Can Family Firms Innovate? Sharing Internal Knowledge From a Social Capital Perspective

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Abstract: Many studies focus their analysis on the effects of knowledge management on the development of organizational innovations. Innovation is posited, in this paper, to be a managerial priority that facilitates the creation of competitive advantage. The data, information and knowledge that contribute to innovation processes are available in social capital. Social capital is understood as the networks, norms and trust that enable participants to act together more effectively to pursue shared objectives (Putnam, 1993). From this foundation, we argue that the effectiveness of these networks can be determined by whether the personnel who interact perceive the relationship to be worthwhile, equitable, productive and satisfying. Only individuals can apply their own experience and contextual understanding to interpret the details and implications of a particular situation in order to determine what is the appropriate action or actions to take. Internal social capital enhances the ability of members within a firm to know who to contact for relevant knowledge. This means that internal social capital facilitates the development of innovation through the acquisition of knowledge from internal and external networks. However, there are some problems in family firms. The utilization of internal capital does not guarantee that appropriate information is used in appropriate circumstances or that information is appropriately updated (De Holan and Phillips, 2004). The influence of the family on the company may inhibit or foster the exploitation of this knowledge. In this context, we try to test the influence of social capital on innovation on family firms. We develop a measure of the extent of family control of family companies – familiness – and examine the moderator role of this variable in the relationship between social capital and product innovation. The results of our empirical study of 282 family firms show that social capital has a positive relationship with product innovation. That is, the active connections among people – "the trust, mutual understanding, shared values and behaviors that bind the members of human networks and communities and make cooperative action possible" (Cohen and Prusak, 2001) – allow companies to generate innovations. Second, we also found that familiness plays a moderator role in the relationship between social capital and innovation. In this case, we have found that cultural dimension of familiness positively moderates the relationship between social capital and innovation.

Keywords: social capital, familiness, power, experience, innovation, family business

1. Introduction

The importance of social capital as a determinant of innovation has received much theoretical attention over the last few years. Social capital theory argues that specific elements of external and internal social relationships provide valuable learning resources (Adler and Kwon, 2002), which may be essential for developing innovations. Certain relationships between employees contribute to enhance the firm's ability to identify and develop innovation opportunities that could not be identified and developed otherwise. However, family firms are clearly conditioned by family spirit. A rather new but key concept for understanding the family business is ''familiness''.

This paper suggests that the relationships among the members of family firms could foster the development of innovations, although this relationship could be conditioned by the family that owns the firm. However, empirical research is scarce, not only regarding this proposition but also in relation to innovation and entrepreneurship in family firms.

2. Background literature

In recent years, there has been an increasing interest in studying family firms because they are the predominant enterprises worldwide (Littunen and Hyrsky, 2000) and because they play an important role in economic development, in creating employment and in improving our quality of life.

Innovation has been conceptualized in a variety of ways in the literature. The definition of Damanpour et al. (1989) broaches these different issues. They understand innovation as "the adoption of an idea or behavior, whether a system, policy, program, device, process, product or service, that is new to the adopting organization". Small and medium-sized enterprises are mostly family owned in many economies (Dunn, 1996). Like other firms, in order to be competitive and even to survive, family businesses have to be innovative. They can be more innovative and aggressive in their markets due

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to their relatively smaller size, greater local market knowledge and relative financial independence compared to very large national companies (McCann et al., 2001). However, they are often introverted, burdened by old traditions, inflexible and resistant to change.

2.1 Social capital

The concept of social capital has recently been applied in a wide range of organizational studies, in the context of both inter- and intra-organizational relationships. Social capital is essentially the sum of resources that a firm accrues by virtue of possessing a durable network of inter-firm relationships (Nahapiet and Ghoshal, 1998). It has been understood as the aggregate of the actual or potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance and recognition (Bourdieu, 1983). Social capital represents the ability of firms to secure benefits from networks. These benefits can include access to knowledge, resources, technologies, markets and business opportunities (Inkpen and Tsang, 2005).

Social capital has been considered as an asset of an individual (Bourdieu, 1983) or of the firm (Subramaniam and Youndt, 2005; Tsai and Ghoshal, 1998). Since social capital is a result of interaction between an organization and its external agents, social capital can also be categorized as internal and external (Kim and Cannella, 2008). While external social capital belongs to internal and external agents respectively, the internal social capital consists of the trust and common visions, which are systematized and internalized by the organization, remaining with the firm even when specific agents have left. By firm-internal social capital we refer to the extent and quality of relationships between individuals and units within a given firm.

According to Nahapiet and Ghoshal (1998), social capital is the aggregate of resources embedded in, available through and resulting from the network of relationships held by a firm. They identify structural (the configuration of linkages and overall pattern of connections in a set of relationships), relational (level of trust and relational dependence) and cognitive (shared expectations, interpretations, and systems of meaning) dimensions of social capital.

Several scholars propose that social capital facilitates the development of a distinctive knowledge base, thereby providing a basis for the creation of organizational advantage (Yli-Renko et al., 2002). Since social capital encompasses norms and trust, but also include social networks, both formal and informal, social relations among employees of an organization are of considerable importance in the product innovation process. Hsieh and Tsai (2007) also suggest that social capital is associated positively with the launch strategy for innovative products.

The social relations and confidence between employees has a positive relationship with product innovation (Tsai and Huang, 2008). High levels of trust are more likely to stimulate innovation (Knack and Keefer, 1997). The interchange of ideas and knowledge between employees fosters product innovation (Subramaniam and Youndt, 2005), since a richer firm-internal communication contributes to a faster build-up of new technological knowledge (Kogut and Zander, 1992). As for networks, they emerge as actors develop reliable and effective communication channels across organizational boundaries (Le Bas et al., 1998). In this case, the extent to which people share a common language facilitates their ability to gain access to people and their information (Nahapiet and Ghoshal, 1998). Confidence, mutual respect and a shared vision among employees promote learning and innovation (Wu et al., 2008). In consequence, we propose that the relationships among organizational employees facilitate the development of product innovations. Thus, we hypothesize:

H_1. There is a positive relationship between social capital and innovation.

2.2 Familiness

Family businesses possess a unique bundle of resources created by the interaction of the family and the business. The interaction between the family and the business may affect how resources are managed and deployed in family firms (Sirmon and Hitt, 2003). Family firms have resources and capabilities that are not available to non-family firms. The unique bundle of characteristics is created by the interaction of the family and the firm, referred to by Habbershon & Williams (1999) as the “familiness” of the firm. Familiness is caused by the family presence in the structures of power, experience, and the affinity between the existing culture in the family and the culture within the business (Klein et al., 2005).

In recent years, research by Gómez-Mejía and colleagues (Gomez-Mejia et al., 2000, Gomez-Mejia et al., 2007, Berrone et al., 2012) has provided overwhelming evidence that family firms make choices depending on the reference point of the firm's dominant principals. These principals will make decisions in such a way that they preserve the "socioemotional wealth in family firms", consisting of the "affective endowment" of family owners, including the family's desire to exercise authority, enjoyment of family influence, maintenance of clan membership within the firm, appointment of trusted family members to important posts, retention of a strong family identity, continuation of the family dynasty, and so on (Gomez-Mejia et al., 2007). Thus, the development of sustainable competitive advantages in the family business is influenced by the family involvement in business or familiness, and involves the development of important resources such as the innovative capacity or social capital. It is therefore expected that:

H_2. Familiness moderates the relationship between social capital and innovation.

Family involvement, or familiness, is determined by the family power, experience and culture. The first dimension refers to the control and influence of family members in the power structures of the company. The power to control can be exerted directly, such as when a family member is CEO or chairman of the board, or more subtly by, for instance, appointing family members to the senior management team. Control can be exerted by the original founder or by a dominant family coalition.

Relying on the arguments outlined, family firms tend to be disadvantaged in developing innovative capabilities, since family firms are ill-equipped to build such capabilities, their financial resources are more limited, and/or their family members are overly concerned with wealth preservation, and thus limit their investments (Carney, 2005). Creating innovative capabilities requires extensive investment in R&D and technological diversification, and it usually forces the family to establish business associations, or cede some ownership to parties outside the firm, such as venture capitalists or institutional investors. On the other hand, research suggests that family firms tend to lack innovative capacity since they are more likely to maximize their profits by investing in political rent-seeking behaviour than in innovation (Ellington et al., 1996, Morck and Yeung, 2003, Morck and Yeung, 2004). The tendency not to adopt innovative capacity is increased by family presence in the power structures of the company, since it increases the interest in preserving family social capital and the socioemotional wealth of the family business. It is therefore expected that:

H_{2a}. Family power negatively moderates the relationship between social capital and innovation.

The family experience, understood as the information, knowledge, judgment and intuition that comes through successive generations affects the company's innovative capacity (Beck et al., 2011). Family firms in different generational stages differ in their innovation-oriented culture. The empirical study of Zahra (2005) emphasizes that family firms have a more innovation-oriented culture when later generations are involved in the management of the firm. An innovation oriented culture has an emphasis on creativity (Hurley and Hult, 1998), and creativity facilitates innovation (Amabile et al., 1996, Prajogo and Ahmed, 2006). This consequently has a positive influence on the family firm's innovative ability. In addition, later generations are often characterized as the drivers behind innovation (Litz and Kleysen, 2001) and the identifiers of entrepreneurial opportunities (Salvato, 2004). They also tend to push for new ways of doing things (Kepner, 1991).

Although the long-term view might suggest some undesirable consequences, such as managerial entrenchment or conflicts over succession, it is well established in the family business literature that the preservation of the firm, the perpetuation of family values through the business, and the intention to pass the business to subsequent generations foster a generational investment strategy that creates capabilities, on a base of social capital, preserves the socioemotional wealth and promotes learning or family experience (Berrone et al., 2012). Therefore, we propose the following hypothesis:

H_{2b}. Family experience positively moderates the relationship between social capital and innovation.

Family culture is an important strategic resource that family firms can use to gain competitive advantage. Family culture refers to the coherent pattern of beliefs and values that represent acceptable solutions to major organizational problems for the family (Dyer, 1988). It is the alignment of the family's goals with the firm's goals (Rutherford et al., 2008). Several characteristics unique to family businesses increase the significance of family culture as a strategic resource. Owners and managers are often one and the same, mitigating the problem of alignment of goals of principal and agent (Daily and Dollinger, 1991). This alleviates concerns about opportunistic behaviour by agents (Schulze et al., 2001) reducing the need for contractual controls and monitoring, and increasing reliance on social controls such as trust (Steier, 2001). Reduced reliance on formal controls and coordination increases the importance of a firm's culture as a key determinant of its behaviour.

Strengthening the family culture favours the development of family's social capital, with increased socioemotional wealth. In particular, the family culture promotes the identification of family members with the firm, binding social ties and emotional attachment of family members, characteristic features of family capital social (see Berrone et al., 2012, Hoffman et al., 2006). It is therefore expected that:

H_{2c}. Family culture positively moderates the relationship between social capital and innovation.

3. Methodology

3.1 Data collection and sample

When approaching the study of family businesses, it is necessary to establish a rigorous and academically accepted definition (Monreal et al., 2009). To do this, we have relied on the official definition used by both the European Group of Family Enterprises (FATF) and the Family Business Network (FBN). This definition indicates that a company is a family company, regardless of company size, if most votes are the property of a person or persons in the family that founded the company and at least one representative of the family participates in the management or governance of the company.

From this definition various statistics arise. The Family Business Institute in Spain has a membership of over 2.9 million firms, or half the family businesses in Spain, as 85% of Spanish companies are family businesses. In terms of employment, they account for 75% of private employment, employing more than 13.9 million workers. The total turnover of family businesses is 70% of Spanish GDP.

In order to establish the population of family businesses, as there is no reliable business census that distinguishes clearly between family and non-family firms, we used the database SABI (System of Iberian Balance Analysis) in this work. From this database, we have selected those companies with more than 20 employees and less than 250 employees. This produces a final sample of 500 companies from a population of 10,412 companies, among which 254 family firms have been identified, representing a response rate of 100% and an overall sampling error of 4.74% for a confidence level of 95.5% and p = q = 0.5. The information was collected by conducting telephone surveys addressed to the CEO / manager. The objective was to ensure the highest possible quality and reliability of the data. A questionnaire was used for the interviews, and consists of closed questions, designed on the basis of a detailed analysis of the research literature.

3.2 Measures and measurement properties

Innovation: Organizational innovation has been measured in a variety of ways in previous research. However, innovation has to do with outputs (e.g. new products or processes). We used the items from the study of Nasution et al. (2011) relating to changes in the products or services. Confirmatory factor analysis suggests the use of four items to measure product innovation (ρcSRE=0.89, ρcAVE=0.67).

Social Capital: To evaluate the social capital we followed the recommendations of Hoffman et al. (2006), Danes et al. (2009) and Sorenson et al. (2009). Four factors shape the creation and development of family social capital (Danes et al., 2009): stability, interaction, interdependence and closure. "Together, these four factors affect the flow of social capital that, in turn, influences social capital stock. Alterations in any of these factors will likely impact social capital stock over time" (Arregle et al., 2007). We used one item for each factor. The confirmatory factor analysis (Table 1) suggests the use of four items to measure product innovation (ρ_c^{SRE}=0.89, ρ_c^{AVE}=0.67).

Familiness: We have used the F-PEC as a measuring device, following the method proposed by Rutherford et al. (2008). The original scale of F-PEC was modified by Astrachan et al. (2002), tested by Klein et al. (2005) and validated by Holt et al. (2010). We have identified three dimensions of family influence: (1) the power or influence of family ownership and management on the company (2 items; ρ_c^{SRE}=0.66, ρ_c^{AVE}=0.54), (2) the experience of successive generations of family involved in the business (2 items, ρ_c^{SRE}=0.80, ρ_c^{AVE}=0.68), and (3) family culture, or alignment of values and goals of the family with the business (eight items; ρ_c^{SRE}=0.88, ρ_c^{AVE}=0.60).

To assess the unidimensionality of each construct of innovation and performance, a confirmatory factor analysis of the four constructs was conducted (Anderson and Gerbing, 1988). The measurement model provides a reasonable fit to the data [$\chi^2(136)=152.56$ (p=0.00), NFI=0.93, TLI=0.97, CFI=0.98, IFI=0.98, MFI=0.92, GFI = 0.94, AGFI=0.91, SRMR=0.04; RMSEA=0.04]. The traditionally reported fit indexes are within the acceptable range. Reliability of those measures was calculated with Bagozzi and Yi's (1998) composite reliability index and with Fornell and Larcker's (1981) average variance extracted index. For all the measures both indices are higher than the evaluation criteria of 0.6 for the composite reliability and 0.5 for the average variance extracted (Bagozzi and Yi, 1998). Furthermore, discriminant validity is indicated since the average for every construct is higher than the square estimated correlation parameter between each two constructs (Fornell and Larcker, 1981).

4. Results

For our final set of analyses, we performed regressions with all factors of family social capital as independent variables and innovation as dependent variable. Table 1 records the final model F-value, the adjusted R^2, the regression coefficients β, and the p-values for the independent variables.

These analyses revealed that a particular social capital factor was always significantly related to innovation, and this supports H_1. In this case, our results suggest that the social relationships of the organization's employees foster the development of innovation in these companies.

Also we have found interesting results when familiness is incorporated in a second model. In this case, we have found that only one factor of familiness, culture, explains the generation of innovations. In this case, social capital contributes to explaining innovation. The main reason is that innovation is conditioned by social capital and the culture fostered by the family firm. Thus, if a family firm promotes an organizational culture that fosters individual work and productivity, and penalizes employees' mistakes, it will not promote the sharing knowledge, cooperation or teamwork.

However, we found positive moderator effects of social capital with family experience. Our results show that social capital can be a vehicle for developing innovation in those family owned firms where the managers believe in and pursue innovation objectives.

Table 1: Hierarchical multiple regression analysis

Model	Independent variable	Model F value	Adj. R^2.	Increm. Adj. R^2.	Standardized β	t
1	Social capital	19.42***	0.07	0.07***	0.27	4.41***
2	Social capital	8.46***	0.12	0.05***	0.19	2.89***
	Power				-0.02	-0.34
	Experience				0.05	0.87
	Culture				0.23	3.58***
3	Social capital	5.64***	0.14	0.02*	0.2	3.03***
	Power				-0.02	-0.3
	Experience				0.03	0.49
	Culture				0.23	3.28***
	Soc.Cap*Power				-0.08	-1.34
	Soc.Cap*Experience				0.11	1.89*
	Soc.Cap*Culture				0.02	0.36

Dependent variable: Innovation; *** p<0,01; ** p<0,05; * p<0,1

5. Conclusions

Family firms are characterized by be managed by a family. But the most interesting characteristic is that these companies try to survive and transmit their business to their own family descendants. This requires that the company adapt to organizational changes and, consequently, innovate. In family firms, innovation is important since it enables them to be passed on to later generations (Beck et al., 2011).

A review of the literature shows that innovation needs a learning process that allows companies to generate new knowledge and provides fresh ideas for generating innovations. However, this process requires the participation of employees and their relationships with their partners. Since individual learning, although valuable, is not sufficient to guarantee success in new product development, employees must share resources and knowledge with other employees in the organization. From a social capital perspective, and focusing in this paper on internal relations, innovation can be supported.

Our results show, on the one hand, that social capital has a positive influence on product innovation. This suggests, that the interaction between employees generates common understanding and creates new knowledge that is useful in each phase of the development of innovations.

On the other hand, there is the influence of the family on these social relationships. Depending on the organization's familiness, family firms facilitate or inhibit the contribution of social capital to the generation of innovations. Specifically, we found no evidence that family power or experience explain product innovations. This result is similar to the findings of other studies that have not found a positive relationship between family firms and innovation (Wu, 2008, Gudmundson et al., 2003). However, the culture of the family firms has a positive influence on innovation, reinforcing the idea of the importance of an organizational culture for innovation (Naranjo-Valencia et al., 2011). Furthermore, the analysis of the moderator effects of the familiness factors on the relationship between social capital and innovation reveals that only family experience fosters this relationship. An explanation for this result is the avoidance of risk-taking behavior in first-generation family firms (Kellermanns et al., 2008), so gathering external information about current customers and their current needs is more appealing to them. In addition, because of changing environmental conditions during the internal orientation and risk-averse behavior of first-generation family firms, later-generation family firms need to reinvent themselves and go beyond the legacy they inherit.

Nevertheless, this study has some limitations. First, the survey used single informants as the source of information. Although the use of single informants remains the primary research design in most studies, multiple informants would enhance the validity of the research findings. In order to get round this limitation, analyses have tested for the presence of possible common methods variance caused by collecting data from a single informant in each firm. The results confirm that there is no single factor with an eigenvalue greater than one (Podsakoff et al., 2003). A second limitation is the cross-sectional design of this research. Thus, researchers should interpret with caution the causality between the constructs (Tippins and Sohi, 2003). Future research should use longitudinal studies and the inclusion of others individual characteristics of the founders of family businesses.

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