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FINANCIAL PERFORMANCE IN THE LIGHT OF CORPORATE GOVERNANCE IN POLISH FAMILY BUSINESSES

Błażej Socha, Ph.D.[1]
Aleksandra Majda-Kariozen, M.A.[2]

University of Lodz
Faculty of Management
Department of Finance and Strategic Management
Matejki 22/26, 90-237 Łódź, Poland
[1] *e-mail: blazej.socha@uni.lodz.pl*
[2] *e-mail: aleksandra.majda@uni.lodz.pl*

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Abstract

The article presents a view (on the basis of theoretical and empirical analysis) of corporate governance models used in Polish family businesses through financial performance. The empirical analysis covered a sample of 24,000 Polish family businesses in the period of 2008–2013. The use of linear regression has allowed the authors to verify the hypothesis concerning the occurrence of differences in profitability ratios in groups of family businesses using variant management models and allowed verifying the relationship between the degree of control and involvement of the owners in management and financial performance. The received results, though inconclusive, indicate that the involvement of the owner in the governance process can affect the financial aspect of a business. The prepared empirical analysis and conclusions of the article contribute to a better understanding of the measures taken on management and control decisions; what is more, they can provide guidance to the owners of family businesses in shaping the corporate governance model.

Keywords: family business, financial performance, corporate governance, family involvement in management; family involvement in ownership

JEL classification: D19, D22

Introduction

The active involvement of family members in management processes and running a family enterprise are not only key constituents that make a clear differentiation between family businesses from non-family ones, but they can also provide an explanation to the divergent financial performance of the former group of enterprises (Mazzola, Sciascia, Kellermanns, 2013; Le Breton-Miller, Miller, 2009). Still relevant scientific discussions on the impact of family involvement on family business performance has its roots in the 1970s.

Different approaches that characterise the effects of family involvement and present its impact on financial results made the authors of this article conduct an in-depth analysis of the relationships between owners and managers in family firms and how these relationships affect the performance of this group of economic units in Poland. In the first part of this article the authors presented corporate governance theories that allow for the classifying and structuring of the mentioned relationship. The agency theory, stewardship theory, stagnation perspective, and resource-based view were found to be meaningful and significant to explain complex owner-manager relationships, and therefore described and characterized.[1] The second part of the article discusses the results of the empirical research carried out on a sample of Polish small and medium-sized family businesses. The results suggest that the degree of family involvement in ownership and management can affect the financial performance of family businesses and their structure of financing.

1. Literature overview

As scholars reveal, when a family member takes over the role of a manager in a family firm, agency costs decrease due to his/her personal involvement in future company development, and consequently also control mechanism expenditures are reduced (Ang, Cole, Lin, 2000; Schulze, Lubatkin, Dino, 2002). Clearly, the results arising from conducted research show that family businesses are exposed to a different type of agency cost related to the shortcomings of altruistic behaviour and desire to take over the management of the firm (Schulze, Lubatkin, Dino, 2003). The literature and empirical assumption regarding agency cost in the case of family businesses do not speak a common language. There may be plenty reasons for this mismatch, however the authors would like to draw attention to the survey findings which indicate that altruism

[1] More information about main assumptions of the mentioned theories were included in: Socha, Majda, *Financial performance in the light of corporate governance in Polish family businesses*, CEST 2015 working paper; available at: http://science24.com/resources/paper/31954/Socha_Majda_proceedings.pdf.

behaviour is contingent on the level of self-control of the principal and is affected by the social and cultural background of every family business, this is why the agency cost can vary among family firms (Lubatkin, Durand, Ling, 2007). It seems to be of equal importance that the discourse was mainly focused on presenting the impact of the discussed relation on economic performance, however for family firm performance financial conditions are integrated with non-economic goals. Due to underlined divergences concerning the family impact on ownership and management on the financial performance of a family business the authors would like to present the stewardship concept.

Due to numerous similarities derived from the specificity of family businesses, on one side, and the main assumptions of the stewardship theory, on the other side, many researchers concurred in using the above assumptions to describe the owner-manager relationship in family firms (Lubatkin, 2007; Eddleston, Kellermanns, 2007; Corbetta, Salvato, 2004). However, opposing voices can be heard around the scientific world as well. A high degree of family involvement in both management and ownership combined with stewardship continuity may put stress mainly on the issue of business transfer to the next generation. Such actions may result in the dispersion of the sense of injustice among the employees, and as a consequence, exacerbate conflicts within the firm thereby leading to the reduced value of the company (Mazzola et al., 2013). As scholars argue, increase in the size, age and the stage in the lifecycle of a company may provoke – apart from the succession strategy – the growth of negative consequences of the stewardship theory (Blanco-Mazagatos, Quevedo-Puente, Castrillo, 2007; Hack, 2009).

Having that in mind, even more scholars pose a question what determinants shape the relationship between the owner and manager in family firms (what circumstances bring them closer to the agency theory, or alternatively to the stewardship theory) (Chrisman, Chua, Kellermanns, Chang, 2007; Nicholsen, Kiel, 2007). The results of research suggest that the adoption of the specific form of this relationship can be conditioned by values and the organisational culture of family businesses, priorities in goal setting by the first owner of the company (Eddleston, Kellermanns, 2007; Lubatkin, 2007) and the existent system of employees' motivation (Corbetta, Salvato, 2004).

The third theory that also characterizes the consequences of the owner-manager relationship and emphasizes its effect on a firm's performance is a stagnation perspective. Researchers point to a limited access to resources (Chua, Chrisman, Bergiel, 2009), conservatism (Habbershon, Williams, McMillan, 2003), slow growth (Weber, Lavelle, Lowry, Zellner, Barrett, 2003) and the low survival rate of family businesses (Mazzola et al., 2013, pp. 568–574). The above presented characteristics can be reflected in risk-avoiding operations undertaken by family firms and their

strategy-driven activities (Habbershon et al., 2003). However, the influence of those factors can be either mitigated or completely eliminated as a result of a generation change that will likely contribute to shifts in a firm's organizational culture. It should be noted that the results of empirical research are ambiguous with this respect and highlight with equal frequency the individualistic nature of the owner-manager relationship that stimulates development-oriented activities undertaken by family firms (Anderson, Reeb, 2007).

A different perspective on what affects firm performance is presented by a resource-based view. The literature suggests that due to their unique construct family businesses possess a bundle of rare resources, in particular concerning the issue of familiness in the business world that may exert their positive impact on the firm's competitive capabilities and superior firm performance (Zellweger, Eddleston, Kelermanns, 2010). Sirmon and Hitt (2003) proposed one of the most comprehensive models that describe an influence of the discussed relation on enterprise performance. They suggested that family firms dispose four unique attributes: human capital, patient capital, social capital and survivability capital, which combined with an efficient and purpose managerial structure can become a rare resource (Sirmon, Hitt, 2003). Scholars confirm that in the case of a family business family members have a positive bearing on the formation of those four attributes, especially due to their in-depth knowledge of business core, loyal behaviour, strategic long orientation, strong motivation (Miller, Le Breton-Miller 2005). Pointed elements build a high level of trust between all employees and a flexible work environment (Miller, Le Breton-Miller, Scholnick, 2008), enables family firms to create more innovative solutions (Zahara, Neubaum, Larraneta, 2007) and formulate a model of unique connection configuration between suppliers, employees and other stakeholders (Carney, 2005). On the other hand, the research outcomes reveal that employees' selection or promotion on the bases on family membership, rather than skills, work experience and general business knowledge can adversely affect the human capital base (Dunn, 1995). It is also important to add that some scientific analysis suggests that family firms show less activity and participation in building a networking connection (Graves, Thomas, 2004) and withdraw assets from the business, which in the result decrease a firm's stability (Dyer, 2006). However, there is still a lack of empirical research which would be addressed to those mechanisms which might impact the value creation of family businesses.

The presented theoretical background on the one hand suggests the positive effect of family involvement in business, especially in terms of a participative strategy, common economic and non-economic goals and a work stability environment due to the succession perspective. On the other hand, negative effects can derive from conflicts that decrease firm value, promoting

employees on the basis of their engagement in family relations and aversion to acquire external resources because of the losing control perspective.

In view of therefore inconclusive evidence of family involvement in business effects the authors would like to present the empirical results corresponding to the main topic. To the best of our knowledge, there exist a large number of empirical research data dealing with family involvement in management and ownership and their influence on a firm's financial performance. These are mainly exemplified by listed family companies. However, we find a lack of scientific analysis based on the sample consisting of private family businesses. Despite this the authors would like to present some of the results of our empirical research. The methods of analysis were chosen with an aim to thoroughly describe the mentioned relationship and its impact on financial performance for private family businesses. The scientific analysis prepared by Chrisman, Sharma and Taggar (2007) on 5,779 small family firms in the USA suggests that if family managers behave as agents and the family owner as the principal the firm's performance is improved. On the other hand, the results of research conducted on 75 Lebanese companies in 2012 suggest that family involvement in management and ownership have a positive relationship with financial performance. Analyses concerning family managers are that they act like stewards by considering the success of the company as their own rather than achieving their personal goals - as agents do (Charbel, Elie, Georges, 2013). What can be interesting according to the empirical research on 158 Chinese family firms in 2011, family involvement does not relate to firm performance. But the greater the support on family longevity goals (succession perspective) the greater the positive relation between family involvement in management and firm performance, so the managers behave more like stewards when the organization strongly supports family interests (Kim, Gao, 2013). Some of those findings are similar with the results of the 523 Colombian family firms (privately held and listed companies) between 1966–2006, where the scholars observe a negative family effect (management, ownership, control) for young and median-age firms when the founder or heirs are in charge. A stronger negative relation can be observed when there is the founder presence. But for old firms this family effect changes and becomes positive in financial performance (González, Guzmán, Pombo, Trujillo, 2013). Based on the research evidence collected in European countries, researchers argue that in general, family control in Western Europe leads to the higher profitability of the company and market value (Bartoni, Caprio, 2006; Maury, 2006). Therefore the authors wish to present the results of two analyses carried out amidst Italian family firms. The first research contained 113 family

businesses (30 listed companies, 83 private)[2] in 2005, and the results suggest the positive impact of the presences of family CEO's on a firm's performance. What is more, the coexistence of family and non-family managers in top management teams (TMT) hurt firm performance and support for the U-shaped relation between the ratio of family members in the TMT and firm performance (Minichilli, Corbetta, MacMilan, 2010). The second one was conducted on a sample of 294 small privately held family businesses, eight years after the first one. Scholars observed an inverted U-shaped relation between family involvement in ownership and return on assets and a positive relationship between family involvement in management and return on equity (Mazzola et al., 2013). In terms of Polish family businesses, the authors find relevant the research conducted by Kowalewski, Talavera and Stetsyuk (2010), among 217 family firms between 1997 and 2005. Its results revealed an inverted U-shaped relationship between family involvement in ownership and financial performance. Results suggest that family involvement in management is positively related to financial performance. Furthermore, firms with family CEOs are likely to outperform their counterparts that have non-family CEOs. According to the authors' best knowledge, there has been no previous research done in Poland that addressed listed family businesses.

The ambiguity of theories and research outcomes that depict the relationships within family businesses and their impact on financial performance encouraged the authors to conduct a survey on a sample of Polish non-public family businesses. In the following part of this article the relationship between financial performance and the degree of family involvement in the ownership and management of family firms was tested. The following hypotheses were assumed:

H1: There will be an inverted U-shaped relationship between family involvement in ownership and company performance. Moderate levels of family involvement in ownership will be associated with the highest levels of company performance.

H2: There will be an inverted U-shaped relationship between family involvement in management and company performance. Moderate levels of family involvement in management will be associated with the highest levels of company performance.

The hypotheses were adopted after Miller and Le Breton-Miller (2006) and Sciascia and Mazzola (2008).

[2] As the authors say: "having both public and private firms in the same sample in the Italian context is not surprising, it is due to the very small less than 300 in total, listed family controlled firms in Italy have a very strong familial character."

2. Research sample and method

The empirical analysis covered small and medium-sized family enterprises with their businesses in Poland. For the purpose of this research, a broad definition of a family business was adopted. In accordance with this definition, a family firm is an entity in which more than 50% of the business is owned by an individual or family. Financial data of the companies included in the sample were gathered by Infocredit SA in Warsaw and come from financial statements submitted to the National Court Register. The research sample consisted of all entities that submitted financial statements and made available data about their ownership structure and the composition of the management structure. In the years 2008–2012 these requirements were fulfilled by more than 25,000 entities, whereas in 2013 by over 13,000.

In the first step of the research, the values of necessary variables were estimated. The variable *performance* that was estimated with the use of an EBITDA margin, EBIT margin, return on sales, return on assets and return on equity, aimed at a synthetic assessment of a firm's performance. As an independent variable, we used a *family involvement in ownership* (FIO) ratio that depicts a proportion of family involvement in the equity of the enterprise. The variable *family involvement in management* (FIM) illustrates a proportion of family members in management structures. In addition, three control variables, that is *size, industry* and *institutional investor* were introduced into the regression equation.

The variable *size* was a dummy variable that enabled to specify whether the enterprise falls into a small or medium-sized category.[3] The variables *industry* from 1 to 4 were dummy variables. Those variables were created on the basis of the most represented activities according to the Polish Classification of Activation (PKD) which allows classifying enterprises into selected sectors of activity. The last control, dummy variable *institutional investor* made it possible to observe whether the involvement of an institutional investor may affect the financial performance of enterprises.

The linear regression equations used in the research took the following form:

$$Performance_{it} = a_0 + a_1\, industry1_{it} + a_2\, industry2_{it} + a_3\, industry3_{it} + \\ + a_4\, industry4_{it} + a_5\, size_{it} + a_6\, institutional\ investor_{it} + a_7\, FIO_{it} + u_{it} \quad (1)$$

[3] Following the Commission Regulation (EC) 800/2008 Annex 1, the category of small and medium-sized enterprises is made up of enterprises which, for a small enterprise, employ fewer than 50 persons and which have an annual turnover and/or an annual balance sheet total not exceeding 10 million euro, and for medium-sized enterprises, those which employ fewer than 250 persons and which have an annual turnover and/or an annual balance sheet total not exceeding 43 million euro, respectively.

$$Performance_{it} = a_0 + a_1\ industry1_{it} + a_2\ industry2_{it} + a_3\ industry3_{it} + \\ + a_4\ industry4_{it} + a_5\ size_{it} + a_6\ institutional\ investor_{it} + a_7\ FIM_{it} + u_{it} \quad (2)$$

where i indexes the firm, t indexes time and u_{it} denotes the error term.

The absence of multicolinearity was checked in each regression model; no tolerance coefficient was close to 0, and no VIF coefficient was higher than 2.

Equation 1 of the linear regression allowed verifying the influence of family involvement in ownership on firm performance. Equation 2 enabled to verify the influence of family involvement in family business management. In order to test inverted-U-shaped relationship between family involvement in ownership and management and financial performance in the second step of the analysis, the additional variables *FIO squared* and *FIM squared* were added to the above equations.

3. Results

The results of the analysis concerning the influence of FIO and control variables on financial performance are presented below in Table 1. Throughout all the years of analysis, the regression equations proved to be of statistical significance at the significance level of 0.001. The models marked as (1) tested a linear correlation between a synthetic measure of financial performance and family involvement in ownership. No statistically significant correlations were found. The introduction of a *FIO squared* variable into the models (2) that enabled to test the form of the relationship also failed to reveal statistically significant correlations. Thus, the H1 hypothesis adopted for this research could not be confirmed. Only control variables were of apparent statistical significance. It was demonstrated that in the years 2008–2012, the sector of an enterprise activity exerts its influence on financial performance. The involvement of an institutional investor in the family firm had a statistically significant impact on financial performance in the years 2008 and 2009, and it was negatively correlated. Also, the size of the family firm proved to be a variable of statistical significance.

Table 1. Regression analysis. Independent variable: Performance

Year	2008		2009		2010	
1	2	3	4	5	6	7
	(1)	(2)	(1)	(2)	(1)	(2)
N	22,504	22,504	22,504	22,504	22,504	22,504
	Beta Coefficients					
Institutional investor	–0.016*	–0.016*	–0.012	–0.012	–0.007	–0.007

1	2	3	4	5	6	7
Size	0.012	0.012	0.044**	0.044**	0.052**	0.052**
FIO	–0.001	0.053	–0.006	–0.135	0.000	0.039
FIO squared		–0.053		0.129		–0.039
Industry 1	–0.036**	–0.036**	–0.051**	–0.051**	–0.053**	–0.054**
Industry 2	0.070**	0.070**	–0.005	–0.005	–0.045**	–0.045**
Industry 3	–0.112**	–0.112**	–0.114**	–0.114**	–0.125**	–0.125**
Industry 4	0.027**	0.027**	–0.020**	–0.020**	–0.020**	–0.020**
Models	Values					
Adj. R^2	0.023	0.023	0.012	0.012	0.013	0.013
F	76.173**	66.695**	42.082**	37.098**	46.097**	40.358**
Year	2011		2012		2013	
	(1)	(2)	(1)	(2)	(1)	(2)
N	23,528	23,528	23,471	23,471	12,114	12,114
	Beta Coefficients					
Institutional investor	–0.004	–0.004	–0.001	–0.001	0.019	0.019
Size	0.048**	0.048**	0.065**	0.065**	0.080**	0.080**
FIO	0.003	0.019	–0.001	–0.038	0.026*	–0.006
FIO squared		–0.016		0.037		0.031
Industry 1	–0.021**	–0.021**	–0.040**	–0.040**	–0.023*	–0.023*
Industry 2	–0.050**	–0.050**	–0.079**	–0.079**	–0.092**	–0.092**
Industry 3	–0.126**	–0.126**	–0.135**	–0.135**	–0.147**	–0.147**
Industry 4	–0.030**	–0.030**	–0.060**	–0.060**	–0.045**	–0.045**
Models	Values					
Adj. R^2	0.014	0.014	0.018	0.018	0.025	0.025
F	48.753**	42.662**	62.762**	54.937**	44.943**	39.331**

* $p < 0.05$; ** $p < 0.01$.

Source: own calculation.

As results from the research show, medium-sized family enterprises outperformed on average their smaller counterparts between 2009–2013.

Table 2. Regression analysis. Independent variable: Performance

Year	2008		2009		2010	
1	2	3	4	5	6	7
	(1)	(2)	(1)	(2)	(1)	(2)
N	22,504	22,504	22,504	22,504	22,504	22,504
	Beta Coefficients					
Institutional investor	–0.019**	–0.020**	–0.014*	–0.014*	–0.012	–0.013
Size	0.011	0.009	0.042**	0.039**	0.050**	0.047**
FIM	0.042**	0.135**	0.028**	0.165**	0.040**	0.180**
FIM squared		–0.095*		–0.140**		–0.143**
Industry 1	–0.022**	–0.023**	–0.036**	–0.038**	–0.037**	–0.039**
Industry 2	0.075**	0.075**	0.001	0.001	–0.039**	–0.040**
Industry 3	–0.082**	–0.083**	–0.084**	–0.085**	–0.093**	–0.094**

1	2	3	4	5	6	7
Industry 4	0.026**	0.027**	–0.019**	–0.019**	–0.020**	–0.020**
Models	Values					
Adj. R^2	0.019	0.019	0.008	0.009	0.009	0.010
F	67.026**	59.638**	29.586**	28.054**	34.675**	32.600**
Year	2011		2012		2013	
	(1)	(2)	(1)	(2)	(1)	(2)
n	23,528	23,528	23,471	23,471	12,114	12,114
	Beta Coefficients					
Institutional investor	–0.010	–0.010	–0.005	–0.005	–0.001	–0.002
Size	0.045**	0.043**	0.062**	0.060**	0.072**	0.071**
FIM	0.034**	0.116**	0.036**	0.134**	0.037**	0.085
FIM squared		–0.084*		–0.100**		–0.049
Industry 1	–0.009	–0.010	–0.027**	–0.028**	–0.007	–0.007
Industry 2	–0.045**	–0.045**	–0.072**	–0.072**	–0.080**	–0.080**
Industry 3	–0.097**	–0.097**	–0.106**	–0.107**	–0.107**	–0.107**
Industry 4	–0.030**	–0.030**	–0.059**	–0.059**	–0.043**	–0.043**
Models	Values					
Adj. R^2	0.010	0.010	0.014	0.015	0.018	0.018
F	38.000**	34.025**	52.540**	47.098**	34.427**	30.274**

* $p < 0.05$; ** $p < 0.01$.

Source: own calculation.

The results of the regression analysis that tested the influence of family involvement in management on financial performance recorded by family businesses were shown in Table 2. Throughout all the analysed periods, an influence of *FIM* on financial performance appeared to be statistically significant. Increased family involvement in family firm management resulted in better financial performance on average. In addition, between 2008–2012 the statistical significance of the *FIM squared* variable indicates that the described correlation is not linear. Positive values of the beta coefficients for the *FIM* ratio combined with negative values of the beta coefficients for the *FIM squared* ratio suggest an inverted U-shaped relationship between family involvement in management and the financial performance of Polish family firms which confirms that the H2 hypothesis is true. This means that moderate family involvement in management allows for the achievement of the highest financial performance. This relationship was not confirmed merely in 2013, which may be the result of a smaller research sample that covered ca. 50% of entities from previous years. As for the *FIO* analysis, in all analysed periods' financial performance was affected by the sector of firm activity, and the size of the firms – on average medium-sized family businesses outperformed small ones. Involvement of an institutional investor in the ownership structure turned out to have an impact on financial performance only in 2008 and 2009 – identical as for the *FIO* analysis.

4. Discussion

Summarizing the results, some salient relationships should be indicated. Firstly, the financial performance of Polish non-public family firms is primarily influenced by family involvement in management. An inverted U-shaped relationship between family involvement in management and the synthetic measure of firm performance show that a moderate degree of family involvement is optimal from the viewpoint of financial performance. It follows that family members in a firm's management structure promoting altruism, mobilising social capital and ties with stakeholders contribute to the formation of the long-term strategic perspective of the firm, and a firm's competitive advantage that can translate into above-average financial performance. For making this come true, managers outside the family should counterpoise to the firm management structure. They can reduce the negative effects of family involvement in management such as self-control problems, attainment of merely family goals, lack of professionalism or excessive conservatism.

Secondly, the ownership structure will not affect considerably a firm's financial performance. However, it will have an effect on the use of the sources of borrowed capital. One should bear in mind that in the analysed enterprises the share of a family in the ownership structure amounted to at least 50%, which in practice means full control of the company. Further increase in capital involvement does not determine, as opposite to the management structure, the change of goals or strategy of the family business.

Thirdly, it was proved that besides the most crucial factors from the viewpoint of this article, namely *FIO* and *FIM*, the financial performance of family businesses is varied depending on the sector of activity and their size. On average medium-sized family firms outperformed financially small enterprises.

5. Contribution and limitations

This article attempts to join a broad academic debate in order to better understand and explain the mechanisms of the functioning of family firms. According to the authors' best knowledge, this is the first effort to verify the relationship between family involvement in the ownership and management and financial performance of non-public family businesses in Poland. Contrary to the research outcome presented by Sciascia and Mazzola (2008) and Minichilli et al. (2010) based on the samples of Italian family firms, there is an inverted U-shaped relationship between *FIM* and financial performance. Variations in the results of the presented pieces of research may have their roots in cultural differences, variables embedded in the external environment of

enterprises and specific features of a given political and legal framework. In the Polish market, no relationships between *FIO* and financial performance like the ones presented by Kowalewski et al. (2010) with the sample of Polish public family companies were revealed.

The presented conclusions may constitute some kind of guidance for the owners of Polish family firms. It turns out that the excessive exposure of family members in the management structures does not lead to the improved financial performance of these firms. The involvement of both family members and outside managers to run family businesses seems to be optimal. Such a combination makes it possible to benefit from the attitudes of family members that promote altruism, and build social capital and ties with stakeholders and managers from outside the family with adequate professional background who reduce the intentions of the other managers to represent merely the interests of the family and are capable of diminishing owners' risk aversion and conservatism.

Finally, one should notice some limitations of the conducted research. The first one concerns the selection of the research sample which by no means can be considered as representative. The sample consisted of all non-public enterprises that had an obligation to submit annual financial reports to the National Court Register and made data on the ownership and management structures available. The second limitation is the relatively low index of adjustment of the models which suggests the existence of other important variables explaining the financial performance of family firms that were not covered by the study. Previous studies also gave consideration – apart from control variables employed in this research – to firm age and the succession perspective which contribute to family firm performance (Miralles-Marcelo, Miralles-Quirós, Lisboa, 2014). Researchers with equal frequency point to the heterogeneity of family businesses which means that one incorporated solution cannot obtain the same financial results in another family firm. A decision concerning the choice of the owner-manager relationship is autonomous to each enterprise (Nordqvist, Sharma, Chirico, 2014).

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