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**Human Capital in Family Businesses: Focusing on the Individual Level**

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# **HUMAN CAPITAL IN FAMILY BUSINESSES**

## **Human Capital in Family Businesses: Focusing on the Individual Level**

### **Abstract**

This theoretical paper focuses on the construct of human capital in family businesses. It makes three key contributions. First, it furthers our understanding of human capital in family businesses by identifying the underlying dimensions of human capital, involving not only knowledge, skills and abilities, but also individual attitudes and motivation. Second, the paper puts forward the conditions under which family businesses can achieve and sustain over time an alignment of interests between individual human capital and organizational goals. These conditions will vary depending on whether the external environment is static or dynamic. Third, the paper heeds the call, shared by strategic management scholars, to focus on the individual level as well as on the (predominant) group and organizational level constructs.

### *Keywords:*

Family business; Human capital; Interest alignment

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## 1. Introduction

It is widely recognized that family businesses play a significant role in the global economy (Anderson & Reeb, 2003; Chrisman, Chua, Chang, & Kellermanns, 2007) and are key for the entrepreneurial process (Rogoff & Heck, 2003). However, not all family businesses fit into this description. Some of them primarily pursue value creation through non-economic benefits, such as giving jobs to family members and preserving family ties. These firms, which have been labeled lifestyle firms (Chrisman, Chua, & Litz, 2003), often resist change, are unwilling to hire non-family managers, and become cautious in their strategy making, thereby reducing their potential for future growth and profitability (Zahra, 2005). Instead, enterprising family businesses are those that mainly pursue wealth creation, support entrepreneurial activities, and recognize opportunities thanks to long term vision and strong relationships with key stakeholders (Chrisman et al., 2003). These are the firms that play an important role in employment creation, technological innovation, and economic progress (Zahra, 2005; Zahra, Hayton, & Salvato, 2004).

Family business scholars are still trying to fully understand why enterprising family businesses have performance advantages over other family businesses as well as many non-family businesses. Several studies have focused their analysis on the group and the firm level. For example, at group or interpersonal level (Sharma, 2004), scholars have explained these advantages by taking into account social capital (Pearson, Carr, & Shaw, 2008; Salvato & Melin, 2008). Family businesses are uniquely characterized by a strong shared component deriving from social relations – such as obligations, expectations, and social norms – among individuals (Coleman, 1988). Social capital is a valuable resource because it reduces transaction costs, solves problems of coordination, and aids flows of information among individuals (Bolino, Turnley, & Bloodgood, 2002; Lin, 2001). At firm level, competitive advantage in family businesses has been explained through the construct of familiness

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(Habbershon & Williams, 1999; Sharma, 2004). Familiness has been defined as a firm-level bundle of idiosyncratic resources and capabilities deriving from the interaction between the family (its history, traditions, and lifecycle), the family members (the interests, skills, and life-stage of participating family owners/managers), and the business (its strategies and structures) (Habbershon & Williams, 1999; Habbershon, Williams, & MacMillan, 2003).

The aim of this paper is to complement our understanding of performance advantages of family businesses by focusing on the individual level of analysis. As the strategic management literature reminds us, “organizations are made up of individuals, and there is no organization without individuals... In fact, to fully explicate organizational anything – whether identity, learning, knowledge or capabilities – one must fundamentally begin with and understand the individuals that compose the whole, specifically their underlying nature, choices, abilities, propensities, heterogeneity, purposes, expectations and motivations” (Felin & Foss, 2005: 441). However, family business literature has not devoted much attention to human capital. In reality, scholars have not delved much beyond offering a taxonomy of individual family members’ human capital (henceforth family human capital) as including their knowledge, skills, and abilities (Carney, 2005; Coleman, 1988; Danes, Stafford, Haynes, & Amarapurkar, 2009; Habbershon & Williams, 1999; Salvato & Melin, 2008; Sirmon & Hitt, 2003). Therefore, there is a key question that remains unanswered: given that family businesses often have limits to their individual human capital, because suboptimal employees may be hired simply by virtue of their family ties and qualified non-family managers are kept away due to limited potential for professional growth and limitations on wealth transfer (Covin, 1994; Dunn, 1995; Sirmon & Hitt, 2003), how can we explain their competitive advantage over non-family businesses, as witnessed by several studies (e.g., Anderson & Reeb, 2003; Lee, 2006; McConaughy, Matthews, & Fialco, 2001; Miller, Le Breton-Miller, Lester, & Cannella, 2005; Villalonga & Amit, 2006)? In other words, if the individual human

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capital of family businesses is often inferior to that of non-family businesses, how can it lead to superior social capital and, ultimately, to the systemic synergies, or distinctive familiness, that are associated with competitive advantage for the family firm (Chrisman, Chua, & Steier, 2005)? The core argument of this paper is that there is more to family human capital than family members' knowledge, skills and abilities. I argue that there is a further dimension to family human capital, relating to the attitudes of family members (Kulik & Roberson, 2008). It is this thanks to this dimension that family businesses are often able to create and sustain a competitive advantage over non-family businesses.

By drawing on the family business, human capital, and human resource management literature, this paper makes three main theoretical contributions. First, it furthers our understanding of family human capital by identifying the underlying dimensions of family members' human capital, involving not only knowledge, skills and abilities, but also individual attitudes and motivation leading to an alignment of interests between individual and organizational goals. Second, the paper puts forward the conditions under which family businesses can achieve and sustain over time a competitive advantage that is based on an alignment of interests between family members' human capital and organizational goals. These conditions will vary depending on whether the external environment is static or dynamic. Third, the paper heeds the call, shared by strategic management scholars, to focus on the individual level as well as on the (predominant) group and organizational level constructs (Felin & Foss, 2005).

The paper proceeds as follows. First, I address the development of human capital theory and address the antecedents of family human capital. Second, I outline three dimensions of family human capital, which are termed – as mnemonics – *head* and *hand* (referring to the capacity to perform), and *heart* (referring to the willingness to perform, achieved through interest alignment). Third, I present propositions relating to how family

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businesses can create and sustain interest alignment between their human capital and organizational goals. Fourth, I discuss the implications of the theoretical model presented. Finally, I draw conclusions, highlighting limitations and directions for further research.

### **2. Development of Human Capital Theory**

The development of human capital theory started in the 1960s, when Theodore Schultz (who was later, in 1979, awarded the Nobel Prize in Economic Sciences), introduced the idea that “skills and knowledge are a form of capital” (1961: 1). Although Adam Smith had already, in the 18<sup>th</sup> century, referred to individual abilities as forming part of a country’s capital, Shultz was the first to argue formally against the predominant values and beliefs, which had held scholars back from “looking upon human beings as capital goods” and as “wealth that can be augmented by investment” such as education and training (1961: 2). Schultz also highlighted a connection between human capital and economic growth, by associating investments aimed at enhancing “human capabilities to do productive work” with an increase in their productivity (1961: 8). Another instrumental figure for human capital theory was Gary Becker, also an economist and winner of the 1992 Nobel Prize in Economic Sciences. Becker expanded the definition and theory of human capital and focused on investments in human capital, that is the “activities that influence future real income through the imbedding of resources in people”. These included “schooling, on-the-job training, medical care, vitamin consumption, and acquiring information about the economic system” (1962: 9). Schultz (1961) identified similar antecedents to human capital, including health facilities and services (aimed at improving life expectancy, as well as individuals’ strength and vitality), on-the-job training, formal and continuing education, as well as migration.

Later studies have emphasized the importance of organizational culture as another key antecedent of human capital. For example, some organizational cultures are oriented towards

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promoting learning, thus contributing to generating a sustainable competitive advantage (Barney, 1986; De Long & Fahey, 2000; Zahra et al., 2004). An externally focused organizational culture is likely to encourage its individuals to acquire knowledge from a variety of external sources, such as customers, competitors, and suppliers, thus increasing the firm's entrepreneurial activities (Kanter, 1983; Zahra et al., 2004). In family businesses, an organizational culture that is based on nepotism – the frequently followed practice of hiring relatives (Vinton, 1998) – may have an effect on a the firm's human capital, either positively through the value of upholding the family's tradition and allowing future owner/managers to get to know the business intimately by growing up around it (Bellow, 2004) or negatively through the creation of agency problems, caused by privileges and a sense of entitlement, which are costly to mitigate (Gersick, Davis, Hampton, & Lansberg, 1997; Schulze, Lubatkin, & Dino, 2003).

This paper is focused on the human capital of family members in family businesses. This resource is distinctive for several reasons. For example, it is developed through learning-by-doing and apprenticeships that differ from those available in non-family firms because they are often provided by other family members at home, through summer jobs, and so on (Le Breton-Miller & Miller, 2006; Memili, Chrisman, Chua, Chang, & Kellermanns, 2011). This allows for the development of tacit and highly specific knowledge, which is not easily transferable (Sirmon & Hitt, 2003). Furthermore, the human capital of family members in family businesses is unique because, unlike non-family members, family members are often willing to work without pay (Danes et al., 2009). Often family members have greater commitment and cooperation than non-family employees, especially if the latter perceive the decision making processes and outcomes as being unfair or unjust (Barnett & Kellermanns, 2006). This may be caused by the uncertainties due to the fact that non-family members are part of the business but not of the family system (Mitchell, Morse, & Sharma, 2003).

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Family human capital is defined in the literature as the knowledge, skills, and abilities of individual family members (Carney, 2005; Coleman, 1988; Danes et al., 2009; Habbershon & Williams, 1999; Salvato & Melin, 2008; Sirmon & Hitt, 2003). Stocks of family human capital represent a potential resource advantage for the firm (Sorenson & Bierman, 2009). By being made available to the family and the business, these flexible resources can flow where needed (Sharma, 2008), contributing to firm success as well as to the quality of life of family members (Rothausen, 2009; Stafford & Tews, 2009).

Human capital theory suggests that there is a correlation between human capital and organizational performance, which can benefit from the accumulation of firm-specific, valuable human capital (Danes et al., 2009; Strober, 1990). According to the resource-based view, human capital is the most valuable and most difficult type of resource to imitate because it is, to a large degree, the product of complex social structures that have been built over time (Barney, 1991). Thanks to their shared histories and close-knit relationships, spanning across two subsystems (family and business), individual family members are, by their very idiosyncratic nature, characterized by being not only valuable and rare but also difficult to imitate and non-substitutable (Barney, 1991; Sirmon & Hitt, 2003). Thus, family human capital is most likely to be a source of sustained competitive advantage for firms (Barney, 2001). In fact, human capital is considered one of the most important resources for family businesses, allowing them to enhance their value for current and future generations (Sirmon & Hitt, 2003). The closeness of the family/business relationship creates a unique context for human capital (both positive and negative), compared to non-family firms (Sirmon & Hitt, 2003). Human capital is also considered to be a crucial resource by outside investors considering whether to provide finance to or invest in family businesses (Dawson, 2011).



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### **3. Family Human Capital and Its Three Dimensions**

Scholars recognize that family members' human capital is more unique and complex than non-family members', because of the simultaneous involvement in both the family and the business (Sirmon & Hitt, 2003). Family businesses are able to implement a value creating strategy that current and potential competitors are unable to replicate (Barney, 1991), allowing the business to attain a combination of objectives, including wealth creation, i.e. generation of above average returns for current and future generations of family members (Habbershon et al., 2003), and/or value creation, i.e. maximization of a utility function that includes non-economic goals (Chrisman et al., 2003). Furthermore, given that family governance is characterized by the integration, rather than separation, of ownership and control, family human capital is a crucial factor in shaping the vision of the family business across generations (Carney, 2005; Habbershon & Williams, 1999).

However, family business scholars have not developed the human capital construct beyond its categorization encompassing the knowledge, skills, and abilities of family members (Carney, 2005; Coleman, 1988; Danes et al., 2009; Habbershon & Williams, 1999; Salvato & Melin, 2008; Sirmon & Hitt, 2003). One exception to this is Hoy & Sharma's (2009) taxonomy of human capital, in which they also include an intellectual and a psychological dimension, including factors such as commitment and emotions, as well as integrity, compassion, and forgiveness.

Thus, what follows is an attempt to further develop the dimensions that make up family human capital. Whereas previous family business research has not delved much beyond the generic labels of "knowledge", "skills", and "abilities", I offer a more in-depth insight into each of these constructs. Furthermore, I attempt to move one step beyond the dimensions of human capital, which the literature has already addressed – i.e., knowledge, and skills/abilities

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(respectively *head* and *hand*) – by proposing a third dimension, revolving around attitudes and motivation (*heart*).

### *3.1. Head and Hand: The Capacity to Perform*

Knowledge is “specific information about a subject or a field” (Nordhaug, 1993: 51). It encompasses the facts and information that individuals acquire through experience or education, combined with a theoretical or practical understanding (<http://oxforddictionaries.com/>). Although there are several types of knowledge – Machlup (1980) identified 13 different forms – here I consider knowledge that has significant effects on management, that is specific (to the market and company) rather than generic knowledge (Becker, 1964; Grant, 1996a). A first key distinction can be made between practical, and more experience-based, knowledge (also referred to as procedural knowledge) and theoretical knowledge (also referred to as declarative knowledge), which is derived from reflection and abstraction from experience (Nahapiet & Ghoshal, 1998). A parallel distinction is between tacit and explicit knowledge. Tacit knowledge (knowing how) is characterized by its incommunicability, whereas explicit knowledge (knowing about) is codified and abstracted (Grant, 1996a). The former – tacit knowledge – has also been referred to as “automatic knowledge” and can include several different forms of implicit knowing, such as theoretical and practical knowledge of people as well as artistic, athletic, or technical awareness. The latter, explicit or “conscious knowledge”, typically consists of facts, concepts, and frameworks that can be stored and retrieved from memory or personal records (Nahapiet & Ghoshal, 1998; Spender, 1996).

A skill is defined as “a special ability to perform work-related tasks” (Nordhaug, 1993: 51). Nelson & Winter (1982) described skills as “a smooth sequence of coordinated behavior” involving a sequence of steps and having knowledge as a prerequisite. Managers

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need to possess technical skills, which relate to understanding and being competent at a specific kind of activity through the use of tools, techniques, and procedures; human skills, which relate to interpersonal relationships such as selecting, motivating, and leading other employees; and conceptual skills, which relate to understanding the total organizational picture by integrating and coordinating key company activities (Katz, 1974; Yukl, 1989). Pavett & Lau (1983) proposed a fourth set of managerial skills, involving political behaviors. These include self-serving behaviors, such as enhancing one's position, building a power base, and establishing the right connections (Robbins, 1979).

Finally, abilities – also referred to in the literature as aptitudes or individual capabilities, see for example Coleman (1988) – are defined as “natural talents that can be applied in work and that form a basis for the development of knowledge and skills” (Nordhaug, 1993: 51).

How do family businesses compare to non-family businesses with regard to individuals' knowledge, skills, and abilities? On the positive side, family members have deep tacit knowledge thanks to early and direct exposure to business matters (Lane & Lubatkin, 1998; Sirmon & Hitt, 2003). However, in general, the governance structure of family businesses is expected to be associated with a managerial, as well as a capital, constraint (Carney, 2005). The human capital pool is often limited to family members, which can mean hiring inferior employees if they are not suitably qualified or capable (Dunn, 1995; Sharma & Irving, 2005; Sirmon & Hitt, 2003). As a result of the reduced number of talented and/or skilled managers, a family firm's wealth creation may be constrained (Sirmon & Hitt, 2003). Non-family managers and directors can benefit family businesses with expert advice, specialist skills, and resources that a family business may not possess (Westhead & Howorth, 2006). However, even when family businesses decide to open their management to non-family members, they may have trouble hiring and retaining high quality non-family

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members in so far as they are excluded from succession, have limited opportunities for career progression, are compensated and monitored differently than family members, and have perceptions of unfair treatment because of bias and favoritism toward family members (Covin, 1994; Dunn, 1995; Lubatkin, Schulze, Ling, & Dino, 2005; Schulze et al., 2003; Schulze, Lubatkin, Dino, & Buchholtz, 2001; Sirmon & Hitt, 2003).

At the same time, family human capital is also credited with many positive attributes, including exceptional commitment and dedication (Sharma & Irving, 2005). This suggests that there is a further dimension in family human capital, which has to do with individuals' *heart*. In order to explore this third dimension of family human capital, I refer to Strategic Human Resource Management (SHRM) literature, which is a sub-field of human resource management.

### *3.2. Heart: The Willingness to Perform (Through Interest Alignment)*

The SHRM literature suggests that the existing classification of family human capital – as knowledge, skills, and abilities – is incomplete. SHRM is dedicated to the study of the role of the human resource function in supporting business strategy (Wright, Dunford, & Snell, 2001). It is based on the premise that human resources are vital to an organization's strategy because, through their behavior, individuals have the potential to provide the foundation for strategy formulation and implementation (Colbert, 2004). SHRM focuses on two key issues. First, it identifies the key role of individuals' knowledge, skills, and abilities. Second, it recognizes the fact that individuals' knowledge, skills, and abilities are not sufficient to create value for an organization, unless they are utilized through individual behavior (Colvin & Boswell, 2007; Wright, McMahan, & McWilliam, 1994). In other words, knowledge, skills, and abilities are necessary but not sufficient for individual behavior to be in line with a firm's strategy and lead to actual performance (Gottschalg & Zollo, 2007;

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Wright & Snell, 1991). Human resources are viewed not only as a human capital pool, but as cognitive and emotional beings possessing free will (Wright et al., 2001). Accordingly, human resources are valuable only if they act upon the potential to contribute to the competitive advantage of the firm, that is if they have a willingness to exhibit productive behavior (Lepak & Snell, 1999; Wright et al., 2001). Thus, a firm has a human resource advantage over another firm under two circumstances: first, there needs to be a stock of human talent and, second, the organization needs to manage an alignment of interest, in order to create a committed workforce (Boxall, 1996). This is important because the firm does not own the human capital, the individuals do. Individuals have discretionary behavior, i.e. within their organizational roles, they can decide how much they want to contribute and choose to engage in behavior that can benefit the firm to a greater or lesser extent (MacDuffie, 1995; March & Simon, 1958).

Given that “a person cannot win a game that they do not play” (Shane, Locke, & Collins, 2003), it becomes obvious that family human capital is not just about *head* and *hand*, but there is also a third dimension: *heart*. Human action is the result not only of cognitive factors (knowledge, skills, and abilities) but also of a willingness to undertake productive behavior (Locke, 2000; Shane et al., 2003; Wright et al., 2001). Theorists posit that, in order to achieve competitive advantage, firms need to *either* develop a human capital pool that has higher levels of knowledge, skills, and abilities *or* achieve a superior alignment between individuals and organization (Wright et al., 2001). Thus, since family businesses often do not possess a superior pool of human capital, in terms of knowledge, skills and abilities, they are often able to achieve competitive advantage thanks to a better alignment between the human capital pool and the strategic goals of the firm (Gottschalg & Zollo, 2007; Wright et al., 2001).

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Interest alignment is defined as “the degree to which members of the organization are motivated to behave in line with the organizational goals” (Gottschalg & Zollo, 2007: 420). Motivated individuals engage in behavior that allows them to accomplish certain goals because of the level of utility they can derive from such goals (Deci, 1976). This motivation is not only extrinsic, or linked to money, power and recognition, but also intrinsic, or associated with internal rewards such as the enjoyment of one’s work (hedonic intrinsic motivation) as well as with the compliance to the norms and values (normative intrinsic motivation) of the social community represented by the firm (Gottschalg & Zollo, 2007). As such, interest alignment is closely associated with affective commitment, which is an emotional attachment to and identification with an organization, revolving around the alignment between individual and organizational goals (Sharma & Irving, 2005).

Family members generally have high interest alignment with the family business because they identify themselves with the organization’s goals and values (Meyer & Herscovitch, 2001). Because they internalize the organizational goals and values (O’Reilly & Chatman, 1986), they display a willingness to exert effort on behalf of the organization (Mayer & Schoorman, 1992). This type of behavior is typically found in family businesses, in which family members value their firm and are willing to work together, help each other and contribute to ensure the organization’s future (Handler, 1989). Family members often base their sense of self and identity on the family business (Rosenblatt, deMik, Anderson, & Johnson, 1985) and boost their self-concept and self-esteem by fulfilling family obligations (Tsui-Auch, 2004; Westhead, Cowling, & Howorth, 2001). This derives from the fact that family members generally start at an early age to have hands-on training and, therefore, have a deep understanding of the nature of the business, its customers, and its competitors (Dyer, 1986). The firm also becomes a way for individuals to define their role in the local community (McGivern, 1978).

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### **4. Family Human Capital and Interest Alignment**

#### *4.1. Conditions for Creating Interest Alignment in Family Businesses*

The literature has identified several motivational mechanisms that induce individuals to behave in line with organizational goals. Here we refer to three such conditions: an appropriate reward system, a flexible job design, and strong socialization system (Deci, 1975; Gottschalg & Zollo, 2007; Lindenberg, 2001). These factors influence the three types of interest alignment presented above, respectively extrinsic motivation, hedonic intrinsic motivation, and normative intrinsic motivation (Gottschalg & Zollo, 2007). First, individuals may be driven by extrinsic motivation, which is linked to obtaining rewards such as money, power, or recognition. Such rewards (or, conversely, sanctions) are a function of individual behavior. Second, individuals who are driven by hedonic intrinsic motivation will engage in behavior that is enjoyable, self-determined, and competence enhancing. These perceptions can be influenced by changes in job design and in the context in which the job is carried out (Hackman & Gersick, 1990). Third, individuals who are driven by normative intrinsic behavior will act in a way that fulfills organizational norms and values, to the extent that such norms and values are aligned with those of the individual. Feeling that one is part of a social community at work can motivate individuals to behave in a way that fits with the norms and values of the organization (Deci, 1975; Gottschalg & Zollo, 2007; Lindenberg, 2001).

All three conditions are typical of family businesses. First, with regard to rewards, family members have been found to be paid higher wages than their market value or earning power (Burkart, Panunzi, & Shleifer, 2003; Sharma & Irving, 2005) and to receive higher salaries and perquisites than non-family members (Kirchhoff & Kirchhoff, 1987). Being part of the family business also allows family members to receive non-monetary rewards, such as participating in and influencing the social, political, and cultural community (Burkart et al.,

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2003). Second, with regard to job design, the closeness of family ties can lead to greater flexibility as is witnessed, for example, in the changes in work schedules that are frequently offered in family businesses, particularly to female family members (Salganicoff, 1990; Welsch & Pistrui, 1994; Westhead et al., 2001). Third, with regard to the socialization system, family businesses are uniquely characterized by a strong social element deriving from the interactions among individual family members, the family unit, and the business (Chrisman et al., 2005). These three interest alignment levers also interact with each other (Gottschalg & Zollo, 2007) and the fact that family businesses typically present all three suggests that the joint effect will generate a maximum degree of interest alignment. This discussion leads to the following proposition:

**Proposition 1.** Family businesses are more likely than non-family businesses to be characterized by superior alignment of interests between their human capital and organizational goals due to (a) higher external rewards, (b) more flexible job design, and (c) stronger socialization system.

### *4.2. Conditions for Sustaining Interest Alignment in Family Businesses*

Family businesses also seem to be in a winning position over non-family businesses when it comes to sustaining an interest alignment-based competitive advantage over time, particularly when the competitive environment is static. Gottschalg & Zollo (2007) considered the sustainability of competitive advantage in two types of environment, by distinguishing between the two extreme cases of static and dynamic environmental conditions. In stable environments, interest-alignment based competitive advantage can be maintained when interest alignment is based on inimitability, which can be achieved through tacitness, context dependence, and causal ambiguity. If these three conditions are satisfied,



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competitors have greater difficulty in detecting and imitating the conditions leading to interest alignment (Gottschalg & Zollo, 2007). First, tacitness can refer to the reward system (affecting extrinsic motivation), for example when bonus payments or promotion mechanisms are not made explicit; to job design (hedonic intrinsic motivation), if job descriptions are not codified and task requirements are not made explicit; or to socialization regimes (normative intrinsic motivation), if norms and values are implicit and not codified. Second, context dependence can refer to the reward system or to job design because the effect of these changes often depends on individual preferences and is tied to the attributes of the organizational context. The impact of changes in the socialization regime can also be context dependent because there will be greater effect if organizational norms and values are in line with strategic objectives (Van Maanen, 1978). Third, causal ambiguity plays an important role because the three types of motivation, and their causal mechanisms, interact with each other, therefore competitors will have difficulty in identifying the exact pattern of causal mechanisms between various interest alignment levers and the resulting motivational effects (Gottschalg & Zollo, 2007).

All three isolating mechanisms can be typically found in family businesses. First, family members generally possess deep firm-specific tacit knowledge, derived from their early involvement in the family business and transmitted through relations among family members, as well as direct exposure and experience (Coleman, 1988; Lane & Lubatkin, 1998; Sirmon & Hitt, 2003). Second, families have distinctive histories and experiences, characterized by complex and intricate relations (Coleman, 1988; Lane & Lubatkin, 1998; Sirmon & Hitt, 2003). Third, families' human capital is characterized by causal ambiguity, because individuals are the result of the family and the firm's unique history, and complexity, due to the intricacy of the family/firm relations. Thus, family human capital can be a source

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of sustained competitive advantage (Barney, 1991). This discussion leads to the following proposition:

**Proposition 2.** In static competitive environments, family businesses are more likely than non-family businesses to sustain their superior alignment of interests between human capital and organizational goals, thanks to higher (a) tacitness, (b) context dependence, and (c) causal ambiguity.

In fast moving environments, isolating mechanisms based on inimitability can actually become a liability because they prevent the firm from adapting to changes. In this case, the isolating mechanisms for competitive advantage are based on the firm's flexibility and adaptability to its external environment (Gottschalg & Zollo, 2007). In this type of context, it is crucial for firms to be able to adapt their configuration of interest alignment levers to the changing strategic objectives. This can be achieved by modifying the reward system or job design and is actually easier for family businesses where the socialization system is based on cultural norms and values that are shared by individuals belonging to the same family. Although there are not many studies on organizational adaptation in family businesses, two recent papers provide relevant insights (Chirico & Salvato, 2008; Hatum & Pettigrew, 2004). First, greater adaptability and flexibility in family businesses has been found to be associated with a strong identity, based on a set of core values that are shared among different generations (Hatum & Pettigrew, 2004). Interestingly, this finding is contrary to some organizational studies, according to which a strong identity can hinder a firm's ability to identify changes in the market and willingness to change (Burgelman, 1983; Ouchi, 1981). This may be explained by the fact that family members sharing common values may also understand each other better, which in turn can reduce the time and effort associated

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with reaching an agreement on important issues (Chirico & Salvato, 2008). These individuals may also enjoy reduced levels of relationship conflict, which can facilitate knowledge integration and change efforts within the family firm (Chirico & Salvato, 2008; Davis & Stern, 1988). Second, a family business has been found to be more flexible if it gives more autonomy to its managers and implements greater formalization and control, which are typical of later stages of a firm's lifecycle (Hatun & Pettigrew, 2004). Again, this differs from previous findings in studies of non-family businesses, in which lower levels of centralization and formalization have been found to be associated with organizational flexibility (Bahrami, 1992; Damanpour, 1991; 1992). Third, dynamic adaptation of family businesses seems to be associated with knowledge integration among family members (Chirico & Salvato, 2008). Such integration and recombination of specialized knowledge from different individuals is typical of family firms, particularly because there are high levels of firm-specific tacit knowledge (Chirico & Salvato, 2008). Finally, adaptability in family businesses has been found to be associated with the presence of non-family managers (Hatun & Pettigrew, 2004). Thanks to their different experiences, the presence in the firm of individuals who come from outside the family brings greater cognitive diversity and heterogeneity of views, which can enable the firm to be more flexible and enhance its management's role in promoting action (Hatun & Pettigrew, 2004). This fourth condition is more in line with organizational literature, which shows that firms with a heterogeneous dominant coalition are more adaptable to changes that are happening in the environment (Bahrami, 1992; Volberda, 1996). Whilst two of the abovementioned factors (strong identity and knowledge integration) are typical of family businesses, the other two (formalization and non-family managers) are not always present in family businesses. This discussion leads to the following proposition:

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**Proposition 3.** In dynamic competitive environments, family businesses are more likely than non-family businesses to sustain their superior alignment of interests between human capital and organizational goals, if there are: (a) a strong identity, (b) formalization, (c) knowledge integration, and (d) presence of non-family managers.

### **5. Discussion**

Because of the intrinsic social nature of family businesses, there has been greater progress in developing the social capital component of family businesses (e.g., Pearson et al., 2008; Salvato & Melin, 2008) than its human capital component. These developments have been largely based on Nahapiet & Ghoshal's (1998) theoretical model on social capital, which identified three interrelated dimensions of social capital: a structural, a relational, and a cognitive dimension. The structural dimension of social capital refers to the overall pattern of connections between individuals (who they reach and how they reach them); the relational dimension refers to assets created and leveraged through relationships, including trust, norms, obligations, expectations, and identification; and the cognitive dimension refers to the shared representations, interpretations, and systems of meaning among individuals.

This paper draws attention to the structural and cognitive dimensions of family human capital (the relational dimension is, by definition, idiosyncratic to social capital), and introduces a third – behavioral – dimension.

The term structural, according to Oxford Dictionaries (<http://oxforddictionaries.com/>), refers to “the arrangement of and relations between the parts or elements of a complex whole”. Therefore, in the analysis of family human capital proposed herein, the structural dimension is taken to consist of the basic characteristics of a person, whose outcome is efficient work performance (Nordhaug, 1993). According to the literature, these characteristics consist of knowledge, skills, and abilities. Knowledge is considered to be a

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necessary, albeit not sufficient, condition for the possession of skills. An individual may have knowledge but no related skills. Also, if skills are associated with some ability or aptitude, individual performance may be superior: for example, two individuals may have equal knowledge about how to perform the skill “mastering a foreign language” (with regard to vocabulary, grammatical structure, and so on), however one may speak the language better than the other because of a natural talent for musicality and a lack of intonation or accent (Nordhaug, 1993).

The second dimension of family human capital relates to cognition, which is “the mental action or process of acquiring knowledge and understanding through thought, experience and the senses” (<http://oxforddictionaries.com/>). The distinction outlined above between tacit and explicit knowledge is mirrored in the way such knowledge is acquired: tacit knowledge is attained through application and experience, while explicit knowledge is acquired through abstractness and communication (Grant, 1996a; Spender, 1996). Similarly, Becker (1993) identified two types of investment in human capital: on-the-job training (general or specific to a firm) and education/formal training. Although there is a debate over whether organizations, as well as individuals, are learning entities (Huber, 1991; Spender, 1996), the focus here is on the individual-level knowledge and learning (rather than on the social processes that generate knowledge – see for example Nelson and Winter, 1982). Knowledge creation is typically an individual activity (Grant, 1996a) and “all learning takes place inside individual human heads”. Simon, who represents one extreme of the argument about individual vs. organizational learning, argued that organization-level learning can only take place through individual learning: “an organization learns in only two ways: (a) by the learning of its members, or (b) by ingesting new members who have knowledge the organization didn’t previously have” (Simon, 1991: 125).

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Family businesses can enjoy at least three types of advantages over non-family businesses with regard to the acquisition of knowledge. First, according to the resource-based view, the issue of knowledge transferability is one of the crucial factors determining competitive advantage (Barney, 1996; Grant, 1996a). Explicit knowledge is transferred through communication, whilst tacit knowledge is transmitted through observation, application, and practice. Thus, in general, transferring tacit knowledge is considered to be slow, costly, and uncertain (Kogut & Zander, 1992). However, family businesses are at an advantage over non-family businesses because tacit knowledge is easily transferred thanks to the early involvement of the next generation in the firm and to relations among family members providing direct exposure and experience (Coleman, 1988; Lane & Lubatkin, 1998; Sirmon & Hitt, 2003). Second, family businesses possess another advantage relating to common knowledge, that is the integration and intersection of each individual's knowledge (also referred to as social tacit knowledge, see Spender, 1996). Sharing and combining knowledge, rather than knowledge itself, are considered to be a key source of competitive advantage (Grant, 1996b). Family members enjoy a common language, both verbal and symbolic, have high shared understanding thanks to their personal ties, and benefit from mutual cognitive frameworks and shared stories (Grant, 1996b). Third, family businesses typically recruit internally (from the family) and this means that high levels of market knowledge are combined with high levels of firm-specific knowledge. Instead, externally recruited managers may possess high levels of market knowledge, as well as experiences from previous employments which can be combined with knowledge inside the organization to create new insights and perspectives. However non-family managers need to interact with family managers to make up for their lack of firm-specific knowledge and to ensure that knowledge creation can take place (Mäkelä, Björkman, & Ehnrooth, 2009; Sirmon & Hitt, 2003).

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Competitive advantage is best achieved when the individuals who represent the core assets for the firm (i.e., those that are both valuable and unique) are developed internally (Lepak & Snell, 1999). Family businesses have an advantage because they do not have to incur the managerial and bureaucratic costs that non-family businesses sustain in order to select, train, and compensate their employees (Rousseau & Wade-Benzoni, 1994). Furthermore, family members are by definition unique to the family firm and the social complexity, causal ambiguity, and tacit knowledge that derive from such uniqueness highlight the benefits of internalizing employment in family businesses (Lepak & Snell, 1999). Family members constitute a human capital pool that is idiosyncratic to a particular firm and, therefore, is best developed internally.

The third dimension of family human capital relates to behavior, which can benefit a family business if family members' interests are aligned to those of the organization. Such interest alignment-based competitive advantage is expected to be typical of family businesses, especially thanks to the socialization of norms and values. As suggested by stewardship theorists, family managers will typically behave in the firm's best interest because they subordinate personal goals to family goals and follow relational contracts that govern family business behavior (Corbetta & Salvato, 2004; Davis, Schoorman, & Donaldson, 1997). Furthermore, family businesses are in a favorable position in sustaining their competitive advantage in static competitive environments, because the tacitness, context dependence, and causal ambiguity (which are characteristic of this type of organization) act as isolating mechanisms precluding competitors from imitating (Gottschalg & Zollo, 2007). In dynamic environments it may be more challenging for family businesses to sustain their competitive advantage, because they need to be adaptable and flexible and they can best achieve this, not only thanks to the strong identity, core values, and knowledge integration that typically characterize them, but also if they implement formalization and control systems

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and hire external managers, which are conditions that are less typically found in family businesses (Hatun & Pettigrew, 2004).

### 6. Conclusions

Successful family businesses are often characterized by distinctive characteristics and strategies (Astrachan, 2010), which are due to family involvement in ownership, governance and management (Klein, Astrachan, & Smyrniotis, 2005). Several scholars have directed their attention to the distinct social capital of family businesses. This paper has focused on the under-researched individual level, by arguing that family businesses also benefit from their human capital and that, without individuals, there can be no social aspect. The knowledge, skills, and abilities of family members (*head and hand*) may be inferior to those of non-family members, with the exception of family members' tacit knowledge that is specific to the firm, its history, and objectives. However, family businesses frequently benefit from a third dimension of human capital, relating to what has been termed here as *heart*. Such advantage is exemplified by family members' enhanced willingness to exhibit productive behavior. Greater interest alignment can lead to the creation of competitive advantage, which can be sustained through isolating mechanisms based on inimitability or adaptability, depending on the nature of the competitive environment.

#### 6.1. Limitations and Future Research

This paper has limitations. First, because I have focused on the performance effects of interest alignment between individuals and their family firms, I have made the assumption that all other determinants of firm performance are held constant (Gottschalg & Zollo, 2007). Second, I have considered human capital as a standalone resource for family businesses, whereas it clearly has deep links with their social capital. Social capital is considered to



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complement human capital by providing it with a context (Burt, 2000). Human and social (as well as economic) capital often interact synergistically and have a positive impact on firm performance (Pieper & Klein, 2007; Rothausen, 2009; Zellweger & Nason, 2008). Social capital can influence the creation of human capital in subsequent generations: for example, genetics inherited by the next generation may be irrelevant if strong social capital is not present to facilitate effective child development (Coleman, 1988; Sirmon & Hitt, 2003). In terms of their consequences, human and social capital are complementary, because returns to intelligence, education and experience (human capital) are, in some part, associated with an individual's position in the social structure of a firm (Burt, 1997). Several other scholars have noted that assuming that individuals are atomistic and isolated may hinder us from understanding important social, institutional, and organizational processes (e.g., Spender, 1996). Training may create a highly productive workforce, however path dependence, in which the benefits of training accumulate over time, and the resulting bundles of routines are also crucial drivers of performance that are so difficult to recognize and imitate (Nelson & Winter, 1982). Although I recognize that social entities such as family businesses are best understood as holistic systems, and not just as aggregations of interrelated constituents, my key concern at this stage is to clarify the definition and dimensions of family human capital. Thus, the next step in future research would be to test the propositions that are proposed herein. Further research efforts can then move on to analyzing the relations with other components such as social capital and the organic nature of the family business (as suggested, for example, by Stafford, Duncan, Dane and Winter's (1999) sustainable family business research model). Once each component, and its dimensions, has been clearly defined and operationalized, future research can focus on developing a multilevel model, aimed at explaining how individual behavior (micro level) and social dynamics (group level) may explain organizational-level outcomes (Hitt, Beamish, Jackson, & Mathieu, 2007). This

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approach would differ from previous research, which has generally considered family business constructs at the organizational level (Habbershon & Williams, 1999; Pearson et al., 2008), and would better reflect the multiple levels of analysis that characterize family businesses (Pieper & Klein, 2007). In turn, multilevel analysis can contribute to our scholarly understanding of nested nature of family businesses as complex systems with multifaceted individual and social factors (Hitt et al., 2007). Family firm practitioners may find the insights presented here on interest alignment levers – in static and dynamic environments – to be particularly useful for addressing the challenges that family firms face in achieving competitive advantage.

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