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Family Firms and the Contingent Value of Board Interlocks: The Spanish Case

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Introduction

In the last three decades, interlocking directorates have become a prominent area of research in the Corporate Governance literature. An interlocking directorate is created when a person affiliated with the board of directors of one organization sits on the board of another organization (Mizruchi, 1996). Over the years, researchers have studied the embeddedness of commercial banks, insurance companies and industrial corporations in the interlocking directorates (e.g., Davis and Mizruchi, 1999; Davis, Yoo and Baker, 2003; Mintz and Schwartz, 1981; Windolf, 1998). Furthermore, scholars have sought to provide direct evidence of the value that interlocking directorates have for corporations. Previous studies showed that interlocking directors affect organizational learning (see, e.g., Haunschild, 1993, 1994), the corporations' power and status (e.g., Davis and Robbins, 2004). Resource dependence theory argues that firms use board ties to manage their resource interdependencies (Pfeffer and Salancik, 1978), for instance, when banks directors sit on the boards of the companies to which they have lent financial resources (Davis and Mizruchi, 1999; Mizruchi, 1996). However, most studies on interlocking directorates have studied primarily US-based public companies and neglected the role of family firms in these networks.

While public firms are diffusing more and more, families still control large chunks of the economy in many countries. Over 60 percent of the 17 million businesses in Europe are family businesses. These firms

employ 80 percent of the total private sector workforce, representing more than 100 million employees. Their contribution to national GNP lies between 40 percent and 65 percent (GEEF, 2005). In Spain, family firms contribute about 60–65 percent to GDP, represent more than 1.5 million firms, and provide more than 80 percent of private employment (Jaskiewicz, Gonzalez et al., 2005).

Even in the United States, family firms are alive and well. Several recent studies show that family firms are at least as common among public corporations as are widely held and other non-family firms (Anderson and Reeb, 2004; Villalonga and Amit, 2006). More than 75 percent of American corporations are family-owned or controlled and one-third of the Fortune 500 companies are family firms. In the US, family businesses account for some 57 percent of employment as well as a similar percentage of the US GDP (Heck and Stafford, 2001).

Whether family firms play a role in the weaving of corporate networks is still an open question, and one that can potentially limit the applicability and relevance of some of the evidence gathered in 20 years of research on corporate interlocks. It seems therefore critical to address this gap by exploring the role of family firms in interlocking directorates. As a first step in this direction, we explore the structure of the interlock networks of the 396 major Spanish firms and focus on the position of family firms in this network.

Even though family firms appear to be quite common in Spain across a broad range of industries and regions, the embeddedness of family firms in the Spanish interlocking directorates is an issue that remains unexplored. Previous research on Spanish Interlocks had mainly focused on the role of industrial corporations, banks, privatized firms and utility companies in the interlocking directorates (Aguilera, 1998; Salvaj and Ferraro, 2005) without considering the role of family firms in the interlocks. Our study provides evidence that family firms are, on average, less central in the Spanish corporate network. Furthermore, the interlocking directorate of family firms is sparse. That is, there are very few directors who sit simultaneously on two or more boards of family firms. Nevertheless, the network of the top 20 family firms by betweenness centrality is more densely connected, thanks to the role of independent directors who sit on the board of both family and non-family firms.

The next section reviews the literature on interlocks. Subsequently, the data, method and results of the present study are presented. Finally, we develop propositions that can explain why we would expect family firms to connect through interlocking directorates.

Embeddedness through interlocking directorates

The concept of embeddedness refers to the actor's relative depth of involvement in the social structure (Granovetter, 1985, 1992). This perspective postulated that the structure of social relations in which a firm is embedded has an impact on its performance because this structure provides both opportunities for and constraints to its action. Researchers have explored the embeddedness of banks and big industrial corporations through the interlocking directorates. An interlocking directorate is created when a person affiliated with the board of directors of one organization sits on the board of another organization (Mizruchi, 1996). Consequently, the embeddedness of one organization in the corporate elite comes from being tied to other boards through shared directors. For instance, based on US data in 1962 and 1966, Mintz and Schwartz (1981) found that at the centre of the US interlocking directorates were major New York commercial banks and insurance companies. Davis and Mizruchi (1999) examined how the position of banks in the intercorporate network has changed as a result of their increasing role as financial intermediaries in the US economy and their reduced reliance on the corporate lending business. An analysis of comprehensive data on the boards of the 50 largest banks, and their connections with several hundred largest non-bank corporations from 1982 to 1994, shows that the centrality of banks has significantly declined over the years. The key driver of this shift, they argue, is financial disintermediation, that is, the fact that corporations were financing themselves primarily on the stock market, and therefore banks were not lending directly to them, and therefore did not need to control the use of these resources by sitting on the boards of the borrowing corporations.

In a study of Spanish corporate networks, based on the analysis of director interlocks among the 100 largest industrial corporations, 50 largest banks and 30 largest insurance companies in 1993, Aguilera (1998) concluded that Spanish domestic banks coupled with utility companies were located at the core of the interlocking directorates; capital intense industrial corporations belong in the inner circle of the network, while foreign-owned and light industry enterprises are isolated in the network. Salvaj and Ferraro (2005) investigated the structure of corporate relationships of the 35 major public Spanish firms in 2002. They found that utilities and privatized companies were now at the core of the interlocking directorates of the IBEX companies. Their results show that banks were not central in the interlocks anymore. Only Banco Santander remained at the core of the interlocking directorate. This finding is

consistent with the trend towards financial disintermediation most European countries experienced in the 1990s, and the associated shift towards retail banking in the banking industry.

The reason why scholars have studied the structure of interlock networks and the position each firm occupies in these networks stems from the evidence that this position affects many critical corporate decisions. Scholars demonstrated that interlock networks affect organizational learning, the imitation of practices among firms and the status and the legitimization of corporate actors. Interlocking directorates are potential sources of learning and diffusion of knowledge (McDonald and Westphal, 2003; Powell, 1990; Uzzi, 1996). Board members are involved in the most critical corporate decisions, so it makes sense that their experience at other firms will be brought to bear on the firm's own decisions. The process through which direct ties among directors might affect the diffusion of corporate practices starts with the monthly meetings of the board of directors. If one or more individuals are board members of more than one company, and both boards meet every month, then a corporate governance reform or a new strategy discussed at a board meeting could in five months make its way via face-to-face contact to almost all the boards of the largest corporations. Monthly meetings and dense local networks provide an ideal situation for the diffusion of practices, strategies and rumors (Davis, Yoo and Baker, 2003). Several studies show that interlocking directorates work as mechanisms for the diffusion of information, knowledge and corporate strategies. For instance, Geletkanycz and Hambrick (1997) found that top managers who held board appointments in different industries were more likely to initiate strategic change in their own firms after learning about new strategies in other industries. Haunschild (1993) showed that executives from the focal firm imitate the acquisition activities of the other firms to which they are tied through interlocking directorates. Westphal, Seidel and Stewart (2001) examined whether interlocking directorates facilitate second-order imitation, in which firms imitate an underlying decision process that can be adapted to multiple policy domains, rather than imitating specific tied-to-firm policies (first-order imitation). They found that firms that have board network ties to firms in other industries that imitate their competitors' business strategy are more likely to imitate their own competitors' business strategy, as well as their competitors' acquisition activity and compensation policy.

Interlock networks not only affect whether corporate decisions are indeed adopted, but also the quality of these decisions. Haunschild

(1994) investigated the effects of inter-organizational relationships on the decision of how much to pay when acquiring another company. Her findings suggest that top executives look at both their interlock partners and professional firms when deciding how much to pay and, in the case of interlocking directorates, this impact is stronger when managers are uncertain about the value of the acquisition target. Beckman and Haunschild (2002) found that firms embedded in interlocks with heterogeneous partner experience pay lower premiums than those in networks with homogeneous partner experience. They found several types of partner heterogeneity to be important: firms pay lower premiums when their interlock partners pay diverse premiums, when they have diverse networks, experience with acquisitions of various sizes, and when the interlock partners are themselves of diverse sizes. These types of diversity provide a wide array of information that helps corporations make better causal inferences. When firms are embedded in interlocking directorates composed of partners with heterogeneous experiences, they are not imitating. Rather, they are improving on partners' experiences and paying lower premiums.

A different approach to interlock networks proposed that social ties are not just relay stations spreading information and knowledge among connected organizations or individuals but also prisms that create differentiation among social actors. In this view, the presence or absence of a tie is an informational cue on which others rely to make inferences about the status and characteristics of one social player (Podolny, 2001). Several studies demonstrate that interlocking directorates affect the status and power of corporate actors (Bigley and Wiersema, 2002; Davis and Robbins, 2004; Finkelstein, 1992; Khurana, 2002; Wade, O'Reilly and Chandratat, 1990). For example, Bigley and Wiersema (2002) found that recently appointed CEOs who are seated on many outside boards are likely to have both more power and a broader cognitive orientation than those who sit on relatively few boards. Knowledge of the CEO's job and its context, provided by their apparent experience, in combination with power and a broadened strategic perspective through outside board membership, may contribute to an increase in strategic change.

CEOs' and executives' board membership on outside boards may increase CEOs' power and self-interested behavior, leading to decisions not necessarily aligned with shareholders interests. According to agency theory, top managers have personal incentives to pursue corporate diversification beyond the level at which shareholder wealth is maximized (Amihud and Lev, 1981; Hill, 1994; Hyland and Diltz, 2002). Agency theorists believe that corporate acquisitions, especially diversifying

acquisitions, and corporate provisions like poison pills and golden parachutes, reflect opportunism by top managers who are insufficiently monitored and controlled (Morck, Shleifer and Vishny, 1990). Palmer and Barber (2001) studied the factors that led large firms to participate in the wave of diversifying acquisitions in the 1960s. They found that firms that pursued diversifying acquisitions were led by well-connected CEOs who were central in elite social networks. In a cross-sectional study, Wade and colleagues (1990) found that CEOs who serve on many corporate boards are more likely to influence a board's decisions and get CEO's beneficial corporate provisions like change-in-control agreements that may go against shareholders' interests.

Most of the studies on the consequences of embeddedness just discussed were conducted on large American corporations. The role of family firms and the behavioral effect of interlocking in family firms were not considered by previous research. There are reasons to believe that family controlled firms might follow different board practices and therefore it seems critical to explore whether and how these firms are connected with the larger corporate network in which they operate. As a first exploratory step in this direction, we will explore the structure of the Spanish interlock network of major business firms and focus on the role of family firms within this network.

Data and methods

Our sample comprises the 396 biggest Spanish firms and 2417 directors. The sample was obtained from the Actualidad Económica ranking for the year 2002. For all these firms we have data on board composition, board size, sales, industry and the region in which the firm's headquarters are located. We compiled our data set from different sources: (1) SABI, Fomento de la Producción, DICOPI 50.000 Anuario de Sociedades, Consejeros y Directivos and CNMV (Comisión Nacional del Mercado de Valores) for detailed information about shareholders, board structures and board members; (2) The Maxwell Espinosa Shareholders directory for information on shareholders; and (3) Actualidad Económica 2002 for information on sales, number of employees, industry and the region in which the firm's headquarters are located.

We followed the Spanish *Instituto de Empresa Familiar* (IEF) definition of family firms. According to IEF, family firms are defined as those ventures in which a family group has the power to appoint the CEO or to set the strategy of the company and where the next generation is being educated to continue with the family business (Corona, 2004). Following

IEF definition, 80 firms of our sample can be categorized as family firms. That is 20 percent of the firms included in our sample.

To achieve a better understanding on the role of corporate ties and board practices in family firms, we interviewed 8 owners of large Spanish family firms and 4 directors of family firms. We interviewed both owners of firms that were isolated from the rest of the Spanish interlock network and owners of firms that were highly connected.

The interlock data was analyzed with the social network analysis software UCINET (Borgatti, Everett and Freeman, 2002). We computed standard network statistics on the Spanish interlock networks. There are different measures to capture the centrality of a board: degree, eigenvector and betweenness. Board degree centrality is defined as the number of boards that a given board is connected to. Degree centrality of a node i can be formalized as:

$$d_i = \sum_j a_{ij}$$

Where a is a board connection between firms i and j .

Eigenvector centrality is best understood as a variant of simple degree. Eigenvector has become the standard measure of centrality in interlocking directorate research (Bonacich, 1987; Davis and Mizruchi, 1999; Mintz and Schwartz, 1981). This centrality measure represents power relations within the corporate elite. The idea behind this measure is that it does not just count how many boards one board is connected to, but how many boards are connected to the boards linked to the focal board. Bonacich (1972) defined centrality as the principal eigenvector of the adjacency matrix. An eigenvector of a symmetric square matrix A is any vector e which satisfies the equation:

$$e_i = \lambda^{-1} \sum_j a_{ij} e_j$$

Where λ is a constant (known as the eigenvalue) and e_i gives the centrality of node i . The formula implies (recursively) that the centrality of a node is proportional to the sum of centralities of the nodes it is connected to. Hence, a board that is connected to many boards that are themselves well-connected is assigned a high score by this measure, but a board connected only to near isolates is not assigned a high score, even if it itself has a high degree.

A third measure of centrality is betweenness centrality. A board that lies on communication paths can control communication flow, and is thus important. Betweenness centrality counts the number of geodesic paths between i and k that board j resides on. A geodesic is the shortest path between a pair of boards (Wasserman and Faust, 1994). Betweenness centrality can be written as:

$$b_k = \sum_{ij} g_{ikj} / g_{ij}$$

where g_{ij} is the number of shortest paths from node i to node j , and g_{ikj} is the number of shortest paths from i to j that pass through k . Betweenness indexes the extent to which a board facilitates the flow of information within the corporate elite. If a board with high betweenness centrality is removed from the interlock, the transmission from one board to another is more damaged than if a board low in betweenness is removed. Table 11.1 presents detailed information regarding firms' degree, betweenness and eigenvector measures. We used Netdraw (version 4.14, a network visualization package bundled with UCINET) to visualize interlocks graphs.

Results

Table 11.1 displays the top 30 companies ordered by betweenness centrality. Only two family firms, *Inditex* and *Ferrovial*, are included in the top 30 firms by betweenness centrality. Table 11.2 shows the top 20 family firms in terms of betweenness centrality.

Figure 11.1 shows the interlock network of Spanish firms in 2002. In Figure 11.2 we removed non-family firms from the graph, so this figure only shows the Spanish family firms and the links among them. Figure 11.3 represents the network of the top 20 family firms by betweenness centrality. In these figures, nodes are firms and the value of a tie between any two firms is defined as the number of directors who belong to both. The width of the tie represents the number of directors shared by two firms. Family firms are depicted as square nodes and non-family firms as circles. Black, white and gray indicate the regions in which the firms' headquarters are located. Table 11.3 reports information regarding the colors of each region and the incidence of firms by region. Data show that most firms are located in Madrid (nodes in color white in Figure 11.1). Size of nodes varies with the firms' betweenness centrality. In Figure 11.1 we can see that most central or embedded firms (biggest nodes) are non-family firms. *Inditex* and *Ferrovial*, which as reported in

Table 11.1 Top 30 Firms by betweenness centrality

Firm	Degree	Betweenness	Eigenvector
Grupo Dragados	24	4.401	40.686
NH Hoteles	14	3.218	21.152
Repsol YPF	18	2.4	42.338
Enagás	17	1.77	28.775
Banco de Santander	21	1.767	17.546
Sogecable	18	1.759	12.357
Endesa	15	1.726	23.344
Cepsa	17	1.722	19.761
Inditex	11	1.538	5.753
Caja Madrid	9	1.425	17.778
Uralita	10	1.412	6.045
Iberia	14	1.411	29.602
Asepeyo	8	1.375	3.249
Corporación IBV	13	1.203	19.967
Participaciones Empresariales			
Grupo Ferrovial	14	1.158	4.451
Acerinox	12	1.14	17.482
Telefónica	25	1.019	31.531
Indra	8	0.951	9.183
Areas	7	0.944	4.388
Banco Bilbao Vizcaya	7	0.941	8.065
Holcim España	5	0.93	5.399
ACS	18	0.899	26.798
Telefónica Móviles España	21	0.876	16.259
Unión Fenosa	16	0.866	14.919
Gas Natural	20	0.835	29.472
Aceralia	7	0.802	3.155
Compañía Logística de Hidrocarburos CLH	12	0.729	7.709
Logista	10	0.722	15.899
Grupo Sacyr Vallehermoso	9	0.7	13.008
Técnicas Reunidas	8	0.7	10.233

Table 11.2 have a higher betweenness centrality, are notable exceptions among family firms.

Table 11.4 presents descriptive information of our sample of firms. This table provides means and standard deviations for all firms and for connected firms, which are firms that have shared directors.

To investigate if there are differences in the level of embeddedness between family firms and non family firms, Mann-Whitney tests were used (Hollander and Wolfe, 1999). Non-parametric tests were used, because the distribution of the centrality measures was non-normal.

Table 11.2 Top 20 family firms by betweenness centrality

Ranking	Firm	Degree	Betweenness	Eigenvector
9	Inditex	11	1.538	5.753
15	Grupo Ferrovial	14	1.158	4.451
36	Vocento	7	0.524	1.862
39	Corporación Agrolimen	7	0.463	1.448
51	TelePizza	8	0.31	6.661
59	Media Planning Group (MPG)	4	0.282	5.782
69	Puig Beauty & Fashion Group	7	0.232	4.141
73	Corporación Gestamp	3	0.201	0.394
75	Centros Comerciales Carrefour	4	0.193	5.662
78	FCC Construcción	7	0.183	12.0
79	Grupo Caprabo	4	0.179	7.282
82	Cortefiel	5	0.149	9.206
83	Ferrovial Agromán	12	0.145	3.11
84	Prosegur	4	0.141	7.943
86	Grupo Campofrío Alimentación	8	0.116	6.965
87	Grupo Villar Mir	9	0.113	0.705
95	Gonvarri Industrial	5	0.07	0.259
98	Acciona	8	0.063	1.38
102	Necso	5	0.05	1.063
105	Henkel Ibérica	3	0.021	3.481

Table 11.3 Incidence of firms by region

Region	Color	Number of firms	Percent
Andalucía	Grey	10	2.53
Aragón	Grey	4	1.01
Asturias	Grey	6	1.52
Baleares	Grey	12	3.03
Cantabria	Grey	3	0.76
Castilla y León	Grey	9	2.27
Cataluña	Black	85	21.46
Comunidad Valenciana	Grey	9	2.27
Galicia	Grey	7	1.77
Madrid	White	219	55.3
Murcia	Grey	2	0.51
Navarra	Grey	6	1.52
Pais Vasco	Grey	24	6.06
		396	100

We excluded from our analysis isolated firms, which are firms with zero degree centrality.

The results of the Mann-Whitney test are presented in Table 11.5. We found that betweenness and eigenvector centrality are greater in non-family firms than in family firms. The Mann-Whitney tests reveal significant differences between the betweenness and eigenvector centrality of non-family firms and the centrality measures of family firms. However, family firms are not significantly different from non-family firms in terms of degree centrality or the number of ties to other boards.

Family firms are indeed linked to other firms through shared directors, but most of these ties are with firms of the same economic group, usually wholly owned subsidiaries. In fact, 56 percent of family firms' ties are among firms of the same business group and just 37 percent of family firms' ties are with non-family firms. For instance, one extreme case is *El Corte Inglés*. Firms that belong to *El Corte Inglés* business group, share many directors among them, so, they have a high degree centrality. Nevertheless, they do not have any directors also

Table 11.4 Descriptive statistics

	All firms		Connected firms (Degree>0)	
	Mean	SD	Mean	SD
Sales	1642.9	3345.6	2190.9	4297.2
Board size	7.7	5.1	9.1	5.2
Degree	3.5	5.2	6.2	5.6
Betweenness	0.2	0.4	0.3	0.6
Eigenvector	3.1	6.4	5.7	7.7
Number of observations	396	396	220	220

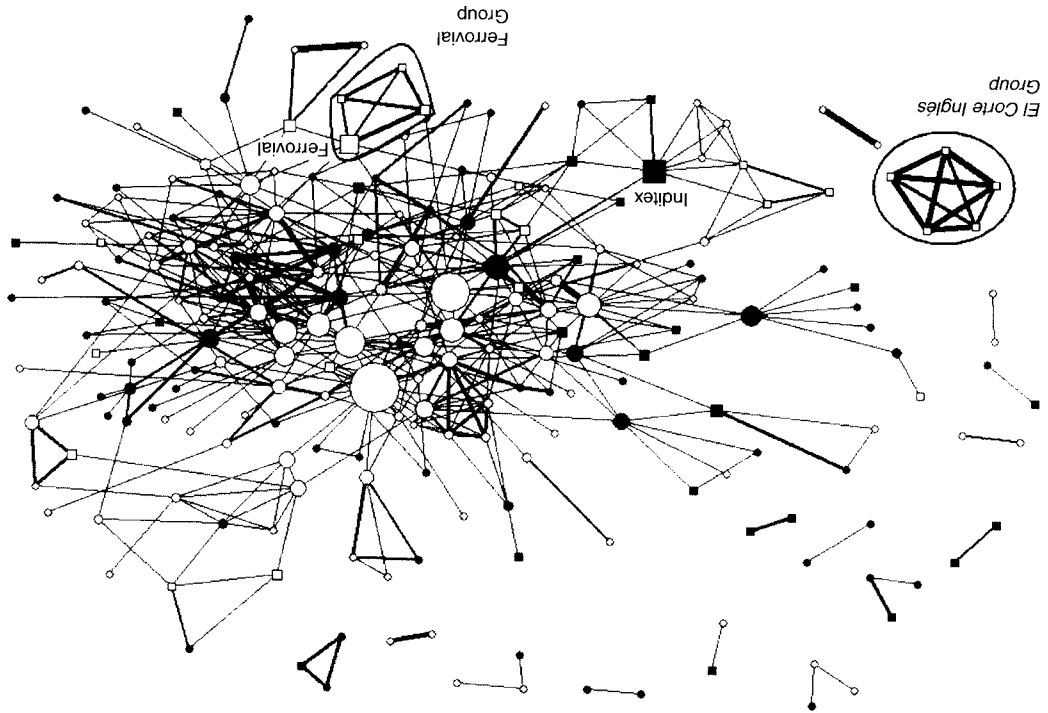
Table 11.5 Differences in the centrality measures between family firms and non-family firms (connected firms only (degree>0))

Variable	Z-score	Significance
Degree	-0.031	0.9755
Betweenness	2.393	0.0167*
Eigenvector	3.245	0.0012**
Number of observations	220	220

+ significant at 10% level; * significant at 5% level; ** significant at 1% level

Note: Nodes are firms and the value of a tie between any two firms is defined as the number of directors who belong to both. The width of the tie depends on the number of directors shared by two firms. Square nodes represent family firms and circles are non family firms. Colors represent the region in which the firm's headquarter is located (Table 11.3 includes the names and colors of Spanish regions).

Figure 11.1 Network of Spanish firms

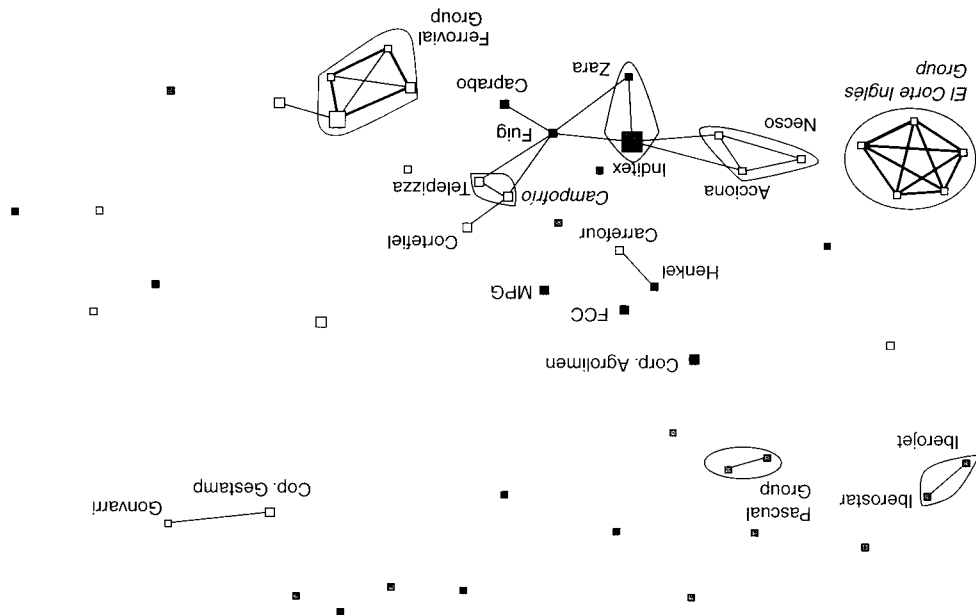


sitting on the board any company not belonging to the *El Corte Inglés* business group. Consequently, these firms have a low betweenness and eigenvector centrality. In Figure 11.1, the boards and relationships of firms belonging to *El Corte Inglés* are represented by a star. As can be seen, *El Corte Inglés* business group is isolated from the main component of the interlocking directorates. Figures 11.2 and 11.3 present other examples of family groups: *Ferrovial* composed of *Ferrovial Inmobiliaria*, *Ferrovial Servicios* and *Ferrovial Agromari*; *Necso* group composed of *Acciona* and *Necso* or *Campofrío* (see the dyad *Campofrío* and *Telepizza*).

Board interlocks in family firms

Family firms can be connected to other firms by either inviting an outside director or by having one of their own directors sit in another firm's board. Most boards of family firms only consist of family members, and there are few outside directors (Ward, 1991). Family owner-managers often resist forming a board with outside directors. This resistance to invite outsiders onto the board of directors may prevent the creation of interlocks. Moreover, the low participation in outside boards of most owners and executives of family firms may also affect the construction of interlocks. Different family values may prevent the embeddedness of family firms. For example, the owner of a family firm explained that his family highly value privacy, discretion and preserving family cohesion, and these values made it harder to invite directors of other firms to the board of his company. In some cases, for instance when there are unusual tensions among shareholders, business owners' resistance to invite outsiders is well founded (Ward, 1991). However, in most cases, resistance to invite outsiders or to participate as an outsider in other boards is rooted in a variety of fears and lack of experience or understanding of the potential benefits of being embedded in the corporate elite. Family firms' owners fear losing their autonomy and giving up control over the company. Previous research on the influence of outside directors on strategic change in public American corporations shows that outside directors, through the selection of a new CEO who has experience at implementing the strategy that board members favor, shape the strategic direction of the corporation (Westphal and Fredrickson, 2001). The owners of family firms learned from the experience of US public companies that external directors and CEOs can take control of the business and force them to change the strategic direction, the culture and values

Figure 11.2 Network of Spanish family firms
 Note: Nodes are firms and the value of a tie between any two firms is defined as the number of directors who belong to both. The width of the tie depends on the number of directors shared by two firms. Square nodes represent family firms and circles are non family firms. Colors represent the region in which the firm's headquarter is located (Table III includes the names and colors of Spanish regions).



of the organization (Gersik, Davis et al., 1997; Hiedrick, 1988; Mathile, 1988; Ward, 1991).

Family firms' owners also resist inviting outsiders because they value the company's ability to operate more secretly. Family firms do not like to share information with outsiders regarding salaries, bonus and perks of family members. Moreover, many owners strongly resist sharing financial information and internal problems with outsiders because they are concerned about potential information leaks (Ward, 1991). Because of confidentiality, family firm's owners are especially averse about inviting members of other family firms to participate as outsiders. There are very few directors who sit simultaneously in two or more boards of family firms. Figure 11.2 shows that, with few exceptions, Spanish family firms do not share directors. Only 7 percent of the board ties of family firms are between family firms of different business groups. One example of a shared director by family firms from different groups is given by *Puig* and *Inditex* (see Figure 11.3).

There is also a concern with the identity of the family. The owner of one family firm explained that he does not want to participate on the board of a firm that belongs to a different industry, he said, "we have an identity, we have been in the pharmaceutical industry for generations. We don't want to be associated with the construction industry." This fear prevents incorporate relationships between family firms from different industries. Other reasons may explain the owners' resistance to invite outside directors. First, business owners may not know how to find and utilize outside directors. Second, firm owners may believe they do not need advice or help. Finally, business owners may feel outsiders are too expensive (Nash, 1988).

Despite the fears and concerns of owners regarding interlocks, many family firms are actually well connected in the Spanish interlock network, but only thanks to the bridge created by a few independent directors who sit on the board of both family and non-family firms. Figure 11.3 shows that the top 20 family firms by betweenness centrality are connected to the corporate elite thanks to the role of outside directors who sit on the board of both, family and non-family firms. For example, *Inditex* is connected with *Cortefiel* through *Banco Santander*. *Ferrovial* and *Inditex* are linked through *NH Hoteles*. *Caprabo* is connected to *Vocento* through *Siemens* and *Inmobiliaria Colonial*. Few independent directors prevent the isolation of family firms and keep the corporate network connected in one component.

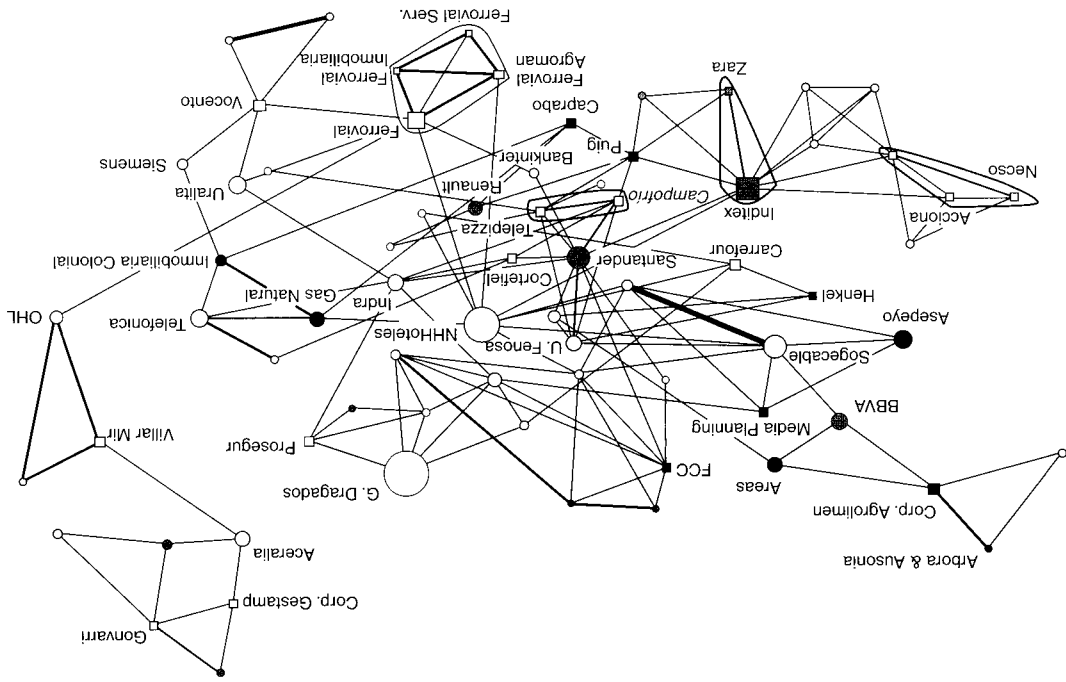


Figure 11.3 Network of top 20 Spanish family firms by betweenness

Note: Nodes are firms and the value of a tie between any two firms is defined as the number of directors who belong to both. The width of the tie depends on the number of directors shared by two firms. Square nodes represent family firms and circles are non-family firms. Colors represent the region in which the firm's headquarter is located (Table III includes the names and colors of Spanish regions).

The contingent value of interlocks in family firms

Studies on interlocking directorates showed the effect of board ties on corporate outputs. But the effect of board ties on firm behavior may be contingent upon several factors (Brass, Butterfield and Skaggs, 1998; Adler and Knowl, 2002). For instance, Mizruchi and colleagues (2006) showed that the effect of interlocking directorates on the level of debt of US corporations is historically contingent. The concurrent rise of the CFO and the decline of financial representatives on boards suggested that firm financing decisions were increasingly made by specialists inside the firm, without reliance on board members and the board networks that their presence both created and reflected (Mizruchi, Stearns and Marquis, 2006).

The value of board ties for family firms may also vary across situations. Family firms scholars suggest that outside directors can bring innovative ideas, a long term perspective and new insights to family firms (Gersik, Davis et al., 1997; Martinez Echezarraga, 2006; Ward, 1991). Outside directors can be invaluable in several learning processes. First, outsiders are very important because they provide precious information and insights when family firms are involved in a strategic change process. Directors can suggest strategies that involve acceptable degrees of risk. At other times, outside directors can help the business owner with an affirmation of her instincts or judgments in relation to a strategic perspective. Following this line of argument a reasonable proposition could be:

Proposition 1. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates if it is involved in a strategic change process.

Gersick, Davis, McCollom Hampton and Lansberg (1997) argue that the invitation of outside directors will depend on the developmental stage of the firm, particularly on the business dimension. Boards with outsiders become essential as the company develops in the expansion stage. At this stage of development the outsider's technical expertise regarding organizational design and product development is critical. For instance, outsiders can bring ideas regarding targets for growth and the volume of products and services required to sustain it, new markets, internationalization, diversification, organizational structure, decentralization and integration of a wider circle of senior professional management

(Gersik, Davis et al., 1997). An outsider's incorporation and participation in the board of a family firm and the embeddedness in the interlocking directorates will be more critical when family firms are moving into the expansion stage of business development. So, we suggest that:

Proposition 2. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates if it is at the business expansion stage.

Literature on family business suggests that outside directors may provide critical knowledge in a succession process (Gallo, 2001; Gersik, Davis et al., 1997; Ward, 1991). Outsiders can be invaluable to the succession process in several ways. A board with outsiders can be instrumental in raising the succession issue at the right time. Also, outside directors help the business owner examine his or her options. Finally, outsiders help in preparing the successor and in completing the succession process (Ward, 1991). Consequently, we propose that:

Proposition 3. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates when the owner is thinking in a succession process.

Board ties may also affect the status and the legitimacy of a family firm's board. Determining the quality of a board of directors is problematic, due to several reasons. First, shareholders, financial analysts and the public media have no access to board discussions and decision-making processes because they occur behind closed doors. Second, legal requirements for board composition and structure are minimal. Finally, each board is uniquely organized with regard to how it performs activities. There is thus no guides to evaluate the quality of boards (Davis and Robbins, 2004). In such a context, the collection of board ties the directors create acts in the market as a signal for corporate governance. The number and quality of board ties represent an informational cue on which others rely to make inferences about the underlying quality and characteristics of a board (Davis and Robbins, 2004; Finkelstein, 1992; Podolny, 1993; Podolny, 2001).

Davis and Robbins's (2004) findings indicate that boards of public firms seek to appoint well-connected directors when they are owned by institutional investors and when they have been subject to governance-related shareholder proposals, because connected directors enhance the

firm's reputation and status. Family firms may become more concerned about their reputation when they are considering the option of going public and opening the company to non-family investors. A director of two family firms, explained that "when owners are thinking about going public, the recruitment of well-known directors is a critical issue because high-status directors may help to improve the company image and raise the firm value." Following this line of argument, a reasonable proposition could be:

Proposition 4. A family business will be more likely to incorporate outside directors and, consequently, become more embedded in the interlocking directorates when considering going public.

The issue of opening the ownership of the company arises most frequently in the third generation of a family firm (Gersik, Davis et al., 1997). Moreover, it is at this stage of ownership development when control among family members is extremely diluted. Outsiders become essential as soon as the ownership is dispersed because representation and control issues arises (Gersik, Davis et al., 1997). Outsiders can give minority shareholders a sense of impartial control. So, we argue:

Proposition 5. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates when it is in the third generation.

Resource dependence theory (Pfeffer and Salancik, 1978) strongly influenced academic thinking regarding the value of embeddedness in interlocking directorates. Resource dependence theory argues that firms use board ties to manage their resource interdependencies and to reduce uncertainty (Pfeffer and Salancik, 1978). Business firms facing uncertainty from technological shifts, deregulation, the globalization of capital and product markets, and political reform, can more efficiently acquire resources by coordinating their efforts from the top of the organization, for instance, the board of directors. For example, organizations belonging to the construction sector face high uncertainty. These organizations could be more connected in the interlocking directorates in order to reduce uncertainty and yet minimize the risks of interdependence. In the Spanish case, 20 percent of the top 30 firms taking interdependence centrality into consideration belong to the construction sector (see in Table 11.1: *Grupo Dragados, Grupo Ferrovial, Holcim España, ACS and Grupo Sacyr Vallehermoso*). Furthermore, 30 percent of the top 20 family firms in

terms of betweenness centrality are construction firms (see in Table 11.2 *Grupo Ferrovial, FCC Construcción, Ferrovial Agronan, Grupo Villar Mir, Acciona and Necsó*). So, from the previous discussion we can advance:

Proposition 6. A family business will be more likely to incorporate outside directors and, consequently, to become more embedded in the interlocking directorates when it faces high uncertainty.

Interlocks exist to coordinate the inter-organizational exchange of resources, such as capital, information and market access, to buffer the effects of environmental uncertainty (Pfeffer and Salancik, 1978). US industrial corporations faced with declining solvency during economic slumps may be more likely to form interlocks with financial institutions to increase their access to financial capital (Mizruchi and Stearns, 1994). Also family firms may form interlocks with financial institutions to increase their access to capital. See in Figure 11.2 that *Inditex, Telepizza, Campofrío, Pescanova, FCC Construcción* and *Cortefiel* have ties with *Banco Santander. Tidela Veguin* has two board ties, both are with banks, *Banco Santander* and *Bankinter*. Other examples are *Corporación Agrolimen* which is connected to *BBVA* and *Prosegur* which has a tie with *Caja de Galicia*. From the previous discussion we suggest that:

Proposition 7. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in the interlocking directorates when it needs to increase its access to financial capital.

Family firms may adopt the use of outsiders because a board with outsiders may become the institutional definition of the legitimate board form (Tolbert and Zucker, 1983) in the region where the firm and the family members operate. In the United States, geographical factors have been identified as important issues shaping the behavior of firms (Davis and Greve, 1997; Kono, Palmer et al., 1998). Geographical factors may be important to determine family firms' behaviors, specifically the use of outsiders. Family firms may imitate other family firms when they are geographically close, that is, their corporate headquarters are located in the same region, when owners are from the same city or when they are members of the same upper-class clubs (Kono, Palmer et al., 1998). Consequently:

Proposition 8. A family business will be more likely to incorporate outside directors and consequently, to become more embedded in

the interlocking directorates when other geographically close family firms include outsiders in their boards.

Conclusion

This study has explored the role of family firms in the Spanish interlocking directorates and the factors that may explain the construction of board ties. Although this study advances our understanding on the role of family firms in the interlocking directorates, it does have limitations. First, the findings of this study are restricted to the Spanish case and other countries with different corporate governance regimes (and regulations) might differ on a number of dimensions. Second, we only explored the interlocking directorates without considering other critical networks. For instance, owners of family firms are likely to be connected by common memberships in social clubs, trade associations and non-profit boards.

Notwithstanding its limitations, this chapter provides several contributions. Our study provides evidence that family firms are, on average, less central in the Spanish interlocking directorates. Consequently, they are less embedded in the corporate network than non-family firms. Furthermore, the interlocking directorate of family firms is sparse. That is, there are very few directors who sit simultaneously on two or more family firms' boards. Nevertheless, the network of the top 20 family firms by betweenness centrality is more densely connected, thanks to the role of independent directors who sit on the board of both family and non-family firms. Because of confidentiality, family firms' owners resist inviting members of other family firms to participate, as outsiders. However, despite this fear, once they invite independent directors who sit on other non-family firms' boards to their board of directors, they inevitably become indirectly connected to other family firms.

This work contributes to the board interlock literature by developing novel propositions on the effect of interlocks on family business by exploring different factors that may promote the construction of interlocks. Embeddedness in interlocking directorates may be beneficial when family firms are involved in a strategic change process, in the expansion stage of development, in a succession process, when considering going public, facing high uncertainty, needing to increase access to financial capital and when the family is in the third generation. Finally, institutional and geographical factors may also promote the construction of interlocks ties.

These findings have important implications for family firms' experts and practitioners. The phantoms and fears of control should not prevail

when considering the use of independent directors; rather, family firms' owners and experts should reflect and think how family businesses can benefit from this type of connections with the wider corporate network.

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