

# Board Processes in Family Firms: The Effect of Family Ties on the Balancing of Trust and Control\*

Yannick Bammens (corresponding author), Hasselt University, KIZOK Research Center, Agoralaan – Building D, B-3590 Diepenbeek, Belgium, tel. +32 11-268633, fax +32 11-268700, email: [yannick.bammens@uhasselt.be](mailto:yannick.bammens@uhasselt.be)

Wim Voordeckers, Hasselt University, KIZOK Research Center, Agoralaan – Building D, B-3590 Diepenbeek, Belgium, tel. +32 11-268613, fax +32 11-268700, email: [wim.voordeckers@uhasselt.be](mailto:wim.voordeckers@uhasselt.be)

Anita Van Gils, Maastricht University, Organization and Strategy Department, P.O. Box 616, 6200 MD Maastricht, The Netherlands, tel. +31 43-3883683, fax +31 43-3884893, email: [a.vangils@os.unimaas.nl](mailto:a.vangils@os.unimaas.nl)

**Abstract:** *In this article we present a theoretical framework for understanding the influence of the family system on the functioning of boards of directors. Our starting point is that effective board processes require non-executive directors to properly balance trust and control in their relationship with the CEO. We clarify how the presence of family ties between both parties facilitates the building of ability and intentional trust, but increases the danger of inadequate control. Moreover, we argue that the influence of family ties is dependent upon the level of family cohesion and the generational dynamics. Our theoretical analysis reveals how the study of agency relationships in family firms must consider opportunistic tendencies, stewardship motives, social context, and the bounded rationality problem.*

**Keywords:** *boards of directors, family firms, trust, control.*

---

\* We have benefited from the suggestions of participants in the 2005 EIASM Workshop on Trust within and between Organizations (Amsterdam, The Netherlands), the 2006 Family Enterprise Research Conference (Niagara Falls, Canada), and the 2007 Academy of Management Annual Meeting (Philadelphia, USA). We gratefully acknowledge the valuable comments of James Chrisman and Pramodita Sharma on various drafts of this article.

## **Board Processes in Family Firms: The Effect of Family Ties on the Balancing of Trust and Control**

In most firms operating in today's economy, ownership and top management are concentrated within a single family (IFERA, 2003; La Porta, Lopez-de-Silanes, & Shleifer, 1999). Involvement of the family system in ownership and management can be expected to result in organizational processes that are distinct from those in non-family firms (Chua, Chrisman, & Sharma, 1999). While the literature is often critical of family firms (e.g. Levinson, 1971), these businesses have significant advantages over non-family firms on dimensions as commitment, flexibility, and patient capital (Habbershon & Williams, 1999; Miller & Le Breton-Miller, 2006). However, existing theories – often based on assumptions of economic rational behavior – do not capture the complexities of family firms (Chrisman, Steier, & Chua, 2006; Dyer, 2003). Therefore, the development of theoretical frameworks for understanding the influence of the family system on organizational processes is of major importance.

In this article, we examine the processes within a firm's most central governance system, namely its board of directors. Exercising control over and providing advice to CEOs are the two primary components of a board's internal administrative function (Pfeffer & Salancik, 1978; Westphal, 1999). Effectively combining the control and advice task may, however, prove difficult for non-executive directors. Control is based on the premise of distrust and may preclude or destroy trust between non-executive directors and the CEO (Ghoshal & Moran, 1996). Advice on the other hand, requires a trusting relationship in which CEOs are encouraged to seek advice and non-executives feel comfortable providing it (Westphal, 1999). The internal administrative function thus requires non-executive directors to embrace both trust and control in their relationship with the CEO (Daily, Dalton, &

Cannella, 2003; Sundaramurthy & Lewis, 2003). This balancing act may be a very challenging undertaking, and we argue that the family system will have an important impact on this process.

Agency relationships in family firms frequently involve family ties between the non-executive directors and the CEO. This results from the fact that families are reluctant to appoint outside (i.e. non-executive and non-family) directors on their board, and often pursue a strategy of internalizing board membership to family members alone (Lane, Astrachan, Keyt, & McMillan, 2006; Ward, 1988; Westhead, Howorth, & Cowling, 2002). The purpose of this study is to develop a theoretical framework for understanding the influence of these family ties on the non-executive directors' ability to effectively balance trust and control in their relationship with the CEO. Furthermore, in order to account for variations within the group of family firms (cf. Chrisman et al., 2006), we include the level of family cohesion and generational dynamics in our theoretical framework.

Earlier studies advancing our understanding of family firms have demonstrated the usefulness of the resource based view, agency and stewardship theory (e.g. Chrisman, Chua, Kellermans, & Chang, 2007; Corbetta & Salvato, 2004; Dyer, 2006; Habbershon & Williams, 1999; Schulze, Lubatkin, Dino, & Buchholtz, 2001). Our study adds to this literature by indicating how the family system – as a unique internal resource for family firms – influences board effectiveness. Furthermore, we specify how the study of agency relationships in a family firm setting must consider opportunistic tendencies, stewardship motives, social context, and bounded rationality problems. The structure of the article is as follows. Seeing that academic knowledge on how to balance trust and control in agency relationships is still underdeveloped (Huse, 2005), we will first demonstrate how non-executive directors can employ both concepts in a complementary manner. We will then apply the developed insights in a family firm context and develop propositions regarding the

impact of family ties, the level of family cohesion, and the generational dynamics on the non-executive directors' capacity to effectively balance trust and control. Finally, we discuss the main contributions of this study and indicate avenues for future research.

## **Trust and Control: A Complementary Approach**

### **Agency and Stewardship Perspectives**

Trust and control are both governance mechanisms which reduce perceived relational risk in a cooperative endeavor (Nooteboom, 2002; Ouchi, 1979). Control is about influencing the behavior of people through monitoring or incentives in order to ensure that they act in a cooperative and effective fashion (Das & Teng, 2001; Lebas & Wiegenstein, 1986). The importance of the control task for non-executive directors is derived from agency theory which assumes that managers are self-interested and inclined to behave opportunistically whenever their interests diverge from those of the shareholders (Eisenhardt, 1989; Jensen & Meckling, 1976). Seeing that agency theorists focus on individual economic utility maximization and neglect the social context of agency relationships, trust relations are formally discounted (Hendry, 2005; Lubatkin, Lane, Collin, & Very, 2007; Roberts, McNulty, & Stiles, 2005).

Trust can be defined as “the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party” (Mayer, Davis, & Schoorman, 1995, p. 712). A theoretical basis for trust in agency relationships can be found in stewardship theory which argues that many managers are intrinsically motivated to behave in line with the interests of the firm and its shareholders (Davis, Schoorman, & Donaldson, 1997). Intrinsic motivations include satisfaction through successfully performing valuable and challenging work, concern for the interests of the

shareholders, and identification with the firm (Donaldson, 1990; Donaldson & Davis, 1991). It is argued that such stewards will never substitute self-serving behaviors for pro-organizational behaviors, and that control should be avoided since it may negatively impact their intrinsic motivation (Davis et al. 1997).

Davis and colleagues (1997) maintain that managers choose to behave as either agents or stewards, and that their choice is contingent upon their psychological motivations and perceptions of the situational context. Such an approach suggests a focus on either control or trust by non-executive directors in their relationship with the CEO. Yet qualitative studies indicate that this either/or approach “does not adequately reflect the lived experience of non-executive directors” (Roberts et al., 2005, p. S5). Moreover, a focus on control or trust may result in extremely dysfunctional organizational dynamics (Sundaramurthy & Lewis, 2003). An emphasis on control stimulates myopic decision-making and impression management, and fosters a polarized agency relationship with insufficient openness for effective advice interactions (Roberts 2001; Westphal, 1999). On the other hand, a focus on trust may result in an atmosphere of groupthink wherein the non-executive directors encourage CEOs but rarely challenge their views (Sundaramurthy & Lewis, 2003). Furthermore, having blind trust in CEOs is inappropriate given the high strategic and financial stakes, and does not correspond with the board’s duty of care (Monks & Minow, 2004; Wicks, Berman, & Jones, 1999).

## **Balancing Trust and Control**

The above arguments indicate that, contrary to agency or stewardship perspectives, non-executive directors must balance trust and control in their relationship with the CEO (Daily et al., 2003; Sundaramurthy & Lewis, 2003). Trust and control refer to complex social processes, and perspectives regarding the nature of their relationship vary (Long & Sitkin, 2006; Reed, 2001). In order to clarify how trust and control can be employed in a

complementary manner, we distinguish between the two dimensions of the CEOs' behavior that they can relate to – namely the CEOs' intentions to act in line with the interest of the shareholders, and their abilities to do so (Das & Teng, 2001; Hendry, 2002).

*Intentional dimension.* Intentional trust refers to the perception that a CEO will forgo opportunities for opportunism because of integrity or altruism (Mayer et al., 1995; Nooteboom, 1996). However, as managerial motivation is typically an admixture of both self-serving and stewardship motives, the intentional trustworthiness of CEOs generally has an upper-limit (Hendry, 2002; Nooteboom, 2002). This means that values or feelings of concern may cause them to forgo opportunities for opportunism, but that certain opportunities will be too tempting to resist (Nooteboom, 1996; Williamson, 1979). For instance, a CEO may be intrinsically motivated to work hard (and thus refrain from shirking or free-riding) because he or she identifies with the firm, but untrustworthy when it comes to making a particular investment decision that increases shareholder value rather than personal prestige or wealth. Through repeated interactions with the CEO, non-executive directors can assess those domains which are situated beneath the upper-limit of the CEO's trustworthiness and those domains which are situated above it (Lewicki, McAllister, & Bies, 1998; Lubatkin et al., 2007).

Seeing that control may lead to cynicism on the part of the controllers and increased opportunistic tendencies on the part of the controllee (i.e. the self-fulfilling prophecy of distrust), CEOs should be allowed to act with full discretion in those domains that are situated beneath the upper-limit of their intentional trustworthiness (Das & Teng, 2001; Ghoshal & Moran, 1996). Yet for those domains which are situated above this upper-limit, non-executive directors should be aware of the threat of opportunism and exercise control (Nooteboom, 2002). The most effective way for non-executive directors to control CEOs is to challenge, question, and discuss their actions via face-to-face interactions (Roberts, 2001; Roberts et al.,

2005). Contrary to more distant forms of control such as incentive pay, face-to-face control can be focused on specific domains of the CEO's behavior and is therefore less likely to give rise to the self-fulfilling prophecy of distrust in other domains.

*Ability dimension.* Ability trust refers to trust in a CEO's competencies and skills that enable him or her to behave in an effective manner (Mayer et al., 1995). The ability trustworthiness of CEOs always has an upper-limit due to human bounded rationality, which refers to the idea that all decision-makers have their limitations regarding knowledge, computational capabilities, and the organization and utilization of memory (Lewicki et al., 1998; Simon, 2000). As a result, CEOs need to rely on simplifying cognitive models when dealing with complex strategic issues, and this increases the danger of ineffective decision-making (Arthur, 1994; Hendry, 2002).

Over time, non-executive directors can gain an understanding of the upper-limit of the CEO's ability trustworthiness (Lewicki et al., 1998). For those domains which are situated beneath this upper-limit, the CEO's judgment can be fully trusted and he or she should be allowed to act with full discretion. Otherwise, the decision-making process is needlessly slowed down and the CEO may become frustrated due to lack of autonomy (Jehn, 1995; Sundaramurthy & Lewis, 2003). Yet for those domains which are situated above this upper-limit, non-executive directors should become actively involved in the decision-making process. Because of their distance from day-to-day affairs and experience elsewhere, non-executive directors may hold valuable complementary cognition which can be used to expose the CEO's judgment to critical scrutiny (Hendry, 2005; Rindova, 1999). By challenging, questioning, and discussing their assumptions and strategic views, non-executives can enrich the employed cognitive models and try to ensure that these do not become obsolete over time (Arthur, 1994; Jehn, 1995; Roberts et al., 2005). Engaging in such investigative face-to-face

interactions constitutes an important task for non-executive directors when the CEO is dealing with complex strategic issues (Forbes & Milliken, 1999).

The above theoretical argumentation clarifies how trust and control can be used in a complementary manner by the non-executive directors. Over time and with repeated social and exchange interactions, the non-executive directors can assess the domains in which the CEO is trustworthy both in terms of intentions and abilities (Lewicki et al., 1998; Lubatkin et al., 2007). These domains should determine the boundaries of the CEO's discretion. For those domains that non-executives perceive as overly tempting (i.e. beyond the upper-limit of the CEO's intentional trustworthiness) and/or as overly complex (i.e. beyond the upper-limit of the CEO's ability trustworthiness), they should become actively involved by engaging in investigative face-to-face interactions with the CEO.

## **Boards of Directors in Family Firms**

In this section we apply the insights developed so far to a family firm context. Family firms can be defined as firms where ownership and top management (i.e. the CEO position) are concentrated within a single family (cf. Arregle, Hitt, Sirmon, & Very, 2007; Litz, 1995). An important feature of the family firm governance system is that boards are frequently dominated by members of the owner-family (Voordeckers, Van Gils, & Van den Heuvel, 2007; Westhead et al., 2002). Families are reluctant to adopt the concept of outside directors since it implies the introduction of an alien element in the family firm and reduces family discretion over organizational decision-making processes (Johannisson & Huse, 2000; Lane et al., 2006; Schulze et al., 2001). Therefore, in family businesses the relationship between non-executive directors and the CEO often involves family ties.

Prior studies suggest that family ties in agency relationships may have a substantial influence on the level of trust and control (e.g. Gomez-Mejia, Nuñez-Nickel, & Gutierrez,



2001; Kosnik, 1987; Steier, 2001; 2003). In this section we examine how family ties between non-executive directors and the CEO influence the building of trust in those domains where the CEO is trustworthy and the exercising of control in those domains where he or she cannot be trusted. Again, we will first consider the intentional dimension and then the ability dimension. Subsequently, in order to account for the variations within the group of family firms (cf. Chrisman et al., 2006; Dyer, 2006; Westhead & Howorth, 2006), we discuss the moderating role of the level of family cohesion and the generational phase of the firm.

### **Family Ties and the Intentional Dimension**

*Building trust.* It is often argued that strong levels of intentional trust among relatives represent one of the main advantages of family firms as an organizational form (Habbershon & Williams, 1999; Tagiuri & Davis, 1996). Because of the long history of social interactions and interdependencies that characterize family relationships, family ties between non-executive directors and the CEO create an ideal basis for mutual intentional trust (Arregle et al., 2007; Nooteboom, 1996). Conversely, when non-executive directors are not related to the CEO, they can only rely on exchange interactions in the organizational setting to build intentional trust (Lubatkin et al., 2007). Yet because of the dominance of agency theoretic principles in corporate practice this may prove very difficult (Daily et al., 2003; Lane et al., 2006; Roberts et al., 2005). Governance structures and norms which emphasize the independence of the board and equate accountability with vigilant control may lead to the self-fulfilling prophecy of distrust and a polarization between non-executive directors and the CEO (Roberts, 2001; Sundaramurthy & Lewis, 2003). Family ties in agency relationships may thus be a valuable resource for building intentional trust, and trust relationships offer the comfort and openness required for effective advice interactions (Huse, 1994; Westphal, 1999).

*Proposition 1a: The process of building intentional trust is facilitated by the presence of family ties between non-executive directors and the CEO.*

*Proposition 1b: Intentional trust increases the openness for advice interactions.*

*Exercising control.* Scholars have traditionally assumed that control by non-executive directors is not very important in a family firm context, mainly because the overlap of ownership and management aligns the economic interests of the managers with those of the owners (Fama & Jensen, 1983; Jensen & Meckling, 1976). Yet Schulze and colleagues (2001) have indicated that owner-managers also pursue non-economic preferences which may harm the welfare of the owner-family and other stakeholders. Just as CEOs in non-family firms, familial CEOs may, for example, pursue pet projects or avoid profitable investments because they entail much personal effort (Gomez-Mejia et al., 2001; Schulze et al., 2001; Schulze, Lubatkin, & Dino, 2003). Therefore, besides building intentional trust in those domains where the CEO is trustworthy, non-executive directors must also assess the upper-limit of the CEO's intentional trustworthiness and exercise control in those domains where he or she cannot be trusted (Lewicki et al., 1998; Nooteboom, 2002).

A negative consequence of family ties between non-executive directors and the CEO is that emotional feelings may bias the non-executives' assessment of the upper-limit of the CEO's intentional trustworthiness, resulting in excessive or even blind trust (Nooteboom, 2002; Schulze et al., 2001). In other words, non-executives may simply not contemplate the possibility of opportunistic behavior on the part of a relative. Furthermore, control can only be effective when the threat of punishment is credible. Yet disciplining a relative is a very emotionally charged issue and may have strong negative ramifications for family relations (Lubatkin, Schulze, Ling, & Dino, 2005). The norms governing family relationships such as love and concern are in conflict with business values of profitability and efficiency, limiting

the capacity of non-executives to effectively implement disciplining measures (Gomez-Mejia et al., 2001; Lubatkin et al., 2005). Therefore, we argue that due to the increased danger of excessive intentional trust and limited willingness to implement disciplining measures, the presence of family ties in agency relationships hinders the employment of effective control of the CEO's intentions.

*Proposition 1c: Exercising control beyond the upper-limit of the CEO's intentional trustworthiness is hindered by the presence of family ties between non-executive directors and the CEO.*

### **Family Ties and the Ability Dimension**

*Building trust.* Ability trust is based on information about an individual's skills and competencies to behave in an effective manner (Mayer et al., 1995). The history that relatives share together in the family system allows them to accumulate detailed information about one another's abilities on a broad array of domains (Barnes & Hershon, 1976, Lewicki et al., 1998). The presence of family ties between non-executive directors and the CEO thus facilitates, *ceteris paribus*, the process of building ability trust. When non-executive directors are not related to the CEO, information asymmetries regarding the abilities of the latter are more significant. Seeing that non-executives cannot completely verify these abilities at the time of hiring, they will need to incur higher verification costs while the CEO is working to make sure that he or she is sufficiently skilled (Chrisman, Chua, & Litz, 2004; Eisenhardt, 1989). During this verification period, CEOs are less likely to ask the non-executive directors for advice since they fear that their need for assistance will engender skepticism about their competency (Westphal, 1999). Therefore, the presence of family ties facilitates the process of building ability trust, which in turn increases the CEO's willingness to ask non-executive directors for advice.

*Proposition 2a: The process of building ability trust is facilitated by the presence of family ties between non-executive directors and the CEO.*

*Proposition 2b: Ability trust increases the openness for advice interactions.*

*Exercising control.* Due to human bounded rationality, all CEOs have their cognitive limitations (Simon, 2000). Therefore, in addition to building ability trust in those domains where the CEO is fully competent, non-executive directors must also assess the upper-limit of the CEO's ability trustworthiness and exercise control in those domains where he or she is prone to make fallible judgments (Hendry, 2002; Lewicki et al., 1998). This type of control may be especially important in family firms where self-imposed selection criteria give exclusive consideration to family members for the CEO position, limiting the pool of competent candidates (Chrisman et al., 2004; Schulze et al., 2001).

If non-executive directors are related to the CEO, then the emotions that characterize family relationships may strongly color their perceptions of the upper-limit of the CEO's ability trustworthiness. As indicated by Gomez-Mejia and colleagues (2001), family ties often lead to excessive ability trust with negative performance attributions shifted from the CEO to exogenous forces. Moreover, in order to limit the negative consequences of the CEO's bounded rationality, non-executive directors need to possess complementary cognitive schemata and use them to challenge and question the CEO's assumptions and strategic views (Rindova, 1999; Roberts et al., 2005). Due to the long history of social interactions in the family system, however, family members frequently share similar cognitive schemata on how to deal with particular situations or problems (Arregle et al., 2007). Family ties also increase the danger of groupthink since members of a cohesive group often do not want to express any criticism of the ideas of one another, and are more likely to come to believe that their own doubts regarding a proposal are incorrect (Ahlfinger & Esser, 2001; Janis, 1982; McCauley,

1998). Therefore, we argue that family ties between non-executive directors and the CEO reduce control effectiveness due to the increased danger of excessive ability trust, and reduced use of complementary cognitive schemata to challenge and question the CEO's views.

*Proposition 2c: Exercising control beyond the upper-limit of the CEO's ability trustworthiness is hindered by the presence of family ties between non-executive directors and the CEO.*

### **Family Cohesion and Generational Dynamics**

In the preceding discussion, we have made the implicit assumption that family ties are embedded in strong positive emotions and that relatives share a long history of social interactions in the family system. In line with Arregle and colleagues (2007), we maintain that it are these characteristics of owner-families that lead to the main distinctive features of family firms as an organizational form. Not all owner-families are alike, however, and there may be variations in the effects of family ties in agency relationships on board processes (Corbetta & Salvato, 2004; Steier, 2003). In order to account for these variations, we include family cohesion as a moderating variable in our theoretical framework. The level of family cohesion captures the degree of closeness and emotional bonding experienced by the members of a family (Olson, 1989). The owner-families considered so far can be described as being highly cohesive, which means that the relatives are very interdependent with high levels of closeness (Olson, 2000).

As argued above, when non-executive directors and the CEO are members of a highly cohesive owner-family, their relationship will be characterized by strong trust but ineffective control. In order to effectively balance trust and control, non-executive directors should have sufficient closeness in their relationship with the CEO to build trust, but also sufficient distance to exercise effective control (Huse, 1994; Roberts et al., 2005). According to Olson

and colleagues, individuals from moderately cohesive families are able to be “both independent from and connected to their families” (Olson & Gorall, 2003, p. 518). This suggests that non-executive directors from moderately cohesive owner-families may be in a good position to effectively balance trust and control in their relationship with a related CEO. At the other extreme, when the level of family cohesion is low, family members experience too much distance and are unable to turn to one another for support (Olson, 1989; 2000). Hence, we expect the relationship between the level of family cohesion and the capacity of non-executive directors to effectively balance trust and control in their relationship with a related CEO to be concave in nature.

*Proposition 3a: The effect of family ties on non-executive directors’ capacity to effectively balance trust and control in their relationship with the CEO is moderated by the degree of family cohesion.*

*Proposition 3b: Family ties have an optimal effect when the owner-family is moderately cohesive.*

Although various contingencies may have an influence on the level of cohesion of owner-families, the factor most frequently referred to by family business scholars is the generational phase of the firm (e.g. Ensley & Pearson, 2005; Gersick, Davis, McCollom-Hampton, & Lansberg, 1997; Steier, 2001). As family firms pass from one generation to the next, the nature of the family relationships alters and family cohesion tends to decrease (Gersick et al., 1997; Neubauer & Lank, 1998). In first generation firms, the involved relatives are member of the same nuclear family unit which usually corresponds with high levels of cohesion (Arregle et al., 2007; Ensley & Pearson, 2005). In second generation firms (i.e. sibling partnerships), the frequency of social interactions among the members of the owner-family is lower and individuals are more involved with their own nuclear family unit than the owner-family as a

whole (Neubauer & Lank, 1998; Schulze et al., 2003). By the third generation (i.e. cousin consortia), the emotional bonds between extended relatives may be no stronger than those between non-family members and many of the attributes that make the family firm governance system theoretically distinct may have been lost (Lubatkin et al., 2005; Raskas, 1998).

*Proposition 3c: The degree of family cohesion is negatively related to the generational phase of the firm.*

## **Discussion**

The starting point of this study is that non-executive directors need to balance trust and control in their relationship with the CEO (cf. Daily et al., 2003; Huse, 1994; Sundaramurthy & Lewis, 2003). First, we have integrated and refined ideas about how trust and control can be employed in a complementary manner by non-executives. We have then applied the developed insights to a family firm context, and examined how the presence of family ties, the level of family cohesion, and generational dynamics influence the non-executive directors' capacity to effectively balance trust and control. This framework contributes to our understanding of the distinctive nature of family firm governance and variations within the group of family firms.

We argue that the presence of family ties between non-executive directors and the CEO facilitates the trust building process. This may be beneficial for firm performance since trust enhances the openness for advice interactions between both parties (Hillman & Dalziel, 2003; Westphal, 1999). Non-executive directors will be more inclined to offer advice when they have trust in the CEO's intentions and abilities, and CEOs are likely to reciprocate this trust by disclosing the existence of problems and asking for advice on them (Westphal, 1999; Zand, 1972). In addition to this indirect effect through the increased openness for advice

interactions, trust will also have a direct impact on firm performance because it is both cheaper and more flexible than control as a governance mechanism. As indicated by Nootboom, “trust, with its implicit, pre-existing and unspecified conditions for cooperation, economizes on the specification and monitoring of contracts and material incentives for cooperation” (Nootboom, 1996, p. 989).

Despite the prevalence of trust in family firms, few familial CEOs will be entirely free of self-serving behavior, and none of them are immune to bounded rationality (Hendry, 2002; Schulze et al., 2003). We argue that family ties reduce the non-executive directors’ capacity to exercise effective control in those domains where the CEO cannot be trusted because the danger of excessive trust is increased, the use of complementary cognitive schemata to challenge the CEO is limited, and the willingness to implement disciplining measures is reduced. Ineffective control of the behavior and performance of CEOs increases the danger of opportunism and ineffective decision-making, which will ultimately have a negative influence on firm performance (Hendry, 2002; Hillman & Dalziel, 2003; Schulze et al., 2001).

With regard to possible variations between family firms, we argue that the influence of family ties is moderated by the level of family cohesion. In line with the hypothesis of Olson and colleagues that moderate levels of family cohesion allow for optimal family functioning (Olson, 1989; Olson & Gorall, 2003), we expect that non-executive directors from moderately cohesive owner-families are in the best position to effectively balance trust and control in their relationship with a related CEO. Furthermore, we have indicated how the level of family cohesion is negatively related to the generational phase of the family firm. These variations in the consequences of family ties also suggest that the value of outside directors as objective and independent controllers may vary between family firms, with the highest added value when owner-families are very cohesive. Our theoretical framework is presented in Figure 1; it



illustrates the link between the family system, board processes, and ultimately firm performance.

-----  
INSERT FIGURE 1 ABOUT HERE  
-----

## **Directions for Future Research**

Several recommendations for future research can be formulated. Firstly, the theoretical arguments that we have presented in this article need to be empirically verified. Given the complex nature of the processes involved, longitudinal qualitative studies seem most promising as an initial empirical test. Observations during board meetings and interviews with CEOs and non-executive directors should allow researchers to verify our propositions. Subsequently, large sample quantitative studies can be carried out in order to test the generalizability of the propositions. Validated measurement scales of process variables such as trust (Mayer & Davis, 1999; Simons & Peterson, 2000), monitoring and advice (Westphal, 1999), and cohesion (O'Reilly, Caldwell, & Barnett, 1989) may prove helpful for future empirical research. It is also important to note that when measuring firm performance in family firms, both financial and non-financial objectives will need to be considered (Chrisman et al., 2004).

Furthermore, in previous studies, scholars have typically assumed that if an individual is (not) trustworthy in one domain of the exchange relationship, then he or she will (not) be trustworthy in any other domain. In this study we adopted the view that relationships are multidimensional and that individuals may be trustworthy in some domains but not in others (cf. Lewicki et al., 1998). While this multidimensional view contributes to our understanding of real-world board processes, further refinements may be made in future research. More specifically, non-executive directors may vary in their willingness to refrain from control (i.e. to engage in trusting behavior) given beliefs about the CEO's trustworthiness in a particular

domain. Research by Fehr, Fischbacher, and Kosfeld (2005) suggests that their exploitation aversion, which seems to have a neurobiological basis, might play an important role here. Yet more research is required on the determinants of trusting behavior by non-executive directors given their beliefs about the CEO's trustworthiness.

In this article, we also indicated that the scope of domains in which the CEOs' intentions and abilities can be trusted should determine the boundaries of their discretion. If the non-executive directors perceive this scope of domains as overly narrow, then adverse selection has occurred and the CEO will need to be replaced (Chrisman et al., 2004; Monks & Minow, 2004). An important avenue for future research concerns the study of those factors which determine whether or not a given scope of domains is perceived to be sufficiently wide in order to allow for effective delegation of authority. Various contingencies may have an influence such as, for example, the overall complexity of the firm, the financial stakes, and the firm's financial and non-financial objectives. So far, however, little research has examined the factors that non-executive directors consider when recruiting and evaluating CEOs (Hendry, 2002).

A final suggestion for future research concerns the explanation of variations between family firms. In our theoretical framework, the level of family cohesion plays an important moderating role. Yet we have only discussed one possible determinant of the level of family cohesion, namely the generational phase of the firm. In order to gain a better understanding of possible differences in board processes between family firms, future research should examine other contingencies that might influence family cohesion such as, for example, familial norms (Todd, 1985), relational governance mechanisms (Neubauer & Lank, 1998), and national culture (Gomez-Mejia et al., 2001).

## **Concluding Note**

While family firms represent a highly pervasive organizational form, they are often overlooked in academic research (Arregle et al., 2007; Chrisman et al., 2006). Research on family firm governance presents a unique challenge for scholars since agency theory, which is the most dominant theory in the corporate governance literature, may have limited applicability in a family firm context. This results from the fact that the standard agency model neglects intrinsic motives, social context, and the bounded rationality problem (Donaldson, 1990; Hendry, 2002; Lubatkin et al., 2007), while these issues are assumed to be highly significant in family firms (Chrisman et al., 2004; Miller & Le Breton-Miller, 2006). The theoretical framework that we have presented in this study encompasses these issues, and offers a useful lens for understanding the complexities of board processes in family firms. As indicated by Chrisman, Chua and Sharma (2005), the ultimate aim of research about family firms should be to develop a theory of the family firm. This study on the distinctiveness of board processes in family firms and variations within the group of family firms contributes to this development.

## References

- Ahlfinger, N. R., & Esser, J. K. (2001). Testing the groupthink model: Effects of promotional leadership and conformity predisposition. *Social Behavior and Personality, 29*, 31-42.
- Arregle, J. L., Hitt, M. A., Sirmon, D. G., & Very, P. (2007). The development of organization social capital: Attributes of family firms. *Journal of Management Studies, 44*, 73-95.
- Arthur, B. W. (1994). Inductive reasoning and bounded rationality. *American Economic Review, 84*, 406-411.
- Barnes, L. B., & Hershon, S. A. (1976). Transferring power in the family business. *Harvard Business Review, 54*, 105-114.
- Chrisman, J. J., Chua, J. H., Kellermanns, F. W., & Chang, E. P. (2007). Are family managers agents or stewards? An exploratory study in privately held family firms. *Journal of Business Research, 60*, 1030-1038.
- Chrisman, J. J., Chua, J. H., & Litz, R. A. (2004). Comparing the agency costs of family and non-family firms: Conceptual issues and exploratory evidence. *Entrepreneurship Theory and Practice, 28*, 335-354.
- Chrisman, J. J., Chua, J. H., & Sharma, P. (2005). Trends and directions in the development of a strategic management theory of the family firm. *Entrepreneurship Theory and Practice, 29*, 555-575.
- Chrisman, J. J., Steier, L. P., & Chua, J. H. (2006). Personalism, particularism, and the competitive behaviors and advantages of family firms: An introduction. *Entrepreneurship Theory and Practice, 30*, 719-729.
- Chua, J. H., Chrisman, J. J., & Sharma, P. (1999). Defining the family business by behavior. *Entrepreneurship Theory and Practice, 23*, 19-39.

- Corbetta, G., & Salvato, C. (2004). Self-serving or self-actualizing? Models of man and agency costs in different types of family firms: A commentary on “Comparing the agency costs of family and non-family firms: Conceptual issues and exploratory evidence”. *Entrepreneurship Theory and Practice*, 28, 355-362.
- Daily, C. M., Dalton, D. R., & Cannella, A. A. (2003). Corporate governance: Decades of dialogue and data. *Academy of Management Review*, 28, 371-382.
- Das, T. K., & Teng, B. S. (2001). Trust, control, and risk in strategic alliances: An integrated framework. *Organization Studies*, 22, 251-283.
- Davis, J. H., Schoorman, D. F., & Donaldson, L. (1997). Toward a stewardship theory of management. *Academy of Management Review*, 22, 20-47.
- Donaldson, L. (1990). The ethereal hand: Organizational economics and management theory. *Academy of Management Review*, 15, 369-381.
- Donaldson, L., & Davis, J. H. (1991). Stewardship theory or agency theory: CEO governance and shareholder returns. *Australian Journal of Management*, 16, 49-64.
- Dyer, W. G. (2003). The family: The missing variable in organizational research. *Entrepreneurship Theory and Practice*, 27, 401-416.
- Dyer, W. G. (2006). Examining the “family effect” on firm performance. *Family Business Review*, 19, 253-273.
- Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *Academy of Management Review*, 14, 57-74.
- Ensley, M. D., & Pearson, A. W. (2005). An exploratory comparison of the behavioral dynamics of top management teams in family and non-family new ventures: Cohesion, conflict, potency, and consensus. *Entrepreneurship Theory and Practice*, 29, 267-284.

- Fama, E., & Jensen, M. C. (1983). Separation of ownership and control. *Journal of Law and Economics*, 26, 301-325.
- Fehr, E., Fischbacher, U., & Kosfeld, M. (2005). Neuroeconomic foundations of trust and social preferences: Initial evidence. *American Economic Review*, 95, 346-351.
- Forbes, D. P., & Milliken, F. J. (1999). Cognition and corporate governance: Understanding boards of directors as strategic decision-making groups. *Academy of Management Review*, 24, 489-505.
- Gersick, K. E., Davis, J. A., McCollom-Hampton, M., & Lansberg, I. (1997). Generation to generation: Life cycles of the family business. Boston: Harvard Business School Press.
- Ghoshal, S., & Moran, P. (1996). Bad for practice: A critique of the transaction cost theory. *Academy of Management Review*, 21, 13-47.
- Gomez-Mejia, L. R., Nunez-Nickel, M., & Gutierrez I. (2001). The role of family ties in agency contracts. *Academy of Management Journal*, 44, 81-95.
- Habbershon, T. G., & Williams M. L. (1999). A resource-based framework for assessing the strategic advantages of family firms. *Family Business Review*, 12, 1-25.
- Hendry, J. (2002). The principal's other problems: honest incompetence and the specification of objectives. *Academy of Management Review*, 27, 98-113.
- Hendry, J. (2005). Beyond self-interest: Agency theory and the board in a satisficing world. *British Journal of Management*, 16 (Special Issue), 55-63.
- Hillman, A. J., & Dalziel, T. (2003). Boards of directors and firm performance: Integrating agency and resource dependence perspectives. *Academy of Management Review*, 28, 383-396.
- Huse, M. (1994). Board-management relations in small firms: The paradox of simultaneous independence and interdependence. *Small Business Economics*, 6, 55-72.

- Huse, M. (2005). Accountability and creating accountability: A framework for exploring behavioral perspectives of corporate governance. *British Journal of Management*, 16 (Special Issue), 65-79.
- IFERA. (2003). Family businesses dominate. *Family Business Review*, 16, 235-240.
- Janis, I. L. (1982). *Groupthink*. Boston: Houghton Mifflin.
- Jehn, K. A. (1995). A multimethod examination of the benefits and detriments of intragroup conflict. *Administrative Science Quarterly*, 40, 256-282.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3, 305-360.
- Johannisson, B., & Huse, M. (2000). Recruiting outside board members in the small family business: An ideological challenge. *Entrepreneurship & Regional Development*, 12, 353-378.
- Kosnik, R. D. (1987). Greenmail: A study of board performance in corporate governance. *Administrative Science Quarterly*, 32, 163-185.
- La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (1999). Corporate ownership around the world. *Journal of Finance*, 54, 471-517.
- Lane, S., Astrachan, J., Keyt, A., & McMillan, K. (2006). Guidelines for family business boards of directors. *Family Business Review*, 19, 147-167.
- Lebas, M., & Wiegenstein, J. (1986). Management control: The roles of rules, markets and culture. *Journal of Management Studies*, 23, 259-272.
- Levinson, H. (1971). Conflicts that plague family businesses. *Harvard Business Review*, 49, 90-98.
- Lewicki, R. J., McAllister, D. J., & Bies, R. J. (1998). Trust and distrust: New relationships and realities. *Academy of Management Review*, 23, 438-458.

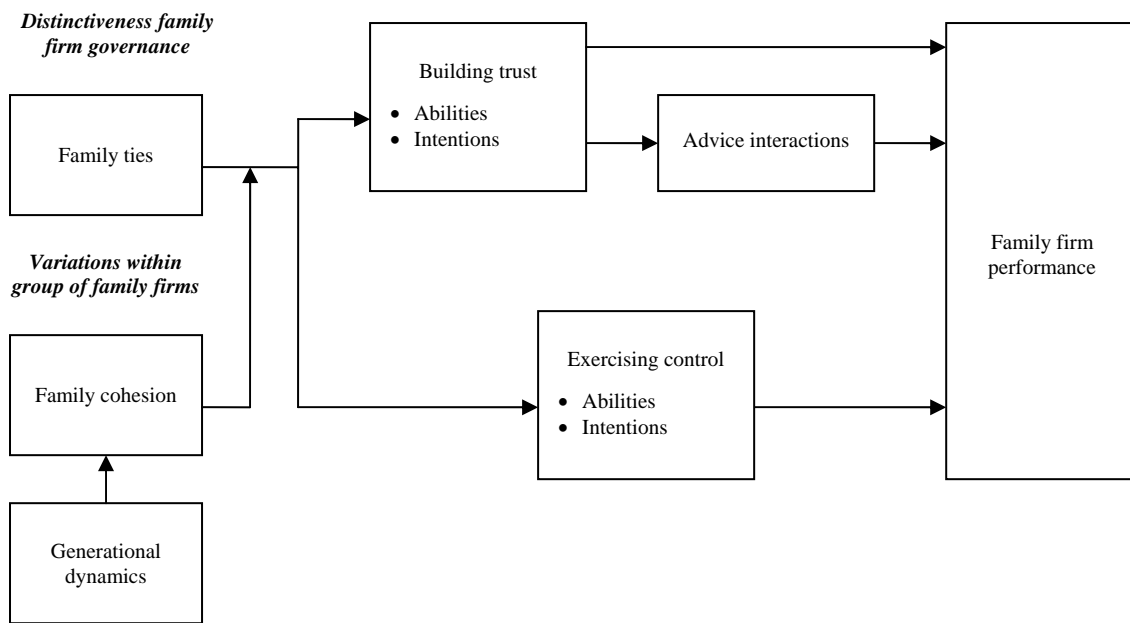
- Litz, R. A. (1995). The family business: Toward definitional clarity. *Proceedings of the Academy of Management*, 100-104.
- Long, C. P., & Sitkin, S. B. (2006). Trust in the balance: How managers integrate trust-building and task control. In R. Bachmann & A. Zaheer (Eds.), *Handbook of trust research* (pp. 88-106). Northampton, MA: Edward Elgar Publishing.
- Lubatkin, M. H., Schulze, W. S., Ling, Y., & Dino R. N. (2005). The effects of parental altruism on the governance of family-managed firms. *Journal of Organizational Behavior*, 26, 313-330.
- Lubatkin, M., Lane, P. J., Collin, S., & Very, P. (2007). An embeddedness framing of governance and opportunism: Towards a cross-nationally accommodating theory of agency. *Journal of Organizational Behavior*, 28, 43-58.
- Mayer, R. C., & Davis, J. H. (1999). The effect of the performance appraisal system on trust for management: A field quasi-experiment. *Journal of Applied Psychology*, 84, 123-136.
- Mayer, R. C., Davis, J. H., & Schoorman, D. F. (1995). An integrative model of organizational trust. *Academy of Management Review*, 20, 709-734.
- McCauley, C. (1998). Group dynamics in Janis's theory of groupthink: Backward and forward. *Organizational Behavior and Human Decision Processes*, 73, 142-162.
- Miller, D., & Le Breton-Miller, I. (2006). Family governance and firm performance: Agency, stewardship, and capabilities. *Family Business Review*, 19, 73-87.
- Monks, R. A., & Minow, N. (2004). *Corporate governance*, 3rd ed. Oxford: Blackwell Publishing.
- Neubauer, F., & Lank, A. G. (1998). *The family business: Its governance for sustainability*. London: Macmillan Press.



- Nooteboom B. (1996). Trust, opportunism and governance: A process and control model. *Organization Studies*, 17, 985-1010.
- Nooteboom, B. (2002). Trust: Forms, foundations, functions, failures and figures. Cheltenham: Edward Elgar Publishing.
- Olson, D. H. (1989). Circumplex model of family systems VIII: Family assessment and intervention. In D. H. Olson, C. S. Russell & D. H. Sprenkle (Eds.), *Circumplex model: Systematic assessment and treatment of families* (pp. 7-50). New York: Haworth Press.
- Olson, D. H. (2000). Circumplex model of marital and family systems. *Journal of Family Therapy*, 22, 144-167.
- Olson, D. H., & Gorall, D. M. (2003). Circumplex model of marital and family systems. In F. Walsh (Ed.), *Normal family processes*, 3rd ed. (pp. 514-547). New York: Guilford.
- O'Reilly, C. A., Caldwell, D. F., & Barnett, W. P. (1989). Work group demography, social integration, and turnover. *Administrative Science Quarterly*, 34, 21-37.
- Ouchi, W. (1979). A conceptual framework for the design of organization control mechanisms. *Management Science*, 25, 833-848.
- Pfeffer, J., & Salancik, G. (1978). *The external control of organizations: A resource dependence perspective*. New York: Harper & Row.
- Raskas, D. F. (1998). Familiarity breeds trust as well as contempt...what about familiarity? An examination of familial involvement and trust in family firms. Unpublished doctoral dissertation, Columbia University.
- Reed, M. I. (2001). Organization, trust and control: A realistic analysis. *Organization Studies*, 22, 201-228.
- Rindova, V. P. (1999). What corporate boards have to do with strategy: A cognitive perspective. *Journal of Management Studies*, 36, 953-975.

- Roberts, J. (2001). Trust and control in Anglo-American systems of corporate governance: The individualizing and socializing effects of processes of accountability. *Human Relations, 54*, 1547-1572.
- Roberts, J., McNulty, T., & Stiles, P. (2005). Beyond agency conceptions of the work of the non-executive director: Creating accountability in the board room. *British Journal of Management, 16* (Special Issue), 5-26.
- Schulze, W. S., Lubatkin, M. H., Dino, R. N., & Buchholtz, A. K. (2001). Agency relationships in family firms: Theory and evidence. *Organization Science, 12*, 99-116.
- Schulze, W. S., Lubatkin, M. H., & Dino, R. N. (2003). Exploring the agency consequences of ownership dispersion among the directors of private family firms. *Academy of Management Journal, 46*, 179-194.
- Simon, H. A. (2000). Bounded rationality in social science: Today and tomorrow. *Mind & Society, 1*, 25-39.
- Simons, T. L., & Peterson, R. S. (2000). Task conflict and relationship conflict in top management teams: The pivotal role of intragroup trust. *Journal of Applied Psychology, 85*, 102-111.
- Steier, L. (2001). Family firms, plural forms of governance, and the evolving role of trust. *Family Business Review, 14*, 353-367.
- Steier, L. (2003). Variants of agency contracts in family-financed ventures as a continuum of familial altruistic and market rationalities. *Journal of Business Venturing, 18*, 597-618.
- Sundaramurthy, C., & Lewis, M. (2003). Control and collaboration: Paradoxes of governance. *Academy of Management Review, 28*, 397-415.
- Tagiuri, R., & Davis, J. (1996). Bivalent attributes of the family firm. *Family Business Review, 9*, 199-208.

- Todd, E. (1985). *The explanation of ideology, family structures and social systems*. Oxford: Basil Blackwell.
- Voordeckers, W., Van Gils, A., & Van den Heuvel, J. (2007). Board composition in small and medium-sized family firms. *Journal of Small Business Management*, 45, 137-156.
- Ward, J. L. (1988). The active board with outside directors and the family firm. *Family Business Review*, 1, 223-229.
- Westhead, P., Howorth, C., & Cowling, M. (2002). Ownership and management issues in first generation and multi-generation family firms. *Entrepreneurship & Regional Development*, 14, 247-269.
- Westhead, P., & Howorth, C. (2006). Ownership and management issues associated with family firm performance and company objectives. *Family Business Review*, 19, 301-316.
- Westphal, J. D. (1999). Collaboration in the boardroom: Behavioral and performance consequences of CEO-board social ties. *Academy of Management Journal*, 42, 7-24.
- Wicks, A. C., Berman, S. L., & Jones T. M. (1999). The structure of optimal trust: Moral and strategic implications. *Academy of Management Review*, 24, 99-116.
- Williamson, O. E. (1979). Transaction-cost economics: The governance of contractual relations. *Journal of Law and Economics*, 22, 233-261.
- Zand, D. E. (1972). Trust and managerial problem solving. *Administrative Science Quarterly*, 17, 229-239.



**Figure 1** Family System, Board Processes, and Firm Performance