

FAMILY BUSINESSES IN THE CORPORATE GOVERNANCE OF MNCS

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Abstract

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The issue of family businesses is currently a very topical theme in the academic world. The importance of family businesses increases with internationalization and is associated with business success in global market conditions. A fundamental part of business activities abroad is the correct application of the corporate governance of subsidiaries of multinational family businesses. The available findings do not cover this area sufficiently, especially in the context of transformed economies in CEE. In view of the nature of foreign business activities, the degree of centralization of competences transferred between subsidiaries and headquarters and the presence of expatriates from the headquarters of multinational companies represented by the family firm in statutory bodies can be regarded as important variables. The main aim of the present paper is, based on research carried out, to describe and analyze the degree of centralization and presence of expatriates in the corporate governance of subsidiaries of multinational family businesses operating in the Czech Republic. The paper presents the results of an empirical investigation with a description of the presence of expatriates in the statutory bodies of subsidiaries of multinational companies in the Czech Republic. The results obtained present the number of subsidiaries corresponding to the definition of a family business with an emphasis on SMEs of up to 250 employees and the degree of centralization and presence of expatriates in administrative or executive authority, or in other positions. The sample which was used to research the family business comprised 214 subsidiaries of multinational companies from the most important sectors of the Czech economy.

Keywords: multinational companies, family business, non-family business, centralization, expatriates

INTRODUCTION

In the modern business world, family businesses are the focus of research interest. Researchers examine the issue of family businesses from many viewpoints, which are dominated by the object of interest – the family business within the borders of one country. The internationalization of family businesses has not yet been sufficiently explored, particularly in countries which formerly had a planned economy. With regard to the internationalization of family businesses, there also emerges the very serious issue of managerial positions in foreign subsidiaries being filled by expatriates. The presence of expatriates in the administration and management of a subsidiary alludes to the transfer of competences to managers outside of the family which owns the family business.

The process of expatriation itself primarily relates to sending a worker from the company's headquarters into a managerial or administrative position in order to represent the head office within a subsidiary of the MNC. The expatriate is therefore an employee carrying out work abroad, that is outside of his home country in a daughter company, which is often a subsidiary of the family-run multinational company (Štrach, 2009). The MNC's headquarters make use of the services of expatriates in the host country's subsidiary primarily because they fulfil a supervisory and coordinating role including the transfer of knowledge across the whole MNC (Gooderham and Nordhaug, 2003). Part of the main function of expatriates in the host country's subsidiary is to fill managerial positions with regard to the subsidiary's workers and ensure the organization's overall development (Edström

and Galbraith, 1977). The results obtained from analyses of MNC subsidiaries operating in the CR show that the presence of expatriates in a subsidiary of a multinational company can have an impact on financial performance indicators. They are also shown to be linked to selected characteristics of entrepreneurial activities, such as the degree of centralization in various areas of management, or the effect on the operation of the subsidiary of the multinational company (Klapalová *et al.*, 2014).

The aim of this paper is to introduce the issues surrounding the conduct of business by subsidiaries of multinational companies which can be considered family businesses. On the basis of the research carried out, it will also present findings regarding selected characteristics of entrepreneurial activities focused on the exercise of corporate governance and the related centralization of operational areas of management within a subsidiary of a family business.

THEORETICAL BACKGROUND

Family vs Non-family Businesses

In view of the diversity in definitions of family businesses, a definition by Odehnalová was chosen for the purposes of the research (2011 according to Lukeš, Nový *et al.*, 2005; Sten, 2007): family businesses are those “in which at least two members of one family work and have a direct influence on the running of the business”.

According to the authors Taguiry and Davis (1996), it is possible to operate on the assumption that a business consists of managers and employees. A non-family business is therefore more focused on operational efficiency. In contrast to this, the family is oriented towards long-term maintenance and consistency.

Taguiry and Davis (1996) also state that the interests of family members manifest themselves primarily in benefit, in the wellbeing of the family and also in its stability and unity. Ownership of a family business in all its forms is associated with the issue of responsibility and initiative (Koiranen, 2007). The main attribute of the entrepreneur as the owner of a family business is his high level of responsibility, which is directly related to the nature of private ownership. The owner of the business cannot relinquish this responsibility in the same way that managers of a business can. Unlike owners of a business, managers of a business can abdicate responsibility for losses which the business may suffer through loss-making management by the managers. The manager of a business can thus be held accountable for a relatively small proportion of the overall losses, because the loss does not concern his own property (Říkovský, 2002).

An awareness of the “ownership” of the business carries with it certain rights and responsibilities (Koiranen, 2007). The responsibility for the firm which the founder feels towards the family in

particular actually motivates the owner towards action which is effective in the long term, oriented towards the long-term future, which is especially evident in the setting of long-term goals. Owners of businesses have a particular stake in return on investment (ROI) and in sustaining the business (Taguiry, Davis, 1996). Říkovský (2002) emphasizes that the manager of a business organization performs solely “managerial functions”, which are merely a form of support for the entrepreneur, and thus relate only to a secondary issue. In his view, the manager can never take over the role of the entrepreneur. Říkovský (2002) also describes the entrepreneur's relationship to risk through this mechanism. The entrepreneur's aversion to risk is a natural consequence of his responsibility for the business and his share in any losses made by the company. The manager of the business can be held accountable only for a relatively small part of the overall losses, because a loss by the business does not relate to his own property. Therefore, managers will be willing to enter into riskier operations than entrepreneurs.

The emotions typical of a family system are also evident in the relationship to ownership of the business. Ownership is described by Koráb *et al.* (1998) as a characteristic of the family business based on trust and the personal value system of the owner of the business.

Expatriation

Multinational companies (MNCs) have to deal with a whole range of issues associated with the exercise of effective corporate governance at the level of a multinational company's subsidiary linked with strategic decision-making (Král *et al.*, 2012) affecting the economic side of the subsidiary's operations. Situations can very often be encountered in which the management of a subsidiary also takes on the function of monitoring (Boyd, 1994) linked with reporting to the owners at the MNC's headquarters. This frequently results in a disruption of the control link between the owner and management (Monem, 2011). In a number of cases it also leads to marked centralization, with the owner taking over all activities linked with the administration and management of the company (Harris and Helfat, 1998) with all its positive and negative effects on market potential in the host country. As some findings have indicated, these phenomena can be affected in post-transition countries by the type of owner (Peng *et al.*, 2009) or the composition of the administrative and executive bodies (Muller-Kahle and Lewellyn, 2011).

One of the options which is most frequently employed by multinational companies to ensure the exercise of corporate governance and effective management of the subsidiary is expatriation (Harzing, 2001; Reiche, 2007). From the findings published to date which have put forward theories, the reasons for the presence of expatriates include the establishment of control and the provision of

coordination functions; the transfer of knowledge and skills; the development of management; and the filling of managerial positions due to a lack of qualified workers in the host country. It can also be connected to a specific purpose, which may include the reduction of costs or the transfer of the corporate culture etc. (Birkinshaw and Morrison, 1996; Harzing, 2001).

Issues related to centralization can be reflected in the autonomy of subsidiaries of family-run multinational companies. The findings obtained indicate that decreased centralization is linked with the presence of expatriates in CEO positions or in the posts of managers, ensuring direct personal control (Ferner *et al.*, 2004) with an impact on the increased autonomy of the subsidiary. In a similar manner, there is evidence of various degrees of centralization linked with the autonomy of the subsidiary and the presence of expatriates (Rosenzweig and Nohria, 1994) in selected operational areas of management (production, finance, HR, marketing).

Centralization in Family Businesses

Centralization in the direction of the family appears to be a consequence of the awareness of ownership of the business (Koiranen, 2007). Family-member owners of businesses are therefore extremely reluctant to give up executive power over the business which they have built. They want to know about everything which is happening in the business, often even a relatively long time after they have relinquished the position of head of the company to their successor. Significant barriers to the professionalization of management in family businesses are considered by Koráb *et al.* (2008) to be the lack of delegation of tasks, and nepotism. The low autonomy of family businesses is also mentioned by other authors (Huovinen, Tihula, 2008). They account for the centralization of the family business's management in the hands of the family through a fear of losing executive power over the business which they own, a lack of understanding of efficient administration and effective supervision and, last but not least, their independence from the other managers. The centralization of decision-making in the family is also supported by the manifested nepotism and paternalism, through which power is concentrated in the hands of the family. The distribution of power in the family business presupposes the renunciation of a certain amount of responsibility by the owner of the business in the interests of the new employee – the hired manager. This step is connected with a rather difficult change of role in the running of the family business and a certain degree of faith in the newly recruited manager.

Another problem which is faced by family businesses is paternalism. Typical features of paternalism in the leadership of family firms are a tendency towards autocracy, a strong need for control, mistrust of other colleagues, a need for recognition and an inability to delegate (Kets de

Vries, 1993; Hanzelková, 2004). In the early days autocratic behaviour by the founder of the firm leads to good results for the business. However, if a situation arises in which a family member takes over the administration and management of the family firm, the negative side of paternalistic behaviour reveals itself. The original founder shows a lack of trust in the new management in the form of constant control. The autocratic behaviour of the original founder prevails over the behaviour of the new management. The situation often causes chaos in the ranks of executive employees of the family business, who come up against unclearly demarcated competences.

These findings and the aim of this paper lead us to the establishment of hypotheses:

H1: With family businesses the degree of centralization will be greater than is the case with non-family businesses.

H2: With family businesses the presence of expatriates will be greater than is the case with non-family businesses.

Methodology

The research was conducted at Masaryk University in 2011 and incorporated subsidiaries of multinational companies operating in the Czech Republic (Blažek *et al.*, 2011). The issue was tackled using methods of qualitative and quantitative research, which included two sets of surveyed subsidiaries of companies – the population and the sample in which a questionnaire survey was carried out. The population comprised 2 509 subsidiaries of multinational companies which operate within the CR and fulfil the parameters of size (50 or more employees), legal form (joint-stock company and limited-liability company) and origin of registered capital (registered capital is fully or partially made up of foreign capital). The sample comprised 335 subsidiaries of MNCs, from which 4 subsidiaries were excluded due to lacking financial parameters. The subject of this contribution is the 214 subsidiaries of MNCs fulfilling the condition of size as an SME, i.e. up to 250 employees, in which expatriates are present. Here 25 subsidiaries with the character of a family business (FB) and 189 subsidiaries not fulfilling the characteristics of a family business (NFB) were identified.

The sample consisted of 214 subsidiaries of MNCs, which amounts to 8.53% of the introduced population. In terms of the business sector, the highest presence of MNC subsidiaries was found in section C – manufacturing (56.5%), G – wholesale and retail trade, repair and maintenance of motor vehicles (15%), M – professional, scientific and technical activities (7%). By way of a brief introduction to the sample we can state that the percentages of the size of subsidiaries according to the number of employees were as follows: from 50 to 99 employees 38.8%, from 100 to 199 employees 48.1% and 200–249 employees 13.1%. In terms of legal form the sample consisted of 14.5% joint-stock companies and 85.5% limited-liability companies. In the introduced set, subsidiaries with

100% foreign capital in the registered capital (87.6% of MNC subsidiaries) outnumbered subsidiaries with a majority of foreign capital – more than 50% of foreign capital in the registered capital (11.4% of MNC subsidiaries) and subsidiaries with a minority of foreign capital – less than 50% of foreign capital in the registered capital (1% of MNC subsidiaries).

The aforementioned companies participated in the questionnaire survey, which covered questions related to the work of expatriates in the MNC subsidiaries and the degree of centralization of decision-making of operational areas represented by the choice of supplier, customers, product portfolio, technological methods, IT, marketing, logistics, personnel and financial management in the subsidiary.

Statistical processing of the survey by questionnaire was conducted after the data collection, which took place in cooperation with an external company specialized in the collection of questionnaire data (addressing, data acquisition, processing in a data matrix). After checking the data, they were coded and subjected to a univariate analysis determining the frequency of the occurrence of individual responses. Arithmetic mean, median and standard deviation were also determined. In the following stage, bi-variation analysis was conducted, which examined the frequency and degree of central tendencies of the given area with regard to the industry sector,

number of employees and the size of the share of foreign capital in the registered capital.

RESULTS

The results of the survey among small and medium businesses pointed to some interesting correlations. In relation to the first hypothesis put forward, concerning the degree of centralization in family and non-family businesses, it showed that although family businesses reported a slightly higher degree of centralization than was the case with non-family businesses (Tab. I), the difference between the averages measured using a t-test of two independent averages is not statistically significant (sign. 2-tailed. 0.693). The aforementioned hypothesis cannot therefore be validated.

An interesting finding was the activities which are most centralized from the viewpoint of the management of MNCs (Tab. II). For family businesses the most centralized area is the financial management of subsidiaries and decision-making about the product portfolio, and for non-family businesses the highest degree of centralization is in the area of information systems, followed by financial management. Conversely, with both the monitored groups of businesses, the choice of other suppliers is among the least centralized activities. Also worth mentioning is the fact that, apart from the area of information systems, the degree of centralization is marked by a higher level of evaluation with family businesses.

I: Degree of centralization

	Mean	Number	Std. deviation	Low	Optimal	High
Non-family business	3.08	189	0.918	31 16.4%	100 52.9%	54 28.7%
Family business	3.16	25	0.688	4 16%	13 52%	8 32%
Total	3.09	214	0.893	35 16.4%	113 52.8%	62 30.8%

Source: author's own calculation

II: Area of centralization

FB/NFB	FB Mean	NFB Mean	Total Mean
Selection of main contractors	5.1200	5.3545	5.3271
Selection of other contractors	3.4400	3.0212	3.0701
Selection of main customers	5.0400	4.8995	4.9159
Selection of other customers	4.0400	3.4974	3.5607
Product portfolio	6.1200	6.1270	6.1262
Technology procedures	5.3600	4.9894	5.0327
Information systems	5.7600	6.4074	6.3318
Marketing	5.7600	5.7513	5.7523
Logistics	4.6400	4.1323	4.1916
HR management	4.3200	3.7196	3.7897
Financial management	6.3600	6.1587	6.1822

Source: author's own calculation

III: Expatriation

	Yes (abs./%)	No (abs./%)	Missing (abs./%)
Family business	10 40%	15 60%	0
Non-family business	73 38.6%	114 60.3%	2 1.1%

Source: author's own calculation

The results of the answers to the questionnaire survey show that not even hypothesis No. 2, based on the supposition that the presence of expatriates in family businesses will be higher than is, the case with non-family businesses, can be validated on the basis of the information established. The number of

expatriates present in the management of companies is similar with both monitored groups of family and non-family businesses (Tab. III). Furthermore, as with the first hypothesis, the difference detected cannot be regarded as statistically significant.

CONCLUSION

From the survey carried out it emerges that the theoretical supposition of a higher degree of control in family businesses in the form of centralization and the presence of expatriates in domestic subsidiaries of MNCs was not validated and the detected differences cannot be regarded as statistically significant. Nevertheless, closer examination of the aforementioned answers indicates a different approach in the administration and management of family and non-family businesses. Even though the hypothesis of a higher degree of centralization in family businesses was not validated, it was nevertheless established that expatriates operate in subsidiaries of family businesses.

The results obtained revealed the fact that the most centralized activity of family businesses was financial management. This correlation would thus correspond with the conclusions of some authors concerned with family businesses and the aversion of family businesses to risk. Some authors (Naldi *et al.*, 2007; Donckels and Frohlich, 1991; Zahra, 2005) refer to differences in the perception of the degree of risk with family and non-family businesses. The concept of risk and the responsibility of the entrepreneur according to Říkovský (2002) is expanded on by Gedajlovic *et al.* (2004), who state that families often make a considerable investment in their own family businesses and thus bear all the risk of bad investment. This is evidently also related to the higher degree of control of financial management detected within family businesses.

For non-family businesses, information technology is among the most centralized activities. This can be anticipated with the emphasis on high-quality, substantiated reporting between the subsidiary and the headquarters of the multinational company (Deans *et al.*, 1991). This reliability of reporting is an important tool for the economic governance of the subsidiary by the MNC's headquarters (Swamy Kumara, 2011), where supervision of the implementation and acquisition of information at the subsidiary by expatriates can be anticipated.

Another interesting finding is the conformity over the decentralization of other suppliers, which is characteristic of both family and non-family businesses. Here is revealed one of the main roles of expatriates in the subsidiary of the MNC, which is also influenced by the low representation of other suppliers in the production of the subsidiary. Conversely, the product portfolio is among the centralized areas both for family and non-family subsidiaries of MNCs.

The results presented provide some new and interesting findings from the area of expatriation in subsidiaries of family and non-family MNCs. In spite of possible limitations of the research (the set of businesses investigated, the number of respondents) there are findings here which are worthy of closer examination. In further study of the results achieved, it is possible to use statistical methods to focus closer attention on causality, yielding new and specific findings from the area of expatriation, especially in family MNCs. Related to this is also a deeper understanding of the mutual connection between the MNC's headquarters and its subsidiaries in host countries and possible developmental trends of family businesses in the internationalization of business.

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