Governance in family SME: A theoretical contribution based on the social capital approach

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ABSTRACT: The field of corporate governance is at a crossroads. Over the years, research on corporate governance was tremendously focused on large firms whilst according less importance to other categories of enterprises. Since 2000, researchers (Charreaux; Hirigoyen; Amann; Gomez...) have begun recognizing the interest of governance for family firms. In fact, family firms represent a significant social and economic institution in both emerging and advanced economies. Family firms are considered as a specific research field because of the intersection between family and firm systems. Otherwise, social capital in family firms is especially important. In fact, family firms share many similarities with social capital. Moreover, social capital indicators such as trustworthiness, shared vision, unique language, culture, external relationships and strong social ties may appear in family SME. Accordingly, the strong presence of social capital in family SME helps to practically decrease governance costs. This idea implies that social capital should be considered as an informal mechanism of governance that decreases governance costs and is supposed to have a central role in value creation within the family SME.

KEYWORDS: Corporate Governance, Social Capital, Family SME, Governance costs.

1 INTRODUCTION

Over the years, research on corporate governance was tremendously focused on large firms whilst according less importance to other categories of enterprises.

More recently, researchers (Charreaux; Hirigoyen; Amann; Gomez...) have begun recognizing the interest of governance for family firms because of their strong presence in economy all over the world as well as their strong contribution to wealth creation.

Theoretically, research on corporate governance is mainly based on firm theories (agency theory, Jensen & Meckling, 1976), transaction cost theory (Williamson, 1985), theory of property rights (Alchian & Demsetz, 1972), and stakeholder theory (Freeman, 1984)) in order to describe and analyze the corporate governance mechanisms in the large listed companies.

Being at the interface of two Systems “Enterprise – Family”, family firms have often been considered as a specific research field in management, economics, sociology, psychology, etc. They are characterized by family involvement in business (ownership, management, family successor).

Accordingly, other theoretical approaches (Stewardship theory (Davis, Schoorman, Donaldson, 1997), trust theory (Fukuyama, 1995; Mayer & al 1995), social capital theory (Bourdieu, 1980; Coleman, 1988; Adler & Kwon, 2002), cognitive-behavioral theory (Lazonick & O'Sullivan, 1998, 2000; Charreaux, 2011), and social network theory (Granovetter, 1973, 1985)) have been mobilized in order to understand how governance works in family businesses.

Nonetheless, the impact of the family on governance within family businesses is still slightly covered. The challenge is in a real consideration of the family dimension.
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However, the analysis is not as simple as it seems. When sociology and management are interwoven, the complexity of understanding and analyzing the interactions between the family and the company social networks as well as the system of values and beliefs established by the family members, become inevitable.

As far family dimension is concerned, several variables relate to influence governance significantly. Among these variables, social capital is supposed to play a central role in value creation and to decrease governance costs (Coeurderoy. R & Lwango. A, 2010).

The purpose of this article is threefold. First, this article summarizes the evolution of corporate governance theory. Second, it shows the specificity of the theoretical framework of governance in family SME and suggests other approaches supposed to have an impact on governance. Third, it raises the link between the family SME governance and their social capital. Accordingly, social capital may be considered as an informal mechanism of governance in family SME.

2 THE FAMILY SME GOVERNANCE

Corporate governance is a topic that has attracted the interest of the scientific community and management practitioners over the recent years.

Over the past years, a plurality of research on corporate governance is witnessed, which helped to identify its mechanisms and to enact its best practices.

Nonetheless, research attributed a great importance to the large listed firms to the detriment of the other categories of enterprises, especially small and medium-sized enterprises.

The theoretical framework of corporate governance, which is mainly based on the contractual theories, will be summarized next. Then, a theoretical controversy to show the specificity of the family SME governance will follow.

2.1 THE CORPORATE GOVERNANCE: THEORETICAL FRAMEWORK

Born out of several theoretical constructs, it was difficult for researchers to rely on one theory to define the corporate governance and to identify its mechanisms. According to Charreau. G, 1999, several paradigms coexist in corporate governance theory.

Initially, the theoretical framework of corporate governance was based on Berle & Means (1932) research on the managerial firm where ownership and control are separated.

According to Berle & Means (1932), this separation push owners to waive the active dimension of the property and only to accomplish the passive one. Over the time, they lose control and boards become dominated by managers.

After these studies on the separation between control and ownership, a plurality of theories was developed. These theories were considered as contractual theories which assume that the firm is above all a node of contracts.

Firstly, research on the theory of property rights (Alchian & Demsetz, 1972) assumes that waiving owners’ rights in favor of managers opens the way toward opportunistic behaviors. As previously stated, the control power of shareholders decreases. Therefore, the cost to detect managers’ opportunistic behaviors as well as the control cost rise. According to the property rights theorists, the only way of dealing with these opportunistic behaviors is the establishment of a control system.

Furthermore, this idea was supported by the theorists of the agency theory (Jensen & Meckling 1976). They assumed that the existence of a divergence of interests and an informational asymmetry reveal the agency costs that aim to monitor and encourage managers to limit their opportunistic behaviors.

Then, the transaction cost theory, developed in 1985 by Williamson, widened the theoretical framework of the corporate governance through including all stakeholders.

In the transaction cost approach, stakeholders may not respect the contracts with the firm and thus minimize their efforts. Accordingly, some transaction costs may appear. Hence, in order to reduce these costs, Williamson proceeded to the study of organizational mechanisms that could manage the transactions between the company and its stakeholders better. Therefore, the establishment of a control system becomes an indispensable asset to firms.

Similarly, the entrenchment theory (Shleifer & Vishny, 1989) reinforced the idea of the managers’ opportunistic behaviors. Indeed, managers can entrench themselves by making manager specific investments in order to maximize their profits, reduce the probability of being replaced and escape shareholders control.
After all, the effective control of managers can only be carried out through the stakeholder theory. This approach, supported by Freeman in 1984 arising from all the contractual theories, demonstrates a common vision of the firm. In fact, it could play the role of the alternative approach to the contractual theories.

According to the stakeholder theory, the firm must take into account the interests and the expectations of all the stakeholders, and to create a stakeholder value. As defined by Charreaux. G, (1997), stakeholders are essentially shareholders, employees, customers and suppliers.

To conclude, corporate governance may be defined under two approaches:

- a shareholder approach based on the only relationship shareholder-manager, where the implementation of organizational mechanisms will reduce agency costs as well as transaction costs; thus, manage the conflicts between the owners and the managers of the firm;
- a stakeholder approach integrating all the stakeholders of the firm in the control process of managers, and thus allowing to counteract their opportunistic behavior by establishing an internal and external control mechanisms.

A schema is presented below summarizing the contribution of each theory to the theoretical framework of corporate governance:

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**Fig. 1. Contributions of contractual theories to corporate governance**

- **Berle & Means (1932)**
  - Separation between ownership and control

- **Williamson (1985)**
  - Transaction cost theory
  - Expanding the theoretical framework of the corporate governance
  - Integrating all the stakeholders
  - Detecting transaction costs

- **Shleifer & Vishny (1989)**
  - Entrenchment Theory
  - Manager's Opportunistic behaviors/the Entrenchment strategies

- **Freeman (1984)**
  - Stakeholder Theory
  - The emergence of a Stakeholder value
  - Taking into account the stakeholders interests

- **Alchian & Demsetz (1972)**
  - Theory of property rights
  - Waiving the ownership rights in favor of the managers

- **Jensen & Meckling (1976)**
  - Agency Theory
  - Divergence between manager’s interests and owners interests
  - Detection of agency costs

- **Stakeholder approach**
  - The effective way to control managers is by establishing a control system based on external and internal mechanisms of governance

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*Own Source*

Based on CHARREAUX’s G. (1996) research, corporate governance may be defined as a set of mechanisms that has a disciplinary role, and aims to define powers and influence managerial discretion.

Below is a table summarizing the internal and external control mechanisms:
2.2 The Specificity of Family SME Governance: A Theoretical Controversy

Family businesses are one of the most widespread enterprises in the world. They transcend all sizes of companies (SME, large listed companies, etc.).

Family businesses research has reached its adolescence as a field of study. Indeed, researchers have begun to draw more attention to family businesses area since the 1980s.

Nevertheless, empirical studies are not fully treated. In fact, only 15 articles were based on empirical research among 53 articles published on family business area in the period 1977 - 1986 (Amann & Allouche, 2000).

Although the theoretical research is plentiful, a unified paradigm to the family business is still missing (Amann & Allouche, 2000). Universally, a common definition of family business was not adopted (Hirigoyen, 2009).

Theoretically, family firms are interesting and unique. They have emerged as a distinctive field of study.

As a phenomenon, family firms represent a significant social and economic institution in both emerging and advanced economies, and represent approximately 90% of all firms worldwide (Gedajlovic & al, 2011).

Indeed, family business is multifaceted (Hirigoyen, 2009) and diverse (large enterprise, Medium Business, Small Business), yet specific (each family business is unique with its values, history, and so forth...).

Nevertheless, family business is usually defined under a multi-criteria definition. The criteria of ownership and control are jointly taken into account. Other researchers emphasize family business succession as an indispensable criterion.

Dyer (1995) assumed that a firm is considered as a family organization when either property or management are influenced by family.

While Litz (1995) clarifies that family business is an enterprise where power and ownership are held by family. Accordingly, members of this family are seeking to sustain the social links and influences within their company.

In sum, some key factors such as familial control, family ownership, mutual influence between the two systems family-business allow making a distinction between family firms and non-family firms.

As mentioned above, family SME and family businesses are generally considered as a specific field of study in which two systems have to coexist, but need to operate differently. On the one hand, the firm works under rationality while family works under emotion on the other. In fact, when these two systems interact, the specificity of corporate governance becomes inevitable.
The variable "family" implies values and belief system, mutual trust, family links, personal ethics and social capital (Nahapiet & Ghoshal, 1998), while setting up the corporate governance system. These key factors are supposed to significantly influence the governance of the family SME.

Theorists have long noted that SME are not a simple reduced model of large companies but a specific field, and that family firms are unique. Hence, theoretical models and governance mechanisms developed for large companies are not very applicable in the framework of small family business and cannot be simply transposed.

The family SME governance should take into consideration other dimensions such as social dimension, ethical and psychological dimensions. In contrast, the theoretical framework of the family SME governance requires taking into account a diversity of theories. It presents a few distinctions against large companies:

- The separation between ownership and control is practically nonexistent in family SME which means that the relationship between shareholders and managers could not be a source of conflicts;
- Owners are usually the business managers. Hence, they accomplish the active dimension of the property, and hold on their property rights and decision making;
- The divergence of interests between shareholders, managers and agency costs are practically non-existent;
- Being an owner, the manager often seeks the interest of the firm. Thus, the entrenchment strategies are practically inapplicable in family SME;
- Taking into account stakeholders' interests and creating a stakeholder value could be easier in family SME where social ties are more prevalent.

In contrast, the corporate governance theory applied to the large company is practically inapplicable in family SME.

Consequently, the establishment of a control system considered as an indispensable asset by the theorists of the contractual approaches could not be necessary in the case of family SME.

However, the analysis of family SME governance should be based on other theoretical approaches such as the stakeholder approach, where the firm is considered as a production team. This approach aims to consider the expectations of stakeholders and create a stakeholder value on the one hand, and to ensure the control of managers by all the stakeholders on the other.
In addition, the Stewardship theory (Davis, Schoorman, Donaldson, 1997) should also be considered as managers seek the firm’s interests. According to this theory, the interests of managers and shareholders are perfectly aligned. Managers are honest and do not have any opportunistic behavior, hence they work in the interest of the firm.

Moreover, family SME governance should be based on the cognitive approach (Lazonick & O'Sullivan, 1998, 2000). This view takes a wider dimension and could be applied to the family SME (Charreaux, 2011). Indeed, the cognitive approach assumes that the governance system should be based on the construction of knowledge and to the participation of the different stakeholders in the process of distribution and value creation. Therefore, governance mechanisms will have an incentive role on the manager instead of on the disciplinary role.

Otherwise, small family business is characterized by a strong presence of social capital. The consideration of the social capital theory is deemed necessary.

In sum, the theoretical framework of the family SME governance is supposed to be based on the following theoretical approaches:

- The Stakeholder theory (Freeman, 1984) attributes a stakeholder approach to governance;
- The Cognitive governance (Lazonick & O'Sullivan, 1998, 2000; Charreaux, 2011) assumes that knowledge plays a crucial role in the stakeholder value creation;
- The Social capital theory (Adler & Kwon, 2002; Nahapiet & Goshal, 1998; Bourdieu, 1980; Coleman, 1988) practically characterizes all family businesses and has a key role in their performance. This approach is mainly based on social trust and on the strength of social ties;
- The Stewardship theory (Davis, Schoorman, Donaldson, 1997) considers the manager as an honest steward who cares about the firm and the stakeholders’ interests.

![Theoretical framework of family SME governance](image)

**Fig. 3. Theoretical framework of family SME governance**

Own Source

3 THE RELATIONSHIP BETWEEN SOCIAL CAPITAL AND FAMILY SME GOVERNANCE: THEORETICAL ANALYSIS

Borrowed from sociology, social capital enjoys an expanding popularity in interdisciplinary research. Indeed, it attracted management sciences researchers, especially researchers working on entrepreneurship and SME.

In fact, social capital is often considered as a key resource for SME. Additionally, it is an advantage for family firms (Arregle & al, 2007).

Based upon a theoretical review, social capital theory and its potential contributions to the family businesses will be described and concluded as an informal mechanism of family SME governance.

3.1 THE SOCIAL CAPITAL CONCEPT

Several sociology researchers have greatly contributed to the popularity of the social capital concept. Theoretically, social capital draws attention to the effect of human sociability. In general, it refers to social ties and especially to the interactions within a sustainable network.
The most common definitions formulated by Bourdieu, Coleman and Putnam are summarized in the table below:

**Table 2. Social Capital definitions**

| Bourdieu (1980) | « Social capital is the aggregate of the actual potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance or recognition. » |
| Coleman (1988) | « Social capital is defined by its function. It is not a single entity but a variety of different entities, with two elements in common: they all consist of some aspect of social structures, and they facilitate certain actions of actors—whether persons or corporate actors—within the structure. Like other forms of capital, social capital is productive, making possible the achievement of certain ends that in its absence would not be possible. » |
| Putnam (1993) | « Social capital refers to ‘features of social organizations, such as networks, norms and trust that facilitate action and cooperation for mutual benefit. » |

*Own source*

According to the definitions above, social capital is related to the size of the network and the volume of past accumulated social capital commanded by the agent (Bourdieu, 1986).

Therefore, social capital has a double view:

- A functionalist view of social action which is conditioned by the social structure;
- A rational theory which suggests that actors’ goals are determined by utility-maximizing pursuit of self-interest (Coleman, 1988).

Coleman (1988) believes that the more closed the social network is, the more powerful social capital is. For him, social capital is productive. It is used for actors to achieve particular ends that would have been impossible without it.

To sum up, social capital could be:

- an individual asset that is created within a network in which actors can influence depending on their position in this network;
- a collective asset which refers to the community and depends on trust.

Unlike Bourdieu, Coleman sees social capital as a bonding mechanism which adds to the integration of social structure. According to Coleman, social structure predates the agent who can use embedded social capital as a resource. In fact, Social capital requires an element of embeddedness in social structure (Granovetter, 1978).

A synthesis of bonding and bridging social capital is presented in the table below:

**Table 3. Bonding and Bridging Social Capital**

<table>
<thead>
<tr>
<th>Bonding Social Capital</th>
<th>Bridging forms of capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ It cements the bonds of homogeneous groups;</td>
<td>✓ It is about the connections created between various social groups;</td>
</tr>
<tr>
<td>✓ It boosts the building of network within a group: family or organization;</td>
<td>✓ It helps businesses to grow;</td>
</tr>
<tr>
<td>✓ Networks help to build trust, cohesion and solidarity in the pursuit of common goals (Coleman, 1988)</td>
<td>✓ It helps actors to achieve their goals through holding on useful information and/or identifying opportunities (Geindre &amp; Dussuc, 2015)</td>
</tr>
</tbody>
</table>

*Own Source*

Although many definitions of social capital have been proposed, an agreement on a common definition has not been reached. However, almost all researchers have approved its multidimensional nature. In fact, a distinction can be made between:
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- Structural social capital, which is associated with the global architecture of networks between actors;
- Relational social capital, which refers to the conditions under which networks were built such as trust and trustworthiness;
- Cognitive dimension, which refers to culture, norms, values, shared vision, unique language, attitudes and beliefs.

To conclude, social capital is a productive asset. It refers to the values and beliefs, shared vision, social trust and ties owned by an agent or an organization. However, the strength or weakness of these ties (Granovetter, 1978) influences the building of social capital.

3.2 SOCIAL CAPITAL: AN INFORMAL MECHANISM OF FAMILY SME GOVERNANCE

As previously stated, family business is characterized by an interaction Family-Enterprise, as well as by the detention of social capital.

Several studies have assumed that social capital is an advantage for family businesses (Arregle & al, 2007) that it is applicable to both worlds coexisting in family firms (Family and Enterprise). Also, family social capital can structure the firm's social capital and vice versa (Arregle & al, 2004). Likewise, Habbeshon & Williams (1999) explain that family firms' performance is a result of their social capital. According to Bosma & al, (2004), a positive link between social capital and the growth of the company exists. In fact, these theorists believe that social capital has a positive influence on the firm's financial performance. Similarly, Arregle & al, (2004) consider that social capital is an important key for a family business under which networks of exchange with stakeholders are born. Equally, Coeurderoy R. & Lwango A. (2011) specify that behaviors within family firms could be analyzed under social capital.

In fact, this strong presence of social capital in family firms is generally due to mutual trust that exists in family businesses. Coleman (1988) acknowledges the central role of trust in social capital. Indeed, this social trust is recognized as an indicator of social capital, and influences the firm's sustainability (Mosek & al, 2007).

According to Amann & Allouche (1998), trust is a key factor to family firm performance. Unlike the non-family firms, family businesses are specified by a multidimensional trust:

- Personal Trust: Trust between managers belonging to the same family or other, but approve the family vision;
- Intra-trust: trust between managers and employees;
- Inter-trust: trust between firm and its environment.

In fact, building trust leads to decreasing costs and increasing the value creation in that it reduces conflicts and encourages the cooperation and relational networks (Lepers, 2014).

Additionally, in family businesses, transaction costs could be reduced if informal and formal trust between the company and its stakeholders increases (butter, Mosch, 2003).

Similarly, Coeurderoy & Lwango (2011) argue that social capital influences governance costs. In fact, because of the intersection between family and firm systems, social structures and affective commitments are particularly salient. Hence, family firms share many similarities with social capital. Also, multiple social capital indicators may appear in family SME, such as shared vision, unique language and culture, trust and relationship outside the company.

To sum up, social capital is a potential asset for family SME. It reflects the value of relationship, and includes the interrelationship network and the asset that could be mobilized through that network. It is, essentially, based on trust, shared vision and the strength of social ties.

As mentioned in the first section, the classic goal of corporate governance is to decrease agency and transaction costs. Hence, the strong presence of social capital and its indicators which characterize family SME and family firms, generally, help to practically decrease these governance costs. This idea implies that social capital should be considered as a variable that significantly influences governance in family SME. Otherwise, social capital is assumed to be an informal mechanism of governance which decreases governance costs and is supposed to have a central role in value creation within family SME.

The relationship between family SME governance and social capital is summarized in the schematic below:
4 CONCLUSION

The primary objective of this paper was to associate corporate governance to a social capital perspective within family SME. It aimed to show the specificity of governance mechanisms of family SME as being unique and characterized by the intersection between Enterprise and family systems.

Indeed, the strong presence of social capital that characterizes family SME attributes to their governance a specific character. In fact, mechanisms that significantly influence governance are far to be formal. Social capital, through its indicators, significantly decreases control costs, and should be considered as an informal mechanism of governance.

This theoretical analysis remains very limited and must be supported by empirical studies. However, it opens a way toward a very promising research that touches upon the impact of social capital on corporate governance.

REFERENCES


