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Blockholder Structures and power mechanisms in family firms

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Abstract

We extend the work of Fattoum-Guedri, Guedri and Delmar (2017) by suggesting that the number of family blockholders moderates the relationship between the distribution of voting power between family and non-family blockholders and firm performance. We argue that the participation of multiple generations of family members in the firm's ownership leads to greater diversity of perspectives that generates potential conflict over the distribution of resources. We highlight four power mechanisms to explain why family blockholders' conflicting and/or misaligned preferences and objectives might influence the nature of the negotiation between the family and the non-family blockholder and impact family firm performance.

Introduction

Focusing on blockholder structures within family firms, Fattoum-Guedri, Guedri, and Delmar (2017) show that a balanced distribution of voting power between family and non-family blockholder improves firm performance. They also demonstrate that the number of blockholder types moderates the positive relationship between a more balanced distribution of voting power and firm performance. We extend their work by suggesting that the *number of the family blockholders* (i.e. when various different family members hold blocks of shares) is another moderator of the relationship between blockholder voting power symmetry and firm performance. While the authors integrate principal-principal agency and familiness perspectives to support their study, we draw from power and negotiation theories (e.g., Kim, Pinkley, & Fragale, 2005; Wolfe & McGinn, 2005; Rubin & Brown, 1975) to explain the mechanisms through which the number of family blockholders works as a boundary condition for the hypothesis that a more symmetrical distribution of voting power among family and non-family blockholders is beneficial for firm performance. We argue that the participation of multiple generations of family members in the firm's ownership leads to greater diversity of perspectives that generate potential conflicts over the distribution of resources. We highlight four power mechanisms – potential

power, perceived power, power games, and realized power - to explain why the potential for conflict and misalignment of preferences, objectives and visions for the family firm among family blockholders may influence negotiations with non-family blockholders and, as a result, impact family firm performance. We draw on power and negotiation perspectives to explain the combined effect of both moderators (number of family blockholders and number of blockholders types) on the relationship under investigation. We offer directions for future research.

The moderating role of the number of family blockholders

We extend the work of Fattoum-Guedri et al. (2017) by arguing that the nature of the relationship between a balanced distribution of voting power between family and non-family blockholders and firm performance is conditional on the number of the family blockholders. We suggest that this positive relationship between voting power symmetry and firm performance is weaker as the number of family members involved in the ownership structure increases (e.g. from multiple generations and in-laws). The involvement of multiple generations in a business has the advantage of preserving tacit knowledge and transmitting family connections across generations (Miller & Le Breton-Miller, 2005). However, this advantage can erode as the number of family blockholders grows due to having to reconcile potentially conflicting interests and misaligned preferences (Miller & Le Breton-Miller, 2006; Schulze et al., 2003).

For the relationships espoused by Fattoum-Guedri et al. (2017) to hold, the assumption that family blockholders think and act as a unitary group of owners with shared interests is required. However, the family firm literature points to heterogeneity among group of family firm owners resulting “from the natural drift of families across generations and the resulting increase in the complexity of family

ownership over time” (Zellweger & Kammerlander, 2015:1281). This suggests that the participation of more family members in the firm’s ownership leads to a greater diversity of perspectives and undermines the ability of the family to exercise power as a unified blockholder group when it comes to negotiating with the non-family blockholder group over corporate strategies and the distribution of wealth created by the firm (Miller et al., 2013).

Consistent with power and negotiation theories (e.g., French & Rave, 1959; Kim et al., 2005; Wolfe & McGin, 2005), we claim that a context of conflicts and misaligned interests amongst family blockholders might redefine the *potential power* of the parties (Crozier, 1964). Changes in related *perceived power* of the parties creates the opportunity to perform *power games* to gain legitimacy and supremacy in order to extract benefits from their interaction (i.e. *realized power*) (Kim et al., 2005). Therefore, we argue that the nature of the negotiation between family and non-family blockholders when it comes to making decisions over the use of firm resources depends on four power mechanisms – potential power, perceive power, power games, and realized power. We analyze these mechanisms in turn.

Potential power. Within the power and negotiation literatures, potential power is defined as the capacity of negotiators to obtain benefits from their agreement (Kim et al., 2005; Wrong, 1968). Family blockholders’ potential power derives not only from their individual voting rights, but also from their ability to leverage the relative cohesion of the family to claim resources from their agreement with non-family blockholders (Pinkley, Neale, & Bennett, 1994). Resources can then be opportunistically diverted for personal use (Morck & Yeung 2003) or wisely employed to develop a unique competitive advantage (Habbershon & Williams, 1999). However, the presence of multiple divergent and potentially conflicting

perspectives among family blockholders changes their potential power as a group. While they can still count on their voting power, they are less likely to be able to act as a cohesive group to extract benefits in their favor; the family blockholders' capacity to exert power over non-family blockholders is therefore constrained.

Perceived power. Perceived power is defined as negotiators' assessments of a party's potential power in the relationship (Emerson, 1962; Kim et al., 2005). Perceptions of power emerge from a process of comparison: people compare their dependence on their counterpart with what they believe is their counterpart's dependence on them (Blau, 1964). If non-family blockholders are thought to be part of a stable coalition (Bennedsen & Wolfenzon, 2000) by family blockholders, then the former are perceived to be more powerful than family blockholders, whose cohesiveness is simultaneously threatened by the aforementioned conflicts and misaligned preferences. Perceptions of unequal power affect blockholders' motivation for negotiating and their subsequent behavior (Rubin et al., 1994). Negotiations can be adversely affected when the relatively high-power non-family blockholders can prioritize the satisfaction of their own interests over those of the family blockholders (Rubin & Brown, 1975). This dynamic has implications for the distribution of resources, which is likely to disadvantage the relatively less powerful family blockholders (e.g. Connelly, Hoskisson, Tihanyi, & Certo, 2010). It is important to highlight, however, that the absence of a stable coalition among non-family blockholders is likely to lead to a different outcome; an option that we discuss later.

Power games/tactics. Power games refer to negotiators' efforts to use or change the power relationship (Kim et al., 2005). Power-use tactics refer to the ways in which negotiators may attempt to leverage existing power capabilities (Lawler, 1992). For example, as claimed earlier, non-family blockholders can form a coalition to take

advantage of the conflict-laden situation that might characterize a family blockholder group that comprises many family blockholders. They can also engage in tactics of pressure, legitimation, exchange, ingratiation, rational persuasion, inspirational appeal, consultation, and personal appeal to obtain desired outcomes (Kipnis & Schmidt, 1983; Yukl & Tracey, 1992). In contrast, power-change tactics refer to the ways in which negotiators may attempt to alter the power relationship, typically to improve their own power relative to that of their counterpart (Lawler, 1992). For example, family blockholders may apply power-change tactics when they believe they do not hold enough potential power to satisfy their personal interests. However, before trying to alter their power against non-family blockholders, each family blockholder is likely to initiate power-change games within the family ownership.

When the ownership is characterized by several contentious family blockholders, their votes enable them to cancel one another's initiatives (Ward, 2004). To avoid this counterproductive exercise of power, some family members can engage in intensive sensegiving activities. Sensegiving activities consist of various tactics individual family blockholders can use to impose their particular worldviews on others and influence meaning construction of others toward a preferred redefinition of organizational reality (Smith et al., 2010; Gioia & Chittipeddi, 1991). While such sensegiving activities seek to enforce individual preferences by influencing key strategic decisions, these acts of persuasion can compromise the future of the family firm by challenging norms and values, and consequently, the family firm's very culture (Gephart, 1993). However, the forms of sensegiving and their effectiveness depend on the family blockholder's position in the prevailing power structure and in the family firm's given historical legacy (Drori & Ellis, 2011).

Realized power. Realized power is the extent to which negotiators extract benefits

from their interaction. Because the extraction of benefits is achieved through the implementation of power games, the type and magnitude of a negotiator's power game efforts directly influences the extent to which that party has realized power over the relationship (Kim et al., 2005). For example, to the extent that non-family blockholders are able to form a stable coalition and gain advantage over the family blockholder group, they can extract resources from the family firm to satisfy the interests of all shareholders (Connelly et al., 2010). Similarly, to the extent that family blockholders are influential in their sensegiving activities, they can extract resources from the family firm to primarily satisfy their own personal interests (Anderson & Reeb, 2004). This suggests that when power is unequal, the extraction of benefits from the interaction is primarily oriented to help the high-power parties achieve their goals and advance their interests at the expense of their counterparts (Rubin et al., 1994). As a result, when power is unequal, firm value creation and maximization may no longer be recognized as the shared primary goal.

In sum, drawing from power and negotiation theories, we argue that a larger number of family blockholders creates the conditions that might lead to the redrawing of power structures beyond those provided by formal voting rights. We suggest that the four power mechanisms can help explain changes in blockholders' motivations during negotiations and use of resources to satisfy their own interests at the expense of firm value creation. We conclude by claiming that this situation is likely to compromise the performance of the firm.

On the basis of the arguments outlined above, we suggest that the relationship between a balanced distribution of voting power among family and non-family blockholders and firm performance is contingent on the number of family blockholders. The presence of conflicting interests and misaligned preferences among

family blockholders triggers power mechanisms that increase the chances of divergence of blockholders' goals away from value creation and/or improvement of firm performance. Accordingly, we propose the following:

Proposition 1: *The number of family blockholders moderates the positive relationship between the symmetry of family and non-family blockholders' voting power and firm performance such that the positive relationship between voting power symmetry and firm performance will be weaker as the number of family blockholders increases.*

Given the potentially detrimental effects of a large number of family blockholders on firm performance, it becomes important to identify the conditions that help establish a more equal perception of power between family and non-family blockholders. To complement the work of Fattoum-Guedri et al. (2017), we suggest that a large number of non-family blockholder *types* might also influence power dynamics and negotiations. Similar to the arguments above in relation to the effects of having a larger number of family blockholders, multiple types of non-family blockholders are likely to compromise non-family blockholders' ability to behave as a stable and united group and leverage their cohesiveness against the potentially conflict-laden family blockholder group.

This potential for conflict among non-family blockholders due to the presence of multiple types likely influences the perception of negotiators' power. Having both lost the opportunity to exercise power as a unified blockholder group, family and non-family blockholders may be more likely to perceive themselves in an equal power relationship. When this happens, they are more likely to realize that there is a mutual dependence on one another. Negotiators come to recognize that helping their counterparts achieve their goals, will, in turn, advance their own interests (Rubin et

al., 1994). This instrumental concern for others as well as oneself limits the activation of hostile power games and redirects the motivation to negotiate in a manner that leads towards those outcomes that increase the opportunity to create common value (Rubin & Brown, 1975). For family and non-family blockholders, as the only common source of value is in relation to the family firm, we propose that in the circumstances outlined above (i.e. when both family and non-family blockholders are characterized by diversity), negotiations will be directed towards integrative solutions that seek to maximize firm value creation (i.e. firm performance). We argue that the number of blockholder types will in essence have a neutralizing effect on the number of family blockholders as a moderator of the relationship between blockholder power symmetry and firm performance. We therefore suggest that:

***Proposition 2:** A large number of blockholders type weakens the moderating effect of the number of family blockholders on the positive relationship between the symmetry of family and non-family blockholders' voting power and firm performance, such that the positive relationship between voting power symmetry and firm performance is more likely to hold when both the number of blockholder types and the number of family blockholders increase.*

Discussion and direction for future research

The work of Fattoum-Guedri et al. (2017) represents a step toward a deeper understanding of the complexity of ownership structures and control mechanisms within family firms. This commentary has sought to guide future researchers wishing to look beyond the formal distribution of voting power between family and non-family blockholders. Our propositions - built on power and negotiation literatures - emphasize the role of (potential) conflict among blockholders and the power

mechanisms such conflicts might trigger.

A logical step forward is to test these propositions. Consistent with Fattoum-Guedri et al. (2017), future researchers can deploy moderated hierarchical regression analysis to examine the relationship between voting power symmetry and firm performance, as well as the proposed moderating effects of the number of family blockholders alone and then combined with the number of blockholder types (Dawson & Richter, 2006). However, we also suggest that a qualitative study can help understand how conflict among blockholders might generate power mechanisms that redefine motivations and behaviors during negotiations. Qualitative approaches are needed to observe power games and sensemaking activities performed at the level of rhetorical, discursive or symbolic articulation of organizational reality. We encourage future scholars to look to exemplars like Drori & Ellis (2011) that seek to capture the contextual and contested nature of power games and sensemaking activities.

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