The Openness of Corporate Governance Structure in Small and Medium Family Firms: The Effects on Company's Internationalization[1]

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Abstract

The paper aims at establishing whether and how a greater openness of corporate governance structure can affect the degree of internationalization of family SMEs. Based on the Resource Dependence Theory, it has been hypothesized that the involvement of entities outside the family - with reference to the ownership structure, the top management and the figure of the CEO - could stimulate and support the internationalization of family SMEs. The analysis of a sample of 2,175 Italian companies reveals that external parties in the ownership structure and in the position of CEO do not represent central elements in the internationalization process of family SMEs. However, an open involvement of non-family members in the top management composition determines a greater effectiveness of the international activity. The paper provides a significant contribution to the literature on corporate governance and internationalization of SMEs, representing a cognitive urge for further study on the topic.

Keywords: family firm; corporate governance; internationalization; SME

1.Introduction

The literature ascribes to family firms a leading role in the process of economic growth in many areas of the world (Sharma et al., 1996; Gomez-Mejia et al., 2001; Zahra, 2003); among these especially small and medium-sized family firms represent a large part – in terms of sample size– in the category of SME (Shanker & Astrachan, 1996; Sharma 2004; Casillas et al., 2007).It is worthwhile noting that the current and increasing pressure towards markets globalization, and the consequent competitive tightening, have had a significant impact on the strategic behaviour of small and medium-sized family firms – traditionally focused on their home market – leading them to a greater orientation towards internationalization (Fernández & Nieto, 2005) as an alternative path for the growth of the company (Claver et al., 2007).However, the launch of an internationalization process is one of the most complex and risky business strategies, since it requires human, financial and managerial skills, combined with a clear business vision and openness to change (Hitt, Bierman, Uhlenbruck, & Shimizu, 2006; Larraza et al., 2007). These aspects are critical especially for small and medium-sized family firms, which – combining the dimensional limits of SMEs and family owned companies– are characterized, on one hand, by a deficiency of key resources for internationalization (Gomez-Mejia et al., 2010; Schulze, et al., 2001; Sciascia et al., 2012) and, on the other,by a closed culture – shaped by history and traditions – and resistant to organizational change and strategy, together with a natural and related attitude of risk aversion (Gersick et al., 1997; Fernandez & Nieto, 2005; Kellermanns & Eddleston 2006; Gomez-Mejia et al, 2010).

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Along this line, several empirical studies point out that one of the critical determinants of the firm about its ability to successfully implement an internationalization process is constituted by the corporate governance structure (Sherman et al. 1998; Buck et al. 2000; Filatotchev et al. 2001; Hoskisson et al. 2002; Filatotchev et al. 2007), particularly for family businesses, given the uniqueness connoting them (Filatotchev et al. 2001; Sirmon & Hitt 2003; Brunninge et al. 2007).Indeed, the governance structure of a firm determines its ability to address the international context complexity and the resources required for the internationalization (Sanders & Carpenter, 1998; Naldi & Nordqvist, 2009). As a result, some governance variables, such as the ownership structure, the composition of the board of directors, together with the presence of external top management, may affect significantly the internationalization processes; therefore an in-depth investigation of the dynamics characterizing them becomes crucial (Brunninge et al., 2007). To this purpose, the study carried out by Arregle et al. (2012) shows that the involvement of external parties (in terms of ownership structure and board of directors) motivates and facilitates the internationalization process in family SMEs, bridging the deficit of resources and delineating in a better way the strategic scenario suited to a greater international openness. However, despite the relevance that the topic plays in the studies on governance and internationalization of small and medium-sized family firms, the literature does not show adequate and comprehensive knowledge about the effects that the involvement of external parties have on the effectiveness of the internationalization processes in family SMEs, leaving margins for several exploratory studies on the issue. The paper focuses on filling this knowledge gap through the empirical investigation of a sample of 2,175 Italian family SMEs, with the aim – resuming part of the work by Arregle et al. (2012) and studying further matters in depth – of analysing the effects that the involvement of entities external to the family SMEs (with reference to the ownership, management and board membership) have on the degree of internationalization in this type of company. The decision to explore the Italian family SMEs is due to the fact that they represent a significant portion of the Italian entrepreneurial sector (Colarossi et al., 2008); therefore the study of the Italian context becomes prominent for this type of research, and its benefits can be also related to the degree of generalization of the study so to contribute to the enrichment of scientific knowledge on the topic.

2. Theoretical Background and Development of Research Hypotheses

Corporate governance refers to the complex methods by which a business is structured in terms of the ownership structure in conjunction with its management, with the aim of shaping its coordination and incentive mechanisms (Cadbury Committee, 1992; Daily et al., 2003; Astrachan, 2010; Dalwai et al., 2015).Therefore, the corporate governance structure includes all the basic elements of control and management in a firm, i.e. the ownership, the board of directors, the CEO (Chief Executive Officer) along with the Top Management (Brunninge, Nordqvist & Wiklund, 2007; Goodstein & Boeker, 1991; Rediker & Seth, 1995). As far as family firms are concerned, a governance structure is defined as open when entities external to the restricted family ownership structure are included in the ownership, in the board of directors, in the position of CEO and in Top Management (Naldi & Nordqvist, 2009).

For a family firm, its propensity to open its governance structure to parties outside the family structure produces significant influences on strategies and processes of internationalization adoptable by the company, and this opening degree is directly related to the extent to which the ownership and management include entities outside the family that control the firm (Arregle et al., 2012).

In order to better understand how these governance mechanisms can affect the degree of, and the tendency to, international openness of family SMEs, it can be useful to refer to the theoretical assumptions of the *Resource Dependence Theory* (Pfeffer, 1981; Pfeffer & Salancik, 2003). According to this perspective, the organizational behaviour is a reflection of the dependence of company management on external resources and on the resulting requirements of the provider that controls such resources (Pfeffer & Salancik, 2003; Hillman et al., 2000; Hillman & Dalziel, 2003). Based on these assumptions, it is worthwhile noting that for many businesses the family becomes a decisive factor giving access to key resources for the effective implementation of an international strategy for it generates the fundamental settings where any internationalization process can be started and made prominent (Fernández & Nieto, 2006; Gallo & García-Pont, 1996; Graves & Thomas, 2006; Hitt et al., 2006).However, given the scarcity of resources which often characterizes family firms, especially those with a limited size scale (Fernández & Nieto, 2006; Crick et al., 2006; Kontinen & Ojala, 2010), it becomes essential to have access to additional resources obtained from external sources through strategic actions that see corporate governance as a key mechanism for the creation of links to parties outside the family structure units (Arregle et al., 2007; Bammens et al., 2011).

Interestingly, a greater openness of the governance structure has a significant impact on the control held by the owners, to the point of limiting it. This restriction will produce effects more evident insofar the resources deployed by external parties are relevant and critical for the firms; and increases simultaneously the degree of influence of external entities on the strategic actions of family SMEs (Naldi & Nordqvist, 2009).From the perspective of the *Resource Dependence Theory*, a substantial compromise emerges between a largest control of family owner – but only based on internal resources – and a family control less meaningful – but with an increased access to strategic resources which are not available inside the family structure in the pursuit of an internationalization process (Graves & Thomas, 2008; Mitter et al., 2014).

In the abovementioned relational process, the ownership structure of the company becomes the first governance mechanism to be involved (Connelly et al., 2010). The possibility of including external parties in the ownership structure of the family firm could facilitate the acquisition of relevant resources for the recognition of entrepreneurship opportunities in the international arena, along with their exploitation (Sciascia et al., 2012).First, they may represent a source of financial resources, which are essential for starting a strategic and organizational process of change on this scale (Buckley, 1989) and become a key lever to acquire additional resources for the international development (Wiklund & Shepherd, 2003), such as technological and human resources needed in the implementation of a sustainable and successful internationalization process due to the contribution in terms of knowledge and key tools, in order to effectively operate in foreign markets. Besides the already mentioned aspects, an additional one refers to the possibility external parties have to introduce significant intangible assets (Fernández & Nieto, 2006), improving the legitimacy of family SMEs in the international arena. In light of the aforementioned, the following research hypothesis is proposed:

H1: The presence in the ownership structure of external parties positively influences the internationalization of family SMEs.

Additionally, the tenure of heterogeneous knowledge and expertise together with the professional practices and attitudinal perspectives of expert managers could lead to a greater effectiveness in the internationalization process of family SMEs (Fernandez & Nieto 2005; Sciascia et al., 2012). In general, the assignment of professional managers with high decision-making power (Top Manager) outside the family structure could positively affect the international performance thanks to their longer-term strategic vision, leading them to pursue more proactive activities (Zahra, 2005); elements which result inmore significant and incisive actions and international commitments (Claver et al., 2009).This assumption takes on a greater value when it is pointed out that an inadequate managerial capacity has been considered as one of the main obstacles to internalization for small family business (Graves & Thomas, 2006; Fernández & Nieto, 2006); an issue partly solved by the managerial skills of external managers. However, concerns related to self-financing of family SMEs could resize and limit the commitments made in the internationalization of the firm. In any case, it becomes necessary for family SMEs to allocate some positions of top-level management to parties outside the family ownership, so that they can be able to starta successful and sustained process of development and international growth (Lin, 2012).Accordingly, in view of the theoretical assumptions outlined above, the following research hypothesis is proposed:

H2: The presence of an external top management positively influences the internationalization of family SMEs.

An additional component to be considered in the governance structure of family SMEs is the role played by the CEO, whose characteristics denote the essential elements in an internationalization process (Strike et al., 2015; Hsu et al, 2013), especially in companies with small size scale (Manolova et al., 2007). In fact, the literature considers and consolidates the role of CEO as the motivating and stimulating force in the strategic change and growth processes of the firm (Boeker, 1997),capable of limiting the uncertainty that connote them (Pfeffer & Salancik, 2003). These characteristics are functional and basic in the process of international development of businesses. Traditionally, in family firms the figure of the CEO is frequently attributed to the ownership structure of the family; which, in turn, could lead to a lower risk aversion by the family firm due the concentration characterizing the management and ownership structure (Brunninge et al., 2007). Moreover, the common lack of family members with the essential skills and knowledge– both as regards the position of CEO and in terms of international operations (Gallo & Garcia-Pont, 1996) – leads to a weakening of the effectiveness and propensity to openness of family SMEs in the foreign markets (Westhead & Howorth, 2006).

In this context, a CEO external to the family structure is increasingly perceived as a need, for the CEO could be the holder of key external resources and could widen, at the same time, the network of relationships linking these strategic resources of the firm (Naldi & Nordqvist, 2009). In addition, external CEOs are usually more oriented towards profit targets and open to strategic change (Hall & Nordqvist, 2008); elements that indicate a greater involvement and pursuit of internationalization strategies, and thus they become central in overcoming cultural and ideological resistances inherent to family businesses by increasing and expanding their strategic vision (Blumentritt, 2007; Naldi &Nordqvist, 2009). Therefore, based on the theoretical assumptions exposed so far,the following research hypothesis is proposed:

H3: The presence of an external CEO positively influences the internationalization of family SMEs.

3. Methods

3.1. Sample

The sample analysed is extracted from the EU-EFIGE / Bruegel-Uni Credit Dataset, a database developed by the EFIGE project, which combines measures related to the firm internationalization by means of quantitative and qualitative data including about 150 items concerning corporate governance, innovation, research and development, work organization, financial structure and organizational activity, along with information about the prices dynamics charged by the firm. Out of 15,000 firms surveyed, we have selected only those that were Italian and were identified as small (10-49 employees) and medium-sized companies (50-249 employees). Afterwards, a further selection has chosen only family-owned firms, as defined by the *components-of-involvement approach* (Chrisman et al., 2005; Kraiczy, 2013). Therefore, a sample of 2,175 firms has been analysed. The data collection was carried out in 2010 and the information related mainly to the period 2007-2009.

3.2. Variables Definition

Dependent Variable

Usually, in literature the internationalization of family SMEs is measured using dimensions referring primarily to the intensity of their export activity (*international scales*) (Fernández & Nieto, 2005; Calabrò & Mussolino, 2013; Gomez-Mejia et al., 2010) and the magnitude of their physical presence in foreign markets (*international scope*) (George et al., 2005; Zahra, 2003; Arregle et al., 2012).However, as pointed out by Calabro et al. (2009) and Mitte et al. (2014), this approach of analysis is constrained and captures only some aspects of the internationalization process, which requires a measure capable of fully understanding the firm's international activity. To this purpose, and with the aim of measuring the degree of internationalization of family SMEs –based on which the effect exerted by the features of corporate governance in line with the research hypothesis developed can be analysed – we have used a dummy variable to establish whether the firm is active internationally, through exports, imports of goods and services, active and passive outsourcing processes, and direct investment (***Active_abroad***).

Independent Variables

In order to measure the involvement of external parties in the ownership structure of family SMEs, it has been employed the percentage of participation in the share capital held by entities not affiliated to the family (***% External_Ownership***), consistent with the approach employed by Arregle et al. (2012) and Naldi & Nordqvist, (2009). The degree of involvement of the external top management has been measured via the number of top managers present in family SMEs outside the family structure (***NExternal_Top Managers***). Finally, the presence of a non-family CEO has been measured by using a dummy variable expressing the family or non-family nature of CEO (***External_CEO***), in line with the approach employed by Naldi & Nordqvist (2009).

Control Variables

The empirical analysis has included control variables that may have an influence on the degree of internationalization. First, we have used a variable concerning the sector of activity of family SMEs according to Pavitt classification on the basis of the NACE original code distinguished in "Traditional", "High tech", "Specialized" and "Economies of Scale" (***Sector***); secondly, we have employed a variable expressing the age of the firm (***Age***) according to their years of establishment (<6 years, 6-20 years;> 20 years).

3.3. Analytical Approach

With the aim of empirically testing our research hypotheses, we have used a binary logistic regression model, a very suitable model of analysis when dependent variable is of dichotomous type (Bonney, 1987; King, 2008).

The use of the ordinary least squares (OLS) method for the regression analysis is inappropriate for this type of dependent variable, for the possible range of values is bounded on two sides in the range [0-1] (Kieschnick& McCullough, 2003). Additionally, the method of binary logistic regression generally produces estimations more consistent and efficient than those produced by the OLS method. The model used in the analysis takes the following form:

Active_abroad= f (%External_Ownership, NExternal_TopManagers, External_CEO,Sector, Age).

4. Results

Table 1 shows descriptive statistics and correlation of the key variables employed in the model of analysis. The results show how the sample denote a remarkable international orientation, since an average of about 78% of the family SMEs investigated are in an internationalization process (standard deviation = 0.41). Furthermore, in the ownership structure of the same firms just over an average of 15 external parties are involved, a piece of information that is only partially homogenous among the SMEs investigated given the moderate sample dispersion detected (S.D. = 28.14). The presence of external top management results to be lower, registering a mean value below the unit (0.69) and simultaneously a low variability in the sample (standard deviation = 1.44). Similar remarks can be also made with regard to the presence of external CEO in family SMEs, registering an average value equal to about 5% of the sample with a limited sample dispersion (S.D. = 0.22).

In view of the absence of a sufficiently high correlation among the independent variables used in the statistical analysis, problems related to the distortive effects of nonsense correlation have not been detected (Aldrich, 1995; Cohen et al 2013). In order to take advantage of a higher control on the goodness of analysis, multicollinearity has been tested using the VIF statistics. The results reveal that the VIF values do not exceed 1.11 – therefore they were not close to the “threshold" value commonly accepted of 10 (Hair et al. 1998) – and an average of 1,057 has been reported; while the "tolerance" level shows acceptable values, greater than 0.10, suggesting that multicollinearity is not a critically issue and allowing the use of multiple regression analysis in order to verify the hypotheses proposed. It should be specified that the estimation method used – i.e. the binary logistic regression – does not allow the estimation of the statistical values of VIF. Therefore, the VIF values obtained were estimated by employing the method of ordinary least squares (OLS).

Table 2 shows the results of the binary logistic regression model regarding the estimation of the internationalization of family SMEs based on the influence of external parties in corporate governance. Model 1 includes the control variables, while Model 2 includes the effects of the independent variables used in the study. *Hypothesis 1* states a positive relationship between the presence of entities outside the family in the ownership structure and the degree of internationalization of family SMEs. The estimated coefficient on the variable expressing the presence of external parties in the ownership structure of family SMEs is statistically significant but negative (coefficient = -0006; p <0.05), and does not allow us to support *Hypothesis 1*. *Hypothesis 2* establishes a positive relationship between the presence of top managers outside the family and the degree of internationalization of family SMEs. The estimated coefficient on the variable expressing the presence of external top management is positive and statistically significant (coefficient = 7.75; p <0.01), thus allowing us to confirm *Hypothesis 2*.Finally, *Hypothesis 3* states a positive relationship between the presence of a non-family CEO and the degree of internationalization of family SMEs. The estimated coefficient on the variable expressing the presence of an external CEO is positive but not statistically significant, and thus H*ypothesis 3* is not supported.

5. Discussion of Results and Conclusions

The paper had the purpose of studying the effects of some features of corporate governance on the degree of internationalization in family SMEs. The study moves its theoretical basis from the *Resource Dependence Theory* in order to clearly understand the manner in which family SMEs have the opportunity to access at the essential resources from the external environment for the improvement of corporate development. In particular, we investigated whether and how a more open corporate governance structure, which extends beyond the boundaries of the limited family structure, can exerts a relevant and significant effect on the internationalization process of family SMEs.

In detail and based on a close preliminary study of existing literature on the subject, it has been advanced the idea that the involvement of some unrelated parties in the family structure - external owners, external top managers and non-family CEO - have a significant effect in starting or in the consolidation of a internationalization process in family SMEs.

Results show that the involvement of unrelated parties of the family in the ownership structure of family SMEs does not stimulate, in a positive manner, the international activity of the firm, facilitating their developmental and expansionist processes, as well as providing vital support in the operations on foreign markets. These results are in contrast with the empirical findings on family firms (even medium and small) of Arregle et al. (2012), by Naldi & Nordqvist (2009) and Fernández & Nieto (2006), highlighting how the non-family owners do not play an active part in creating the chain of multifaceted links with the external context (Arregle et al., 2012) in order to reach resources of various kinds (Buckley, 1989) and increase the scope and the eminence of the internationalization process of family SMEs. Probably, the external owners fail to sufficiently remove the cultural resistance intrinsic in the family SMEs and motivate corporate governance towards a more international profile of the firm (Goodstein & Boeker, 1991).

However, the results of the analysis show that the involvement of top managers outside the owning family has positive effects on the internationalization of family SMEs, thus indicating that the degree of expansion and international involvement of the firm – in terms of export and import activity, marketing, direct investment and outsourcing - is closely linked to the presence in the corporate governance of a management leadership with medium-high skills and competencies. These conditions are scarcely evident in the small family structure (Graves & Thomas, 2006; Fernández & Nieto, 2006; Zahra, 2005; Claver, Rienda & Quer, 2009). The positive inflow of external resources to the highest corporate decision-makers leaders can overcome the psychological and behavioural resistances of the family corporate governance structure, encouraging a deep alteration of approach toward change (Blumentritt et al., 2007); an essential starting point for a profitable internationalization path.

Ultimately, the findings show that the involvement of non-family CEO has no significant effect in terms of increasing international openness of family SMEs; hence, he is not represent a key lever of internationalization processes implemented by this type of firm. This evidence is partly in contrast with the results of the study carried out by Naldi & Nordqvist (2008), which shows a composite effect about the ability of an external CEO towards a greater effectiveness of the internationalization processes of family SMEs. Indeed, the study was conducted on two-dimensional measurements of firm internationalization: the internationalization scale and the internationalization scope, pointing a positive effect for the first aspect and not for the second. In view of this - and given that the degree of internationalization that we used is a synthesis of different dimensions - it is possible to state that non-family CEOs contributes to the international development of family SMEs only in some aspects - especially those closely linked to the expertise and skills related to the intangible assets acquired through the experience (as in marketing or sales).In contrast, the contributions of non-family CEOs are less prominent in other aspects, such as the research and development of new markets for which the previous knowledge are lacking (Naldi &Nordqvist, 2009).This study is not free from limitations, some of which may provide impetus for future research. First, even if it was based on existing literature and theoretical approach commonly accepted, the results should be carefully interpreted, for the reason that thy are obtained from a sample of Italian family SMEs; aspect that could limit the generalization of the study to SMEs of other countries(especially those characterized by cultural and structural differences with the Italian ones). This element could even be the basis of the dissimilar results obtained in our study compared to others ones similar on the topic. The observations advanced could be the starting point to investigate how the contextual features - especially the cultural influence on the governance of family SMEs - enabling the basic strategic and organizational change in order to develop projects of growth, such as those concerning the internationalization of the firm. Secondly, the exclusive use of the *Resource Dependence Theory* as a theoretical basis for this type of study - albeit relevant to understanding the phenomena - does not include in a comprehensive way the issues regarding the possibility that an open governance structure can contribute to the degree of internationalization of family SMEs. In fact, future research on the subject could benefit from the jointly investigation of elements more related to the internal dynamics of family SMEs - such as organizational culture, propensity to risk and opens, the ability to develop skills and internal resources (LeBreton-Miller & Scholnick, 2008), as well as the resources acquired externally - in order to have a more broad framework about the effects of corporate governance mechanisms on corporate strategies of family SMEs and assess the relative strength of the two dimensions (internal and external).

The paper provides some remarkable contributions to the literature. Primarily, the paper contributes to the enrichment of knowledge about the interconnections between governance structure and internationalization, with specific reference to small and medium-sized family firms.

In addition, the same contributes significantly to studying the role that the dependence on external resources has for the international development of the family firms through the mechanisms activated by the corporate governance, stimulating further empirical studies (both qualitative and quantitative) on the topic.

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Table 1: Means, Standard Deviations and Correlations among Variables

		Mean	*S. D.*	1	2	3	4	5	6
1	Active_abroad	.787	.4098	1	-.057*	.030	.113**	.079**	.026
2	%External_Ownership	15.594	28.1374	-.057*	1	-.028	.016	.012	-.021
3	NExternal_TopManagers	.686	1.4465	.079**	.012	-.085**	.048*	1	.181**
4	External_CEO	.052	.2220	.026	-.021	-.025	-.040	.181**	1
5	Sector	4.049	1.2496	.030	-.028	1	-.039	-.085**	-.025
6	Age	2.554	.6049	.113**	.016	-.039	1	.048*	-.040

Source: Authors' own elaboration.
** p< 0.01; * p < 0.05 (all two-tailed tests).

Table 2: Binary Logistic Regression Estimation with the Degree of International Activity as the Dependent Variable

Variables	***Model 1***		***Model 2***	
	B	*S. E.*	*B*	*S. E.*
Control variables				
Sector	0.067	(0.111)	0.035	(0.474)
Age	0.456***	(0.000)	0.358***	(0.000)
Hypothesized effects				
%External_Ownership			-.006**	(0.007)
NExternal_TopManagers			0.139**	(0.009)
External_CEO			0.114	(0.690)
Likelihood-ratio chi-square	2152,535		1627,778	
Cox-snell R-square	0.015		0.019	
Nagelkerke's R-square	0.023		0.028	

Source: Authors' own elaboration.
*** p< 0.001; ** p < 0.01; * p < 0.05; (all two-tailed tests).