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Performance Measurement Systems' Role In Fostering Trust Within Family Businesses

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Abstract

Trust is a critical source of competitive advantage for family firms (FBs) and yet the initial trust embedded in the family firm is often replaced by conflict and strife; consequently, investigating how this resource can be sustained and fostered is significant. The aim of the paper is to identify which mechanisms can be useful in maintaining and growing the initial level of trust: clear and transparent processes can clarify responsibilities and expectations of family members and employees and engender system trust. Transparency of rules and operational mechanisms can be therefore translated into practice through corporate governance systems: specifically, effective governance will be based on performance measurement systems, taking into consideration clear guidelines on key issue governing family and non-family members, reducing conflicts among shareholders. Thus, FBs can exploit the competitive advantage of strong trustworthiness if they can leverage the interpersonal trust; this sustained level of trust may indeed be a key ingredient for emotional capital that is central to the continued success of family firms (Sharma, 2004).

Ⅰ. Introduction

Trust is a critical source of competitive advantage for family firms and yet the initial trust embedded in the family firm is often replaced by conflict and strife; consequently, investigating how this resource can be sustained and fostered is significant.

The concept of trust is crucial in considering competitiveness, because it constitutes the basis of social capital: the latter is defined as a unique, not imi-

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table, deeply embedded resource, extremely difficult for competitors to imitate (Dess and Shaw, 2001). From this point of view, sustaining and fostering trust in FBs can be a way to preserve competitive advantage.

As shown by many scholars such as Sundaramurthy (2008) and Steier (2001), the initial trust inherent in the early stages is not sustained as the company grows and evolves. Thus, the mechanisms useful in maintaining and growing the initial level of trust that enable family business to flourish should be investigated.

The aim of our work is to identify which mechanisms can be useful in maintaining and growing the initial level of trust: clear and transparent processes can clarify responsibilities and expectations of family members and employees and engender system trust.

In order to investigate operational mechanisms, we have to start by the consideration that they derive from corporate governance decisions: the aim of the governance system is to guarantee a balance between property and control, prescribing rules and codes of conduct, which define the way to divide the power and responsibility of management and decision making process.

The expectations of family-managers and family members not involved into the business may vary and the clarification of these aspects is central in mitigating conflicts and sustaining trust.

In this paper we assume that, in order to consider the need of preserving shareholders' expectation (managers and non-managers), attention should go beyond formal governance rules (compliance) (Busco, Giovannoni, and Riccaboni, 2007), taking into consideration mechanisms to monitor organizational performance.

We discuss the importance of effective governance: the latter can be defined as a balanced combination of structures, plans, policies, rules and decision making power that enables ownership group to play a constructive role in the FB system.

While we focus our attention on these mechanisms, such as performance measurement systems, we will not analyze governance choices, such as board of directors' composition, shareholders' meetings, etc.

Effective governance will be based on performance measurement systems, taking into consideration clear guidelines on key issue governing family and non-family members, reducing conflicts among shareholders.

Thanks to performance measurement systems, FBs can exploit the competitive advantage of strong trustworthiness; this sustained level of trust may indeed be a crucial basis for social capital, central in preserving FBs' competitiveness.

Ⅱ. Theoretical Framework

1. Exploring the Concept of Familiness

In most countries FBs account for major share of business, employ a significant portion of total employees and record significant amount of investments, accumulated capital and added value: different studies underline the importance of FBs across different countries, such as Western Europe (Maury, 2005), Spain (Gallo and Estapè, 1992, 1994), Germany (Riedel, 1994), United States (Astrachan and Kolenko, 1994), Australia (Owens, 1994) and Chile (Martinez, 1994).

In spite of the significant role played by FB in the global economy, researchers still don't converge on a unique definition of FB, but propose different definitions depending on the framework used to investigate FBs, such as strategic management, organizational theory, economics, sociology, anthropology, etc.

The matter of definition is crucial, especially with reference to researches on FBs: Westhead and Cowling (1998) consider how definitions of FBs affect comparative studies of family versus NFBs; when they split a sample into FBs and NFBs on the basis of seven different definitions, they obtain very different results.

The importance of this construct has been highlighted by Pearson, Carr and Shaw (2008) who state that identification of a unique definition of familiness is both groundbreaking and important for family business research.

The component of family involvement is a necessary but not sufficient condition for defining FB: in fact, only if family involvement is directed toward behaviors that produce certain distinctiveness, it can be considered FB.

According to the governance perspective (Corbetta, 2005; Montemerlo, 2000; Corbetta, 1995), especially with reference to the kinship degree, we can classify FB differently in presence of (1) a controlling owner-usually the founder, (2) a sibling partnership between brothers and sisters, or (3) a cousin consortium (see also Ward and Dolan, 1998).

Another classification is based on the number of shareholders or families involved and considers, for example (a) close firms-with one family at the first or second generation or more than on family at the first generation and (b) wide firms-usually one family after the third generation, with a great number of members.

Many traditional definitions of family business are focused on the combination of some components of family's involvement in the business, such as ownership, management and trans-generational succession (Chua et al., 1999; Chrisman et al., 2005); these authors argue that a positive contribution by the family leads to distinctive familiness which can serve as a source of competitive advantage for the family firm.

Villalonga and Amit (2006) outline that most definitions include at least three dimensions: one or several families hold a significant part of the capital; family members retain significant control over the company, which depends on the distribution of capital and voting rights among non family shareholders, and family members hold top management positions.

The influence of family is also related to the level of family control; in this sense, Anderson and Reeb (2003) make a distinction between active and passive family control. The crucial point in finding out a definition for FBs is that it should be able to explain why family involvement in a business leads to behaviors and performances that might be different from the ones of NFBs (Lee, 2006; Moscetello, 1990).

All this conducts to investigate FBs behavior to catch the essence of family business and thus understand how they perform.

FB seems to be a complex aggregate of systemic factors that impact on strategy processes and firm performance; Habbershon and Williams (1999) state that these unique family influences can be described through the resources and capabilities peculiar of the firms. In particular, Habbershon et al. (2003) identifies the main elements that interact in a family business system as:

- the controlling family unit: representing the historical background, traditions and life cycle of the family;
- the business entity: representing the strategies and structures utilized to generate wealth;
- the individual members: representing

the interests, skills and life stage of the participating family's owner/managers.

The pool of resources and capabilities generated, familiness, it's hard to duplicate because it represents unique, inseparable, synergistic resources and capabilities arising from family involvement and interaction. Hoffman, Hoelscher and Sorenson (2006) introduce the concept of family capital: it is an asset that derives from the family ties existing in family firms.

Resource Based View (RBV) has the potential to help identify the resources and capabilities that make family firms unique and, through their interaction, allow them to develop family based competitive advantage. This approach has been successfully used to explain long run differences in firm's performance that can't be attribute to economic conditions or industry, as Porter (1980) stated in his environmental models.

In particular, he assured that:

- firms in an industry are identical in terms of strategically relevant resources they control and strategies they adopt;
- resource heterogeneity developed in an industry is short-lived because resources are highly mobile.

The RBV framework, instead, states that firms in an industry are heterogeneous and considers the intangible bundle of various resources as the cause of competitive advantage and underlines that firm's resources are not perfectly mobile across firms (Barney, 1991).

So a firm can sustain its competitive advantage depending on the inimitable nature of its resources, including, for example, both physical and intangible assets, individual and corporate skills, organizational processes and firm attributes.

FBs have unique characteristics that play an important role in their performance: through RBV it's possible to delineate the competitive capabilities of family companies (Habbershon, and Williams, 1999).

Literature on RBV (Barney, 1991; Grant, 1991) usually identifies four main categories for resources:

- physical capital resources;
- human capital resources;
- organizational capital resources;

- process capital resources.

In each of these four categories family business literature has included much family business characteristics that constitute the potential of FBs (Habbershon, Williams, 1999).

At this point it's crucial to recognize under which conditions these elements can provide competitive advantage: the interaction between the family, its individual members and the business creates that bundle of resources peculiar of each firm that constitutes "familiness."

The RBV can bring two bodies of literature-strategic management and family firm theories

- together into one comprehensive framework to investigate FBs' performance.

Some researchers (Habbershon, 2003; Chua et al., 1999), in order to investigate FBs, start from the evidence that this kind of companies exists because of the reciprocal economic and non economic value created through the combination of family and business system; in particular the sustainability of a family business is a function of both business success and family functionality (Olson et al., 2003).

As shown by SFB Model (Sustainable Family Business Model), family business are complicated by dynamic relationships within the owing family: the sustainability of a family business is a function of both business success and family functionality (Stafford et al., 1999).

2. Family and Business Interaction: Social Capital as Source of Competitiveness

Family businesses are characterized by the interaction of two complex systems, the family and the business, that are dominated by different rules and values, with mutual influences (Corbetta and Salvato, 2004; Chrisman, Sharma and Taggar, 2007).

Family is often labeled as the emotional arena and business is labeled as the ration arena; principles such as equality, members' protection and support, saving, traditions, sentimental feelings, shared values, dominate family, while business should be managed according to economic and financial standards, rational decision making processes and flexibility.

The potential for conflict is high in

family firm because several systems overlap as the family business grows (Tagiuri and Davis, 1996): family tasks and values are often placed in opposition to those of the business.

The relationship between family and business differs as the life stage of the business evolves (Ward, 1997): strategic changes represent the most critical phases because they require decisions about leadership, involvement into the business of different members of the family, their compensation, roles' attribution, etc.

Family usually tend to uniform members' treatment in order to avoid conflicts, evoking equality values: in a family firm context, this lack of meritocracy can cause managerial problems on the business side (Tillet, 2001).

Family tension is not helpful in achieving success for either the family or the business: productivity declines in presence of family tension. Ward (2004) notes that successful family business recognizes that predictable conflicts are likely to arise, and suggests dealing with them even before they become real.

Compensation, entry into the business and succession are all such decisions that should be given attention before they become personal and emotional. In this sense, particular attention should be paid to social capital, which involves the relationship between individuals or organizations and is considered a specific source of competitive advantage for family firms.

Leana and Van Buren (1999) define social capital from an organizational perspective, as the character of social relationships within the organization realized through members' levels of collective goal orientation and shared trust.

Social capital is by definition socially complex, related to norms, values, purpose and trust that exist in the family firm; it is considered a deeply embedded resource, tacit in nature and extremely difficult for competitors to imitate (Dess and Shaw, 2001).

According to Nahapiet and Ghosal (1998), social capital is defined as "the sum of the actual and potential resources embedded within, available through and derived from the network of relationships possessed by an individual or social unit" and is conceptualized as consisting of three dimensions-structural, cognitive and relational.

The latter dimension provides necessary elements to link firm resources and capabilities: trust is an essential component of effective collaboration within the firm. The type of trust that exists in the firm has implications for the linkage between trust, organizational processes and capabilities.

3. Trust as Organizing Principle: the Basis of Social Capital

Trust is a concept which has been widely explored in the management and organization literatures (Gambetta, 1988; Tyler and Kramer, 1996; Nooteboom, 2002).

At a general level trust can be defined as the willingness to accept vulnerability based on positive expectations about another's intentions or behaviors (Mayer et al., 1995; Rousseau et al., 1998); the concept of trust implies a preference for a stable and predictable environment.

For our purpose, we will assume the viewpoint of some scholars (Mc Evily, Perrone, Zaheer, 2003) that conceptualize trust as an organizing principle, investigating how it affects organizations. They define trust as expectation or intention because they are most interested in explaining the behavioral manifestations of trust that shape and influence organizing.

It's important to consider the two main forms of trust: a confidence in the reliability of (a) specific individuals (personal trust) and (b) abstract systems (system trust). Importantly, these two forms of trust are often interdependent, as individuals are usually the access points for the systems and through face-to-face contacts such individuals can absorb risks by assuring potential users that the systems are trustworthy (Bachmann, 2001).

In an organizational context, expectations about another's intentions or behaviors include competent role performance from those involved within a social relationship system. In addition to competence, trust is also based on behavioral integrity and benevolence of others; consequently, the view of trust includes of course an element of calculated expectation but also a non-calculative component, depending on bounded rationality.

Trustworthiness plays a crucial role in making trust effective: trustworthiness implies being worthy of having trust placed in one (Barney and Hansen, 1994); without trustworthiness, trust is not sustainable and the alignment between the two factors determines the effectiveness of trust as an organizing principle.

According to Mc Evily, Perrone and Zaheer, trust influences organizing through two main causal pathways: structuring and mobilizing. From structuring perspective, trust influences the stable and enduring interaction patterns within organizations (for example, by influencing the status and reputation of certain actors, trust affects their position within organizations); from mobilizing perspective, trust motivates actors to combine and coordinate resources toward the achievement of organizational goals.

Trust has been characterized by two dimensions: fragile and resilient trust (Leana and Van Buren, 1999). Fragile trust is given in exchange for the possibility of fairly immediate rewards. Fragile trust, that is more dependent on formal rules of allocation, doesn't provide a strong link to the organizational capabilities of information flow and collective action. On the opposite, resilient trust is based on frequent social interaction with parties and involves their moral integrity.

Trust is central to family business, in which a group of individuals affiliated with enterprise are connected through ancestry of familial ties, because their existence goes well beyond economical rationality. Even if family firms are fertile grounds for resilient trust, often it is replaced by an atmosphere of fragile trust (Steier, 2001).

In fact trust, a competitive advantage for family business in early stage, often deteriorates as the firm grows. Thus it's significant to investigate the mechanisms useful in maintaining and growing the initial level of trust that enable family business to flourish.

Furthermore, it's also central understanding how various structures and processes can through additional trust bases complement and sustain the initial relationship-based trust within family firms.

The model proposed by Sundaramurthy (2008), the cycle o trust within family firms, offers a contribution to understand how additional governance structures and processes can complement initial familial trust; specifically, the interweaving of competence trust and system trust into a sustaining cycle allows to understand how the different forms of trust need to coexist to benefit the firm, also according to the firm's life stage.

The model is based on many premises; the main ones are summarized as follow:

- trust is a multidimensional phenomenon with cognitive and affective aspects;
- trust is dynamic, considering internal or external relationships (between fa-

mily business and external business transactions) and the different phase of firm's development;

- the trust cycle is regenerative and the family firm will continue to revisit each of these three aspects of trust after the initial cycle.

Family businesses in the early stages are characterized by an high level of trust that is relational and interpersonal (Corbetta and Salvato, 2004). Interpersonal trust, among members of the family, is based on kinship, familiarity, history and extended period of experience.

This kind of trust takes a huge amount of time to build between strangers; in this sense family firms are unique because they begin with deep level of trust: the family constitutes the common identifying factor.

Over time, as a family business grows, complexity on a number of dimensions is introduced; ownership and management of the family business may dispense among cousins and affiliates. Lack of deep knowledge of each other and common experiences can dilute the level of interpersonal trust: a need for additional cognitive trust bases arises.

Competence trust represents the belief that parties entrusted with a job are not willing but capable of performing the job effectively. In a family context, those members who are not actively involved in the business seek to have confidence that those running the business system are capable of adapting to changing environmental needs. Such confidence can be fostered when the family business system is open to outside influences, including the presence of non-family members on the board and encouraging family members employed in the business to gain work experiences outside the family firm (Gersick, Davis, McCollom Hampoton, and Landsberg, 1997).

A third dimension, crucial into the cycle of trust in a family business, is system trust: this type of trust is impersonal and related to the trust individuals place in the system and processes. As the family business grows, interpersonal trust cannot be sustained without confidence in the system that governs key interpersonal exchanges: clear and transparent rules can clarify roles, responsibilities and expectations of actors within family firm enhancing the potential for trust in the working of the family business system. This sustained level of trust may indeed be a key ingredient for emotional capital that is central to the continued success of family firms (Sharma, 2004).

4. Sustaining Trust: Effective Corporate Governance and Performance Measurement Systems

The governance of a FB is more complicated than for NFB because of the central role of the family that owns and leads the business: in a FB, the business, the family and the ownership group all need governance. Clear policies allow the integration of family values within clear boundaries and help establish trust in the family business system. In this sense, control systems are crucial to maintain and foster trust: starting from corporate governance's decisions, the identification of operational mechanisms is required to translate the expectation of family shareholders without a managerial role into achievable objectives.

The first step in approaching corporate governance' decisions refer to the definition of the following elements (e.g. Catturi, 2005; Comoli, 2002):

1) roles (which family members will be involved into management, their responsibilities, their position, etc) and
2) shareholders' expectations, referred to long and short term firm's goals, both measurable with financial and non financial performance indicators.

According to the prevalence of family or business within the family business system, it's possible to classify family firms into business or family oriented ones (Miglietta, 2009): this classification is significant with reference to the governance assets of family firms; consequently, when family prevails over business, all strategic organizational roles are covered by family members, while, when the focus is on business, family members can be involved or not into management, even if they are shareholders.

Often, within family firms, we can observe the separation between ownership and control, owing to the fact that several members of the family may not be involved with the daily operations as they may choose different careers.

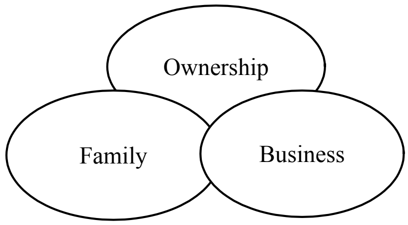
Moreover, as successful FBs open themselves to external members, an additional stakeholder-the non-family employee-is involved in the management. Consequently, the first group of decisions to be taken is about the attribution of decisional power to those family members involved into the management (a-roles): generally, they will be members of the board of directors, with different competences.

In order to benefit from the interaction of family and business, it's crucial to identify proper governance mechanisms to guarantee a balance between property and control. The expectations of family-manager and family members not involved into the business may vary and the clarification of these aspects is central in mitigating conflicts and sustaining trust.

The formalization regards main firms' goals setting (in the long and short ter zm), financial and non-financial: this formalization is crucial because it derives from the strategic vision of the business and implies the commitment of family managers in achieving that objectives (b-shareholders' expectations); family members with no managerial responsibilities could have some difficulties in controlling business's results.

Corporate governance prescribes rules and codes of conduct, which define the way to divide the power and responsibility of management and decision making process; in other words, it represents the system, which regulates business executives to run business in a way to meet the interests of different shareholders as well as all stakeholders, such as creditors, workers, and consumers (Berle and Means, 1932); in a narrow sense, it means internal control system to control business management through proper mechanisms such as internal corporate body, such as general shareholders' meeting, board of directors and auditors.

According to Davis (2007), effective governance allows to manage issues within and across three overlapping groups: the family, the business and the ownership group.



Source: Davis, 2007.

[Figure 1] The "3-circle" Model of FB

The overlap among the three groups leads to different points of view among individuals depending on their location in the three circles; different viewpoints must be reconciled in a respectful way to set direction for the company: effective governance should be helpful in

- creating a suitable identity for the owners;
- setting a sensible and motivating direction for the owners, business and family;
- maintaining discipline among the owners to help the business achieve and purse important goals.

Effective governance can reduce tensions in FBs by clarifying family-business-ownership needs and managing the conversations needed to agree on goal, values and policies. Usually, all these issues are translated into governance structures, such as shareholders meetings, family council, board of directors.

Considering the need of preserving shareholders' expectation (managers and non managers), the attention should go beyond formal governance rules (compliance) (Busco, Giovannoni and Riccaboni, 2007), taking into consideration mechanisms to monitor organizational performance. In this way it's possible to focus attention on effective governance: the latter can be defined as a balanced combination of structures, plans, policies, rules and decision making power that enables ownership group to play a constructive role in the FB system.

Performance is itself an ambiguous term, with no simple definition, depending on the main strategic goals identified by shareholders; the term doesn't specify to whom the organization is delivering its performance: at an organizational level we will assume that an organization that is performing well is one that is successfully attaining its objectives, implementing an appropriate strategy.

If we consider governance, a crucial ingredient in making it effective is the performance measurement system (Coda, 2002). The designing of such systems, in fact, requires the formalization of shareholders' expectations through the firm's goal setting (both for the long and the short term), financial and non-financial: the formalization of objectives and the commitment of family managers in achieving them can increase the level of trust by family members non involved into management, because there have explicit mechanism to control business's results.

Any controlled system requires objectives and goals against which its performance can be assessed; specifically, according to Otley (1999), the main issues that need to be addressed in developing a framework for managing organizational performance can be the follow:

1) what are the key objectives central to the organization's overall future success?
2) what strategies and plans has the organization adopted and what are the processes that it has decided will be required for it to a successful implementation? How does it measure the performance of these activities?
3) how does the organization set appropriate performance targets for each measure?
4) what reward managers gain by achieving the performance targets (or, on the opposite, what penalties will they suffer by failing to achieving them?)
5) what are the information flows (feedback and feed-forward mechanism) that are necessary to enable the organization to learn from its experience and to adapt its behavior?

As outlined before, these questions are very closely related to shareholders' expectations and involve management practices. Particularly, the first is concerned with the definition of goals and measurement of goal attainment, not just financially but also in term of meeting all shareholders' expectations.

The implementation of performance measurement systems should lead to effective governance, moving from compliance to accountability. While the respect of corporate governance standards and guidelines (compliance) is important because imposed by law, the commitment of managers (accountability) is crucial to achieve corporate objectives.

We must notice that compliance itself doesn't guarantee effective governance: the respect of formal rules must be accompanied by performance measurement system, able to control goal attainment and preserve shareholders' expectations.

Busco, Giovannoni and Riccaboni (2007) outline the importance of integrated governance: the system is based not only on compliance, but also on performance and knowledge. The constant application of performance measurement systems, transparency, clear guidelines on key issues governing family and non-family members provides the foundation for trust, that, at this point, we can define system trust.

As previously underlined, as the family business grows, interpersonal trust cannot be sustained without confidence in the system that governs key interpersonal exchanges. Performance measurement systems create an additional cognitive base for trust: starting from the initial interpersonal trust (based on kinship, familiarity, history, etc), it's possible to generate competence trust, that represents the belief that parties entrusted with a job are not willing but capable of performing the job effectively.

In a family context, those members who are not actively involved in the business seek to have confidence that those running the business system are capable of adapting to changing environmental needs. Such confidence can be fostered when the family business system is open to outside influences, including the presence of non-family members on the board and encouraging family members employed in the business to gain work experiences outside the family firm.

Ⅲ. Discussion

Supported by researches on familiness and trust, in this paper we offer an integrated view on how supporting the initial level of FBs' trust (competitive advantage for FBs) through operational mechanisms.

When a FB grows, trust embedded in the family firm in the early stage of life is often replaced by conflict and strife. Furthermore, in a family context, those members who are not actively involved in management need to entrust those running the business: they have be capable of adapting to changing environmental needs and preserving all shareholders' expectations.

The expectations of family-manager and family members not involved into the business may vary and the clarification of these aspects is central in mitigating conflicts and sustaining trust. The concept of trust is referred to the belief that parties entrusted with a job are not willing but capable of performing the job effectively.

In our work we assume that, in order to consider the need of preserving shareholders' expectation managers and non-managers), attention should go beyond formal governance rules (compliance), taking into consideration effective governance. The importance of effective governance is mainly connected to the need of reducing conflicts among shareholders.

Performance measurement systems make governance effective because they represents mechanisms to monitor organizational performance, taking into consideration clear guidelines on key issue governing family and non-family members.

The designing of performance measurement systems, in fact, requires the formalization of shareholders' expectations through the firm's goal setting (both for the long and the short term), financial and non-financial: the formalization of objectives and the commitment of family managers in achieving them can increase the level of trust by family members non involved into management, because there have explicit mechanism to control business's results.

The constant application of performance measurement system, transparency, clears guidelines on key issues governing family and non-family members provides the foundation for system trust: from the initial interpersonal trust, based on kinship, familiarity, history, etc, it's possible to move to competence trust, based on more cognitive basis. Competence trust is the type of trust needed when FBs grow and evolve.

Thanks to performance measurement systems, FBs can exploit the competitive advantage of strong trustworthiness not only in the early life stage; this sustained level of trust may indeed be a crucial basis for social capital, central in preserving FBs' competitiveness. From this point of view, sustaining and fostering trust in FBs can be a way to preserve competitive advantage.

The purpose of this study was to bring performance measurement perspective and associated research on trust into the literature on family business.

Ⅳ. Limitation and Further Researches

We need to address some limitations of our work that also offer future research opportunities. While we focus our attention on mechanisms, such as performance measurement systems, we didn't investigate governance structures, such as board of directors composition, shareholders' meetings, etc. Accordingly, future researches should investigate corporate governance structures and the implementations of performance measurement systems through empirical analysis.

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