

Research: Family Firms Are More Innovative Than Other Companies

by Nadine Kammerlander and Marc van Essen

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Family firms aren't typically thought of as particularly innovative. More often, they're viewed as risk averse, traditional, and stagnant.

However, many family-owned businesses are among the most innovative in their industries. Consider Herr's Potato Chips and Enterprise Rent-A-Car. There are countless other examples of family firms that have brought innovations to market. We wanted to determine how

family firms actually compare to their nonfamily counterparts when it comes to being innovative. Our research, conducted with Patricio Duran and Thomas Zellweger, suggests the answer is not simple.

About the Research

We collected all available publications, working papers, and dissertations that compared family and non-family firms when it comes to their investments in innovation (in terms of R&D expenses) as well as their innovation success (in terms of introducing new products, patents, and patent citations). We conducted a meta-analysis of 108 empirical studies that focused on 42 countries during 1981 to 2012. Accordingly, we statistically investigated all the correlation coefficients reported in these studies by running several regressions and structural equation models; this allowed us to discern significant relationships between family control of a firm, its innovation input, and its innovation output, while controlling for a series of study-, firm-, and industry-related factors. This helped us understand the relationship between family control of a firm and its willingness and ability to innovate.

The findings, published in the *Academy of Management Journal*, show that family firms invest less in innovation than other firms (both public and private) that aren't family-owned. On average, family firms have a smaller R&D budget than other organizations of similar size, but that does not mean they are less innovative. On the contrary, our study found that family firms are more efficient in their innovation processes. For every dollar invested in R&D, they get more innovative output, measured by number of patents, number of new products, or revenues generated with new products. The level of innovation is higher in family firms.

Why might this be? We offer one explanation: Entrepreneurial families tend to concentrate their wealth in one or few firms – consider, for instance, the Walton family's huge wealth concentration in Walmart. These families are very cautious about investments, aiming to avoid any waste. Family firm owners can use their powerful shareholder positions to ensure

that managers engage only in prudent investments.

Their parsimony extends to their innovation process. In contrast to many other shareholders, family owners have the ability to make sure that money is invested in the right projects and that resources are employed in an effective way. Because of their long relationship with the firm, family owners typically have a deep knowledge of the industry, the firm, and its stakeholders. They also spend considerable time with the organization and communicate frequently with

employees, clients, and other stakeholders. Moreover, many family firms profit from their “family-like” culture and their close relationships with a handful of partners, from suppliers to customers, who can help these firms develop their creative ideas, products, and processes.

We also find that the “less input, more output” effect is stronger when family members not only own but also lead the company. In such cases there are fewer conflicting interests between the owners and managers. For instance, family owners and family managers are often aligned with regard to the time horizon of their investments as well as with their appetite for risk. A family CEO can be a valuable resource since they have grown up in the business, socializing in the firm’s network and becoming more familiar with the industry dynamics and the power distribution among competitors.

Yet this finding is not true for all family CEOs. Contrary to what we expected, our results show that firms led by later-generation family members are more innovative than other firms, while firms led by their founders are less efficient with regard to innovation. In other words, the latter spend more money on innovation but have less innovative outcomes. Based on existing theory on family firms, we argue that this is because the advantages of family firms build up over an extended period of time; they do not appear right away or when firms are led by first-generation members. In addition, one might argue that *groups* of dedicated owners, which most later-generation family firms have, are better able to identify and discard bad ideas, whereas founders may have largely unrestricted discretion to push risky ideas.

Findings from our study reveal that family firms, despite their risk aversion regarding investment, can build on many strengths in order to leverage their innovativeness:

Be a committed and informed owner. As Kammerlander and Ganter show in their case-based work on digitization in family firms, family owners can have a positive impact on firm innovation when they actively participate in the innovation process. They can support innovation by drawing on their personal networks and by sharing industry information with the employees they have worked with over decades. Owners can also foster innovation by allocating budget for long-term innovative projects.

To be able to effectively steer innovation processes, family firm owners need to be informed about what is going on in their organizations. They need to gather as much information on technology developments and customer demands as possible. One example of a committed and

informed family firm owner is Simone Bagel-Trah, chair of the board at Henkel, a multigenerational consumer goods firm where some 150 family owners (descendants of the founder Fritz Henkel) possess more than 60% of the company's shares. According to various interviews with the German press, Bagel-Trah is active in bundling the interests of the family and discussing them with company representatives on a frequent basis.

Use the family firm's culture to empower employees. One example of a trust-based family firm culture that fosters innovation is the manufacturing firm W. L. Gore and Associates. It gives employees one afternoon per week to come up with new ideas for improving processes and products, and it tries to foster an open, creative, and constructive exchange of ideas within the organization. One of the company's guidelines is: "If you haven't made a mistake this week, this means you haven't sufficiently tried to think outside the box." It also makes sure ideas are shared openly, without fear, across hierarchical levels and departments by holding cross-functional, cross-hierarchical meetings to exchange ideas.

We've found that other family firms facilitate encounters between the CEO and employees. While some innovative family firms formally schedule "idea exchanging" lunches with the CEO and employees, others invest in events, such as anniversaries and workshops, with the family owners and employees.

The CEOs of family firms that empower employees are also frequently in touch with employees – not only electronically but also in person. Many family CEOs we have talked to enjoy walking through their buildings and plants to exchange thoughts and ideas with their employees.

Leverage your trust-based external network. Research has shown that building on a small number of trusted sources can be effective for developing innovative and implementable ideas. When searching for new business models, for example, a German family business invites a diverse group of "friends" of the organization – internal and external managers, politicians, university professors, and other family firm owner-managers – to discuss ideas.

One Swiss family business hosts a yearly innovation competition among its suppliers. The winner, which is the supplier that comes up with the best idea for improving the business's products or services, is awarded with a certificate and a dinner with the firm's management team. The benefit for both sides is huge – the family firm receives valuable ideas and the supplier gets a reputation boost – while costs remain manageable.

Nadine Kammerlander is a full professor of family business and the director of the institute of family business at WHU – Otto Beisheim School of Management in Vallendar, Germany. Her research interests include entrepreneurship, innovation, governance, and family firms. Her work has been published in Academy of Management Journal, Academy of Management Review, Journal of Business Venturing, Entrepreneurship Theory and Practice, and Family Business Review, among others.

Marc van Essen is a full professor of Entrepreneurship and Innovation at the School of Management, University of St. Gallen. His research interests include comparative corporate governance, international business, family business, and meta-analytic research methods. His work has been published or is forthcoming in the Academy of Management Journal, Journal of Banking and Finance, Journal of International Business Studies, Journal of Management, Journal of Management Studies, and Organization Science.

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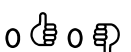
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