sectional data that has some limitations (e.g., low response rate, establishing causal relations). Therefore, future research could look for larger databases including panel and longitudinal data. Third, the family constitution is a protocol document of the family but needs to be approved by the board of directors to become a part of the business policy. It is still an open question how the interactions and processes between the FGP and the board of directors occur and how effective they are. To unravel the complex interdependencies that may exist among key corporate and family governance factors, future research may use configuration approaches like fuzzy set Qualitative Comparative Analysis (cf. Hughes et al., 2018; Kraus et al., 2018).

7. Conclusion

This study analyses the relationship between family governance evolutionary stages as a source of family firm heterogeneity and the minimum rate of return required by family business shareholders (k_e) in private family firms, building on an institutional and relational governance lens. The findings reveal that family firms in the family constitution stage present a lower k_e than family firms in both the informal and the family council stages. Moreover, when the number of family shareholders is low and therefore, family governance needs are low, being in the family council stage may be even worse than the informal stage, which points to ceremonial adoption effects and a mismatch between family governance needs and practices in this stage. On the contrary, when the number of family shareholders is higher, this detrimental effect will disappear. Overall, the family constitution stage will be most beneficial for family firms.

Data availability statement

The data that support the findings of this study are available from the corresponding author upon request.

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Table 1: Descriptive statistics and pairwise Correlations

Variables	Mean	StDev	Min	Max	1	2	3	4	5	6	7	8	9	10	11	12	13
1. k_e	0.12	0.05	0.09	0.44	1												
2. Firm Age [a]	24.26	9.53	7.85	85.04	-.190***	1											
3. Firm Size	22.7	74.88	3	1,103	-.066	.119*	1										
4. ROIC	0.05	0.06	-0.26	0.31	-.142**	-.083	.124*	1									
5. Leverage	3.12	9.95	0.01	146.55	.352***	-.052	-.035	-.143**	1								
6. NonfamShareholders	0.11	0.31	0	1	-.068	.018	0.05	.008	.02	1							
7. PassiveShareholders	0.27	0.31	0	1	-.088	.268***	-0.058	-.158**	-.065	-.054	1						
8. Generation	0.55	0.49	0	1	.044	-.180**	-.04	-.009	0.02	.053	-.047	1					
9. Construction	0.11	0.31	0	1	.035	.023	-.02	-.133*	.11†	-.015	-.091	.031	1				
10. Whosale&Retail	0.4	0.49	0	1	.003	-.044	-.01	-.07	0.1	.003	.008	.098†	-.283***	1			
11. FamCouncil stage	0.28	0.45	0	1	.101†	.035	.029	.121*	.015	.000	.012	-.061	-.096†	-.011	1		
12. FamConstitution stage	0.12	0.33	0	1	-.092	.121*	.218***	.023	.097†	.001	-.001	-.149**	.001	.024	-.235***	1	
13. Informal stage	0.60	0.49	0	1	-.031	-.113†	-.172**	-.126*	-.079	-.001	-.01	.156**	.087	-.006	-.758***	-.456***	1
14. FamShareholders [a]	3.47	3.46	1	38	-.087	0.315***	.075	-.081	.027	-.005	.387***	-.250***	-.094	-.044	.052	.174**	-.164**

Note: N=299 ; *† p <0.10; * p <0.05; ** p <0.01; *** p <0.001* ; [a] Correlations calculated with Natural Logarithm

Table 2: Regression Analyses

Model	1	2	3
Firm Age [a]	-0.025*** (0.007)	-0.025*** (0.007)	-0.025*** (0.007)
Firm Size	-0.001 (0.002)	0.000 (0.003)	0.000 (0.003)
ROIC	-0.095 (0.075)	-0.106 (0.074)	-0.106 (0.074)
Leverage	0.002* (0.001)	0.002** (0.001)	0.002** (0.001)
NonfamShareholders	-0.012* (0.006)	-0.012* (0.005)	-0.012* (0.005)
PassiveShareholders	-0.008 (0.007)	-0.008 (0.007)	-0.008 (0.007)
Generation	0.001 (0.006)	0.001 (0.006)	0.001 (0.006)
Industry [b]			
Construction	-0.004 (0.011)	-0.003 (0.010)	-0.003 (0.010)
Wholesale&Retail	-0.003 (0.006)	-0.002 (0.006)	-0.002 (0.006)
FGP stages			
FamCouncil stage		0.024** (0.008)	
FamConstitution stage			-0.024** (0.008)
Informal stage		0.012† (0.007)	-0.011 (0.007)
R^2	0.173	0.192	0.192
F statistic	2.76**	2.90**	2.90**

Note: N=299. ROIC = Return on Invested Capital; FGP= Family Governance Practices; Dependent variable = k_e. Robust standard errors in parentheses. Intercept included.

[a] Natural Logarithm [b] Other sectors is the suppressed sector comparison category. *† p <0.10; *p <0.05; **p <0.01; ***p <0.001*

Table 3: Regression Analyses

Model	1	2
FamShareholders [a c]	0.002 (0.005)	0.001 (0.006)
Firm Age [a]	-0.023*** (0.007)	-0.023*** (0.007)
Firm Size [a]	0.000 (0.003)	0.000 (0.003)
ROIC	-0.112 (0.073)	-0.112 (0.073)
Leverage	0.002* (0.001)	0.002* (0.001)
NonfamShareholders	-0.012* (0.005)	-0.012* (0.005)
PassiveShareholders	-0.008 (0.008)	-0.008 (0.008)
Generation	0.000 (0.005)	0.000 (0.005)
Industry [b]		
Construction	-0.003 (0.010)	-0.003 (0.010)
Wholesale&Retail	-0.003 (0.006)	-0.003 (0.006)
FGP stages		
FamCouncil stage	0.012† (0.007)	0.025*** (0.007)
FamConstitution stage	-0.013* (0.006)	
Informal stage		0.013* (0.006)
FamCouncil stage*FamShareholders [a]	-0.019* (0.009)	-0.018† (0.009)
FamConstitution stage*FamShareholders [a]	-0.001 (0.007)	
Informal stage*FamShareholders [a]		0.002 (0.007)
Relative conditional effects[d]		
Panel (a): Low number of family shareholders (16th percentile)		
FamCouncil stage	0.019* (0.009)	0.031*** (0.009)
FamConstitution stage	-0.013* (0.006)	
Informal stage		0.013* (0.006)
Panel (b): Moderate number of family shareholders (50the percentile)		
FamCouncil stage	0.011 (0.007)	0.024** (0.007)
FamConstitution stage	-0.013* (0.006)	
Informal stage		0.013* (0.006)
Panel (c): High number of family shareholders (84th percentile)		
FamCouncil stage	0.001 (0.007)	0.015* (0.007)
FamConstitution stage	-0.014† (0.008)	
Informal stage		0.014† (0.008)
R^2	0.202	0.202
F statistic	2.49**	2.49**

Note: N=299. ROIC = Return on Invested Capital; Dependent variable = k_e. Robust standard errors in parentheses. Intercept included. [a] Natural Logarithm [b] Other sectors is the suppressed sector comparison category. [c] Mean centered, [d] Famshareholders as moderator. *† p <0.10; *p <0.05; **p <0.01; ***p <0.001*