

**WHICH FAMILY-CONTROLLED BUSINESS REMAIN-FAMILY
CONTROLLED?
A RESOURCE BASED APPROACH**

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Which Family-Controlled Businesses Remain Family-Controlled? A Resource Based Approach

ABSTRACT: This paper develops a link between the family business succession literature and the resource-based view of the firm, addressing the need for a more comprehensive family business succession model. We develop a resource-based model in which family culture provides the intangible resources around which the family firm finds competitive advantage, focusing on the tacit family knowledge regarding the family's ability to limit shirking, and on familial bonds' beneficial impact on decision making. We propose which family firms will tend to remain successful and under family control, and develop testable hypotheses and outline a strategy for future empirical work.

1. Introduction

Family businesses are among the most prominent features of the United States economy, representing approximately ninety per cent of all businesses established in the U.S. (Dyer 1986; Dyer and Handler 1994) The list of prominent businesses that began as or remain family businesses reads like a "Who's Who" list of successful American firms; Ford, Campbell, Gallo, Du Pont are all representative of successful family businesses. For these reasons, family businesses have attracted considerable attention from entrepreneurship and small-business scholars.

Within these literatures, family business succession remains among the most critical research questions. The primary reason for this analytical interest goes beyond the sheer magnitude of family businesses in the economy; it is because the succession rate among family businesses has been consistently very low. According to Dyer (1986) and Applegate (1994), only 30 percent of family businesses succeed as family-owned enterprises past the first generation and only 10 percent to 15 percent survive to the third generation. While researchers have debated the reasons for such low succession rates, including Handler (1992) and Sonnenfeld (1988), no clear consensus has emerged. We propose an alternative approach to the question of

family business succession that synthesizes the resource-based theory of the firm, family culture, plus models of incentive alignment and shirking drawn from the economics literature.

Following Chua and Chrisman, we propose that a "family business is a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families" (Chua and Chrisman, 1999, p. 28). This definition is particularly useful because it is theoretically and empirically driven. Chua and Chrisman (1999) specifically make a distinction between a theoretical and an operational definition of the term family business. They argue that "a family business is distinguished from others, not on the basis of the components of family involvement, but by how these components are used to pursue the family's vision. The vision provides the context, meaning, and reason for family involvement just as a strategy provides the context for the functional policy decisions of the firm" (Chua and Chrisman, 1999, p. 31).

Through time, three possible outcomes face the initially viable family business. First, the business family can sell the firm to non-family owners, after which

the firm may or may not profitably continue. Second, the firm may remain in the family but fail either due to larger market forces or due to an internal lack of competitiveness. It is no surprise that poor economic conditions may cause otherwise well-run firms to fail, or that families cannot meet the regulatory, tax, and long term planning burdens of maintaining control of the business. Failures due to external market forces do not concern this study. Third, the family may retain control of the firm, which remains viable. This study examines the differences between family-controlled firms that fail or are sold in the second or later generations, on the one hand, with persistently successful family-controlled firms on the other hand. Other factors remaining the same, what causes some family firms to remain healthy and within the control of the founding family, while other family firms are sold or fail? We examine family owned firms within the framework of the resource-based theory of the firm. Within this literature, the search for rare, valuable, imperfectly imitable, non-substitutable resources (Barney, 1991) has led researchers to consider a variety of intangible resources. We discuss family culture as one such intangible resource. We apply family culture as an imperfectly imitable, non-substitutable resource to the question of family business succession. We seek to exploit identified differences between family cultures to explain why some firms remain successful and within the founding family. These explanations yield testable hypotheses.

Section two reviews some of the relevant literature. Sections three and four present our model and related discussion, and map out an empirical strategy. Section five concludes.

2. The Resource-Based View and Family Succession Literatures

2.1 Resource-based View

The resource-based theory of the firm has its origins in Penrose (1959), Wernerfelt (1984), and Barney (1991). However, Barney's description is the most widely cited (Priem and Butler, 2001).

The resource-based view of the firm argues that firms differ in their performance because of differentials in their resources. Resources that are valuable, unique, and can not be imitated can be the basis for a sustainable competitive advantage (Barney, 1991). Firm resources can be tangible or intangible. However, intangible resources are able to produce a competitive advantage because they are often rare and socially complex, thereby making them difficult to imitate (Barney, 1991).

A perusal of the extant literature on the resource-based view of the firm finds very few articles that focus on "culture" or "family culture." Most of the literature focuses on other forms of intangible resources, such as human capital (Hitt, et. al., 2001). However, upon reading this literature, one can conclude that "culture" is, indeed, indirectly one source of knowledge associated with human capital.

Knowledge can be either articulable or tacit (Lane and Lubatkin, 1998). Articulable knowledge can be written and easily transferred (Liebeskind, 1996). Tacit knowledge is imbedded in uncodified routines (Liebeskind, 1996) and a firm's social context. It is often embedded in collaborative working relationships within a firm (Nelson and Winter, 1982). We argue that these working relationships are highly likely to exist in a family, and likely transferred to the family business. While the research of Hitt, et. al. (2001) emphasizes the existence of human capital among professional service firms, it can easily be

argued that the development of tacit knowledge in a family business would also occur. Tacit knowledge is gained by learning by doing. We argue that young family members, like young professionals, can build tacit knowledge through experience. Thus, the culture of the family firm and all that it entails, derived from the internal culture of the controlling family, may be a resource that leads to a sustainable competitive advantage.¹

Goldwasser (1986) suggests that family culture in a family firm can be the source of a sustainable competitive advantage when he argues that successful family firms are characterized by a feeling of paternalism and an insatiable desire to exist and prosper over the long run. Furthermore, consider Hoy and Verser (1994), who ask the question “Do Family Firms Have a Competitive Advantage?” (Hoy and Verser, 1994, p. 15). They surmise “that family members in a business are more influenced by this unique set of family values than non-family employees would be.” They reference Barney (1986) when they argue that inimitable cultures can be a source of sustained competitive advantage. The authors argue that to the extent that owners can inculcate values in family members that are conducive to organizational success, the family business may have a sustainable competitive advantage; however, they do not identify which aspects of family culture lead to success (Hoy and Verser, 1994).

Organizational culture is more directly considered in the research of Hall (1992, 1993). He argues that intangible resources “range from the intellectual property rights of patents, trademarks, copyright and registered design; through contracts; trade secrets; public knowledge such as scientific works; to the people dependent; or subjective resources of know-how; organizational culture; and the

reputation of product and company” (Hall, 1992, p. 135). Coyne (1986) argues that sources of competitive advantage emanate from functional, positional, cultural, and regulatory differentials.

That cultural differentials constitute an intangible resource is particularly applicable to this research. Hall (1992) argues that culture applies to the entire organization. It entails “habits, attitudes, beliefs, and values, which permeate the individuals and groups which comprise the organization” (Hall, 1992, p. 136). We argue that the culture of a family business is derived from the culture of the controlling family, and may be the basis of a competitive advantage, to the extent that it is characteristic of the qualities presented by Hall (1992, 1993).

Hall’s arguments are interesting because he notes that the culture of an organization is a dual-edged sword. A culture of an organization “both sets it apart from others, and also binds its members together; it may work to the organization’s advantage or to its disadvantage (Hall, 1992, p. 138). In his research, Hall (1992) found that culture was ranked as the fourth most important intangible resource in a survey of firms in the United Kingdom. However, Hall did not distinguish family businesses from non-family businesses in his sample. It is interesting to note that Hall’s sample of firms specifically did not include firms that had fewer than 100 employees.

Entirely separate from the resource-based theory of the firm, yet of importance to this research is the shirking model of Alchian and Demsetz (1972), arising from the economics literature. Alchian and Demsetz propose that the output of firms is greater than would be the output of its employees individually; hence we desire to organize production into firms. However, once production is so organized, individuals have a desire to shirk, enjoying some

personal leisure while having only a minimal impact on firm output; hence, on an individual's share of firm revenues. Unfortunately, all employees have the same incentive, and firm performance suffers; hence, each individual's share of firm revenues suffers. To address this situation, firms are constituted so as to have a residual claimant. Thus the residual claimant has the incentive to align incentives and reduce shirking throughout the organization, to each individual's benefit.

2.2 Family Business Succession

Research on family businesses has explored a variety of issues such as managing conflicts inherent in family businesses (Dyer, 1989), the firm's strategy (Daily and Dollinger, 1992), organizational structure (Kahn and Henderson, 1992), and family influence on the firm (Donckels and Frohlich, 1991). Yet, many family business researchers would agree that succession is the primary issues facing family businesses (see e.g. Applegate, 1994; Davis, 1998; Dyer, 1986; Dyer, Jr. and Handler, 1994, and Handler, 1994). Succession is the transference of leadership for the purposes of family ownership, which must be addressed in order for the business to survive and be passed on to subsequent generations. The issue is critical to our understanding of family businesses because only 30 percent of family businesses survive past the first generation (Dyer, 1986) and only 10 percent to 15 percent survive to the third generation (Applegate, 1994). The extant literature regarding succession has developed in several directions.

Founders and their resistance to planning for succession are emphasized in one branch of the literature. Sonnenfeld (1988) categorizes founders or CEOs according to their retirement style. Each of the different styles is associated with a different approach to succession. For

example, "ambassadors" leave willingly, while "monarchs" only leave when they are forced out or die. Others address the psychosocial dynamics that make it difficult for owners to contemplate retirement (Handler and Kram, 1988). Lansberg (1988) argues that the family, managers, and other stakeholders in the family business may actually collude against succession planning because of an inability to deal with the mortality of the founder.

Handler (1992) explores the role of the next generation and their experience of succession as another stream of research. She identifies the degree of mutual respect, understanding between successor and founder, and next-generation career interests, among other factors, to be critical to the succession decision. Dyer and Handler (1994) point out that the "process of succession and the changing power relationships" is another issue. Handler (1990) finds that succession represents a period of mutual role adjustment. A next generation family member(s) may move from having no role to helper, to manager, and finally to chief decision maker.

Presuming that a decision is made to turn over management to a family member, research indicates that certain characteristics of the family seem to be critical. Dyer and Handler (1994) note that the following characteristics help the succession process proceed effectively: 1) consistent view of what is equitable; 2) well-developed contingency plans, 3) superordinate goals, 4) effective conflict management, and 5) a high level of trust; to us, factors which seem closely related to the habits, attitudes, beliefs, and values which permeate the individuals (to paraphrase Hall (1992); the family culture, in short.

A summary of the literature on family business succession suggests that our understanding of family businesses is somewhat limited by a need to understand

succession, and our understanding of succession is limited to an understanding of a number of behavioral or psychological factors. However, Dyer and Handler (1994) note that very little is known about performance issues of family businesses. Much of the succession research focuses on behavioral issues surrounding the succession process. Such a perspective is an important part of our understanding of family firms. Dyer and Handler (1994, p. 78) state, “we need more comprehensive models to show how various dynamics of succession relate to one another.” A comprehensive model must be developed because succession is such a dynamic and complex process. We begin to address the need suggested by Dyer and Handler (1994) by proposing a resource-based perspective of family business that relates several variables of interest such as family culture, succession to subsequent generations, and the family business’ financial performance.

3. Discussion

Much of resource-based theory necessarily revolves around intangible resources. Otherwise, one expects the resources to be well defined, hence, marketable and not a sufficient condition to confer a sustained competitive advantage. Following Barney (1991), a firm possessing a rare, valuable, imperfectly imitable, non-substitutable resource may be at a considerable advantage relative to its competitors. As such a resource is imperfectly imitable and non-substitutable, it will be only imperfectly exchangeable in the broader market. Therefore, the discovery and exploitation of such a resource may yield a persistent advantage relative to competitors lacking the resource.

Adapting Hall (1992), we define family culture to be the habits, attitudes, beliefs, and values which permeate the individuals comprising the family. Family

culture provides a convenient referent to the resource-based theory of the firm literature. Each family possesses an intangible resource in its family culture. Thus, family culture provides an imperfectly substitutable / imperfectly exchangeable resource around which the family can construct a business. As family cultures differ from one another and from corporate culture, so may the competitive advantage conferred by this resource differ, thereby helping to explain which family firms remain viable and within family control.

We may think of a variety of ways in which a particular family-controlled firm may possess advantages relative to non-family-controlled and other family-controlled competitors, not all of which are directly related to family culture. Organizing as a family firm may confer legal, illegal, or “extra-legal” tax and regulatory cost advantages. In situations of imperfect access to broader capital markets, family firms may allow for conservation of capital. Especially in cases of immigrant families, organizing as a family firm may allow family members to avoid linguistic and/or other broader, external cultural constraints. While we briefly discuss these potential cost advantages in section three point one, they are not the primary emphasis of this research.

Rather, in this paper we focus on certain aspects of *family culture* as potentially conferring a competitive advantage. Specifically, one’s family culture may create the ability to align incentives and improve long-term decision making within the firm, because of the altruism and the non-market enforcement mechanisms available to families.

3.1 Potential Advantages of the Family Firm

Family-owned firms relying on family labor *may* enjoy substantial legal and illegal wage, tax, and regulatory cost

advantages of firm organization. Family members will often contribute substantial labor at below-market wages, which may also allow the family firm to evade minimum wage laws. Family members may work for “free,” or may allow the family to shield corporate income by receiving it as earned wages. Family labor will be less likely to notify authorities if the business fails to provide mandated benefits, improperly withholds wages, or fails to comply with costly OSHA or EPA mandates. Thus, family members may, but not necessarily do, provide below-wage and/or non-regulatory compliant labor, at a consequent significant cost savings, relative to the non-family-controlled competitors.

Organizing as a family firm allows for the conservation of family capital or assets, and internal, family-based finance may be less costly than financing the firm in the external market in certain circumstances. To the extent that market participants’ knowledge is imperfect, or other capital market imperfections exist, capital allocation decisions may not be based purely on the merits of a firm’s profitability or the soundness of its business plan. In this event, firms may seek alternative financing. The family offers the most likely source of alternative financing. Thus, family owned businesses may be at an advantage relative to other, non-family small businesses, and the competitive disadvantage (differential cost of capital) relative to firms with access to formal capital markets may be minimized, allowing the family firm to successfully compete. Such internal business finance seems common, especially among new businesses within immigrant communities. This is not to suggest that most immigrant families arrive well heeled, with sufficient liquidity to launch successfully competitive business ventures. However, given the fact of immigration, and the difficulties one easily imagines immigrants face in financing

their ventures via the formal capital market, it seems plausible that many of the immigrant ventures established will be funded by a family or consortium of families pooling their internal resources, as meager or bountiful as those resources may be.

Especially among immigrant families, working in a family business may offer a family member numerous benefits that would be unavailable if she worked in the broader labor market. By working in the family business, numerous family members may avoid the substantial costs of learning the dominant social culture’s language, business and social practices, and/or avoiding xenophobia that may be encountered by working in the broader labor market. The ability to avoid these broader constraints does not necessarily confer a competitive advantage, but one may be willing to work for less within the family firm to avoid these constraints, lowering the family firm’s costs. The existence of these external constraints may make external employment less desirable at any wage, increasing the likelihood that future generations of family members may remain affiliated with the family enterprise.

3.2 Family Culture, Intergenerational Utility, and Reduced Shirking

Family culture may confer advantages in a different way, as demonstrated by referencing a separate model of firm organization, the shirking model of Alchian and Demsetz (1972). Alchian and Demsetz argue that people wish to organize production of goods and services into firms to take advantage of economies of scale, specialization and complementarities among inputs unavailable to the individual producer. As such, total output of the firm is greater and cheaper than the total output of an equal number of individuals. However, just because the incentive to organize a firm exists does not mean that

incentives are completely aligned among people within the firm. As an individual, an employee benefits from the existence of the firm that employs him. However, since he is one wheel in a larger machine, he knows that the total productivity of the firm (and, hence, his share of the profits or revenues) will not be reduced too greatly if he indulges in some shirking and enjoys some on-the-job leisure. But if one person has that incentive, all people do, and the firm suffers. Therefore, the employees would agree to create a residual claimant to the firm. The residual claimant benefits or suffers directly as the firm overall benefits or suffers. As a residual claimant, a person would have the incentive to monitor her employees and reduce shirking. As such, the value of her residual claim is increased. Importantly, as the residual of the firm increases, so too will the individual employee's absolute share of the revenues or profits. Thus, with the creation of a residual claimant, the incentives to produce and not shirk become aligned in a way that increases profitability and benefits everyone.

The connection between family businesses, family culture, the resource-based theory of the firm, and the Alchian and Demsetz theory lies in the mechanisms to align incentives that may exist within the family and may be transferable to a family-controlled business, *but, as these family cultural mechanisms are tacit, may not be marketable to outsiders nor necessarily persistent through generations.* Firstly, families have powerful abilities to detect and reduce shirking within the family. For example, consider the home production of laundry, cleaning, shopping, and child-rearing services. Family members know when someone is shirking and are able to identify the shirker with amazing precision. Furthermore, families are able to apply incredible leverage on the shirker to get him to amend his behavior. Family members

seem able to accomplish these tasks more consistently, quickly, and cheaply than could an outsider hired to enter the home and “manage” such family production. Such abilities will be difficult to exchange in the market because they are the product of long, familiar (no pun intended) association and intense interest. We implicitly use this concept in common phrases such as “family takes care of its own,” especially in the disciplinary sense. It also seems likely that families *differ* in their ability to detect such shirking and in the ability to limit it. This ability is likely related to an earlier discussion, serving to intensify this effect; namely, the more a family or family members may be constrained by limited access to capital markets, linguistic or other cultural barriers, the less attractive social and business opportunities outside the family may appear. Therefore, the family may more intensively monitor and limit its shirking. The families that are more efficient at detecting and limiting shirking will be more successful should they transfer these skills to a family-controlled business.

Secondly, families are often able to better align incentives from the patriarch/matriarch down to children, from children up to patriarch/matriarch, and across siblings, than non-family organizations are able to align incentives vertically and horizontally in productive teams. This is because of the fondness, affection, love, sense of duty, and willingness to sacrifice often engendered by family, but largely lacking in the corporate setting. As an example, we may consider firms' efforts to create employee loyalty, devotion to duty, and goodwill as attempts to produce the bonds naturally created within families. How often have we heard an employer say, “We're like a family here,” as a “selling point” of the enterprise? Thus, family and family-business members may be more disposed to care about the family's

(business') prosperity and less inclined to individualistic benefits than would be members of a production team hired in the market. Equally importantly, families will differ in these abilities. And, again, the strength and effectiveness of these family bonds may be related to external capital market and social constraints facing the family.

In numerous settings, economists have reduced these family bonds to overlapping or intergenerational utility functions. (Becker and Tomes, 1986) "Utility" is a catch all concept encompassing the satisfaction or pleasure an individual derives from her life/decisions/behaviors. A person is presumed to seek to maximize discounted lifetime utility; that is, to make forward-looking decisions designed to increase her overall happiness and satisfaction. Overlapping or intergenerational utility results when a person's (say, a parent's) present and future happiness depends on the present and future happiness of another (say, a child's). Intergenerational utility functions result from biologic/genetic self-interest, and long, familiar association, and love, not something often discussed by management scientists or economists! Again, consider the phrase "family takes care of its own," but now in the supportive, assistance-giving sense. Such overlapping utility functions are non-marketable to outsiders. Furthermore, the degree of utility overlap will differ across families, and across generations within a family. For instance, one's grandparents may care greatly about their children, their children's children, and so on. Thus, as business owners who wish to leave a generous bequest, they will retain control of the firm and make good strategic decisions. As a counterexample, consider a family whose utilities are less intertwined. While not denying the love and affiliation which may exist, a member of such a family may

be more likely to sell the family business, and possibly make poorer (shorter sighted) decisions. And, again, we see the possibility that families facing more binding external constraints may draw together in tighter association, familiarity, and intergenerational bonds, making retention of those family-controlled firms within the family more likely.

4. The Model

We are now prepared to develop testable hypotheses. Families whose tacit family cultures demonstrate greater degrees of intergenerational altruism and more efficient anti-shirking practices, should be more likely to retain the family business within the founding family. Furthermore, families with further social or ethnic distance from the dominant social culture, and with reduced access to formal capital markets also should be more likely to retain the family business within the founding family. Repeatedly we have suggested that these family advantages are likely to be correlated with immigrant family status. Our model suggests that immigrant families form more family owned business than others, *ceteris paribus*, and that these firms remain within control of the founding family longer. However, the theory also suggests that as immigrant families become assimilated into the dominant social culture through successive generations, the benefits the family confers relative to the wider market will diminish. Therefore, the failure / disposal-through-sale rate of immigrant-founded family firms should converge to the rate of "dominant social culture" family firms. Our model and the derivative hypotheses are summarized in Figure One. Of course, our list of potential advantages in organizing as a family firm is not exhaustive. Neither do we suggest that family-cultural traits tending towards family business success are in any way exclusive to

immigrant families; however, focusing on immigrant families offers a convenient way of empirically approaching the construct.

The model allows us to outline an empirical strategy. The model is sufficiently general or robust to permit a wide variety of empirical work. A reasonable starting point would be to survey the literatures surrounding immigrant or minority small businesses, entrepreneurship, or small-business start-ups, with an eye to interpreting the literature's findings in light of our model. Following that, a wide variety of statistical tests can be conducted, either on proprietary survey data (yet to be gathered), or on a variety of public data.

Figure 1 about here

5. Conclusion

We view each family's "family culture" as one of the rare, valuable, imperfectly imitable, non-substitutable resources around which the family may organize a family-owned firm. We view family culture as an asset (resource) or as a tool that may provide competitive advantage or may reduce the disadvantages facing the family firm. Organizing as a family firm may confer legal, illegal, or "extra-legal" tax and regulatory cost advantages; may family firms may allow for conservation of capital or provide lower-cost alternative financing; and may allow family members to avoid linguistic and/or other broader, external cultural constraints. However, among other potential advantages in organizing as a family firm, we focus on family culture's tacit ability to align incentives and improve long-term decision making within the firm,

because of the altruism and the non-market enforcement mechanisms available to families but absent in other labor market arrangements.

Significantly, family culture will differ from family to family in these important areas. Thus, family firms arising from families whose culture is marked by efficient internal mechanisms to identify and reduce shirking and marked by powerfully intertwined individual utility functions are expected to be more successful and remain under family control longer. We expect these and other possibly business-beneficial aspects of family culture to be more pronounced initially among immigrant families.

We can use this model to address issues surrounding family business succession. All other things being equal, families with more strongly intertwined utilities and with better internal abilities to eliminate shirking will translate into families who retain control of their successful family businesses. Thus we can state testable hypotheses. Immigrant families will form more family-owned businesses than others, *ceteris paribus*; these firms will remain within control of the founding family longer; and as immigrant families become assimilated into the dominant culture, the failure / disposal-through-sale rate of immigrant-founded family firms should converge to the rate of dominant social culture family firms.

This paper presents our theoretical model and a proposal for an empirical strategy. Our remaining task is to carry out that empirical strategy and test our model.

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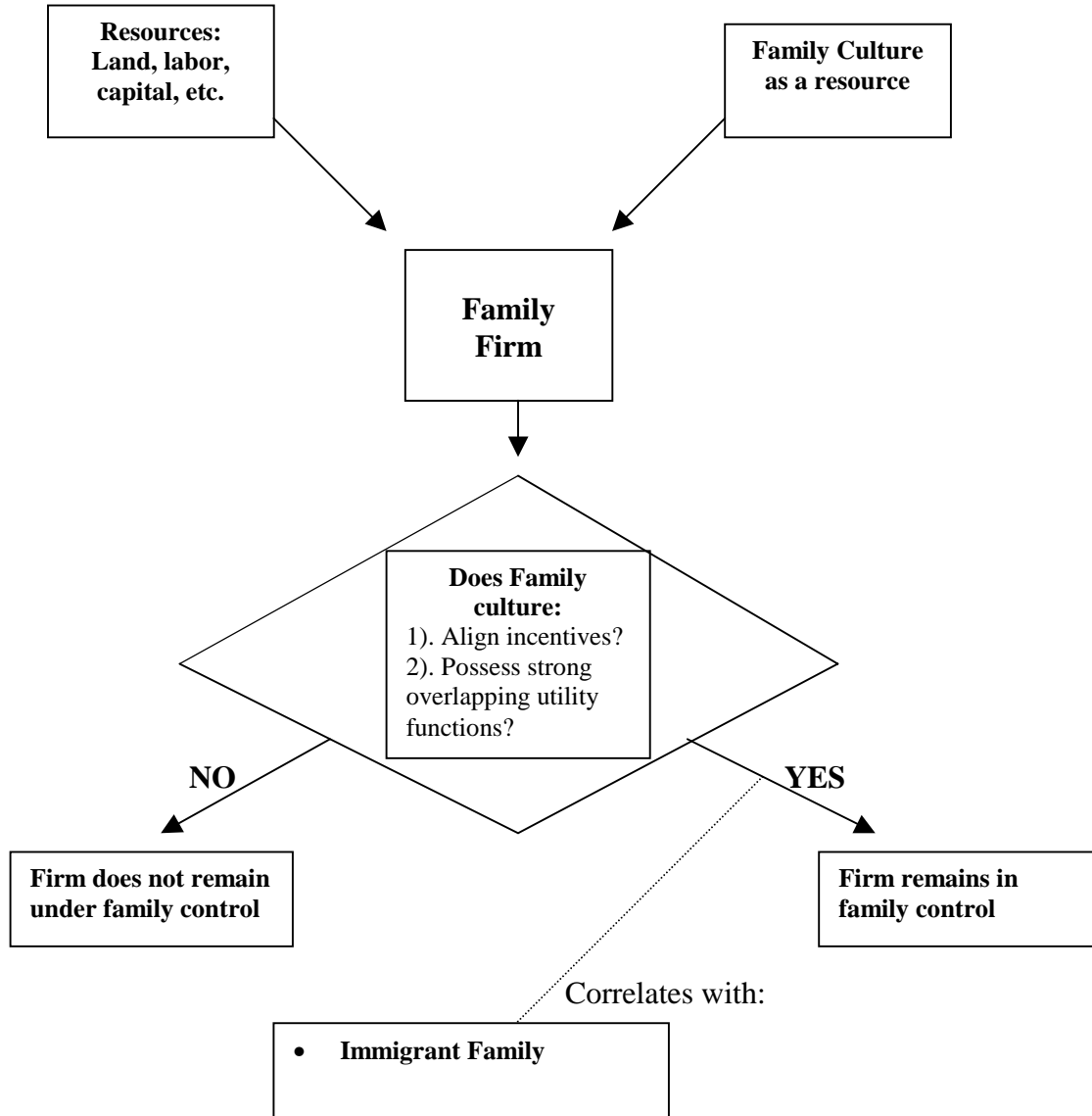
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¹ Clearly, the family-controlled firm may have other resources that lead to a competitive advantage. However, culture is a resource that tends to sustain a family and family firm from generation to generation.

FIGURE 1: The Model and Derivative Hypotheses

- Family culture is one of the rare, valuable, imperfectly immitable, non-substitutable resources around which the family firm forms and can exploit for competitive advantage.
 - Does family culture tend to lead to firm success as a family-controlled firm?



Therefore:

- **IF** immigrant family firms initially remain within the family at a greater rate than “dominant social culture” family firms
- **And / Or IF** Immigrant family firm succession rate converges to “dominant social culture” family firms succession rate
- **THEN** this constitutes evidence supporting our theory.