Patient Capital

The Role of Family Firms in Sustainable Business

Sustainable businesses create economic and social value while simultaneously protecting the natural environment for future generations. This examination of environmental sustainability through the lens of the family business identifies factors that help family and non-family organizations address the dilemma of balancing short-term productivity, efficiency, and profitability objectives, with innovating for long-term sustainable value creation. Exploring the case of the wine industry – an industry characterized by a variety of governance systems – Sanjay and Pramodita Sharma develop fresh insights into influences and drivers for proactive environmental strategies to address major global sustainability challenges. By doing so, the authors are able to demonstrate that family firms with a focus on transgenerational continuity of business, long temporal orientation, shared vision, faster decision-making processes, and the goal of preserving socioemotional wealth are more likely to make patient long-term investments for innovations in products, services, processes, and business models to address environmental sustainability challenges.

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Preface

Sustainable business is about the creation of economic and social value while simultaneously protecting the natural environment for future generations. Therefore, sustainable businesses not only generate economic, social and environmental value, but they also seek to be long-lived and resilient. Such enterprises face the challenge of balancing their short-term performance objectives while simultaneously making long-term patient investments in the future. A major challenge for the achievement of such a balance is a focus of publicly listed companies on short-term financial performance and quarterly reporting and financial analyst scrutiny in response to the expectations of capital markets. These short-term financial results impact the performance of the firm's share value and executive compensation for the top management team of the firm. While the short-term focus certainly has positive impacts on efficiency and productivity improvement, it is often attributed as a reason for the discouragement of investments in radical innovations in clean technologies and business models. This is because such sustainable investments more often than not require patience and a long-term pay back and competitive advantage in the unknown future while having the potential to affect short-term financial results or cash flows negatively.

An important question that researchers in corporate sustainability and organizations and the natural environment seek to address is *how can organizations address the dilemma of balancing short-term productivity, efficiency, and profitability objectives, with innovating for long-term sustainable value creation?* We address this research question by comparing and contrasting organizations with two different governance systems:

1) Firms with dispersed ownership, public listing in capital markets, and in which the relationship between the top management and the firms' owners is guided by an employment contract and agency; and

2) Family firms with an overlap of ownership and management and closely held control by a group of individuals with kinship ties.

In both types of firms, the controlling shareholders' and investors' goals and preferences guide the strategic orientation and resource allocation decisions of the managers. While institutionalized control dominates the mind-set of contractual managers, personalized control guides family firms (e.g., Carney, 2005). In contractually driven firms, delivering on short-term financial performance objectives is not only critical for an organization's relationship with its shareholders, but is also important for the career progression of its top managers since their quarterly and annual performance evaluation is tied to stock prices and a major portion of their compensation includes stock options. The short-term orientation aligns the preferences of the controlling shareholders and firms' top managers.

In sharp contrast, in family firms guided by a relational contract based on an overlap of ownership and management, the primary organizational goal is often the survival and sustainability of the enterprise *to create value for the future generations of the controlling family*. Although such firms certainly cannot afford to ignore the achievement of short and medium-term economic objectives, investment of resources to build valuable capabilities for future business, entrepreneurship, and long-term value creation by succeeding generations is equally, if not more, important.

These insights are not entirely new. Behavioral researchers have differentiated between contractual and relational contracts (Clark and Mills, 1979; Gagné, Sharma and de Massis, 2014), while strategy scholars have made inroads to understanding the agentic vs. stewardship mind-sets (Schulze et al., 2001). Nevertheless, with some notable exceptions (e.g., Berrone et al., 2010; Gómez-Mejía et al., 2011), most of the research in both literatures is focused on contractual and agentic issues. We argue that this inherent bias in the literature is divorced from the realities of a large majority of enterprises (family owned and controlled firms) that dominate between 70 percent and 90 percent of most global economies in number and also in terms of the share of the GDP. Hence, the literature is incomplete in its usable knowledge to help resolve the dilemma of balancing short-term and long-term performance and investments for business organizations and achieving societal goals of meeting global sustainability challenges such as clean air, clean water, preservation of diversity of life and species, and protecting natural habitats on which mankind relies. Without understanding decision-making processes in a major sector of the world's most developed as well as developing economies, namely, family firms guided by relational and stewardship mind-sets, it is difficult to generate comprehensive knowledge of the factors that enhance or inhibit the development of sustainable businesses that simultaneously create economic, social, and environmental value in the short- and long-term.

In this monograph, we address this gap by comparing and contrasting strategic decision-making for sustainable innovation in family and non-family firms. Family enterprises create the bulk of economic and societal value in most economies and contribute to maintaining sustainable environment and communities (Astrachan and Shanker, 2003; La Porta, Lopez-de-Silanes and Shleifer, 1999). Firms in this major sector of the economy are more often, albeit not always, guided by the relational contracts and stewardship mind-set (Miller and Le Breton-Miller, 2005). Yet, in spite of their ubiquity, depth of impact on the economy or society, and a greater likelihood of community and environmental rootedness, these enterprises are an under-researched context in the sustainability literature (Dyer Jr. and Whetten, 2006; Sharma and Sharma, 2011; 2018).

Just as there are major differences between non-family corporations in their sustainability strategies (Àragon-Correa, 1998; Russo and Fouts, 1997; Sharma and Vredenburg, 1998), not all family firms are equally motivated to build capacity for creating sustainable value by preserving natural capital and contributing to social welfare and their communities (Delmas and Gergaud, 2014; Marques, Preses and Simon, 2014). Family firms are also heterogeneous in their strategies and missions (Ward, 1987; Westhead and Cowling, 1998). In this monograph, we also seek to understand the factors that lead to such differences not only among publicly held corporations with diffused ownership but also among family firms where ownership is concentrated with a kinship group. That is, we identify drivers of patient long-term investments in a proactive environmental sustainability strategy in family firms.

To limit the literature and scope of the phenomenon to be studied, *we focus only on environmental sustainability* since the social sustainability and corporate social responsibility literature is substantial and merits another monograph by itself. We identify factors that help and hinder investments of resources by family and non-family firms to build their capacities for long-term sustainable value creation. For such comparisons, it is important to control for external variation in the industry and the institutional environment. Thus, we supplement our theoretical analysis with data from one setting – the winery industry in three countries. This industry is characterized by a variety of governance systems: multi-generational family firms, first-generation family firms, corporate-owned wineries, and lifestyle wineries. Hence, it allows comparison of sustainability drivers and practices across different governance systems. The theoretical arguments presented are illustrated by multiple research interviews and archival data from over twenty-one wineries in Canada, the United States, France, and Chile, supplemented by secondary data from archival material from eleven other wineries. The data are woven into our review of extant literature and theory development to offer our framework, propositions, and recommendations for the unique characteristics of family firms that can be useful guides for organization design and change for non-family firms seeking to develop an effective proactive environmental strategy via innovations, technologies, and business models based on patient long-term investments.

This monograph fills a gap in the sustainability literature by presenting fresh insights for sustainability scholars, family business scholars, practitioners, and policy makers to better understand drivers that help firms balance their short-term goals with long-term sustainable investments. Simultaneously, it casts new light on why some family firms do better than others in building capacity to pursue long-term orientation and trans-generational sustainable value creation. We have enjoyed the process of researching and writing this monograph and hope that the readers will find ideas that stimulate empirical research projects, organizational and strategic change, and policy changes for unleashing the power of business for a sustainable planet.

August 2018

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