The Role of family Business in the Economy

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ABSTRACT

The scope of paper is the role of family business in the economy. This topic is important because family business is the platform from which most SMEs sprung and a significant part of the GDP in many countries, particularly those of the ASEAN, depends on SME and family businesses. We assert that family business is a form of direct domestic investment for the economy. Success in family business means economic growth for the nation. As such, the success or failure of the family business serves as an indicator for the health of the national economy. Family business springs from successful entrepreneur; since an entrepreneurial is the source of innovation, family business also serves as an incubator for innovation which, in turn, contributes to economic growth.

Keyword: entrepreneur, entrepreneurship, family business, direct investment, innovation

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1.0 INTRODUCTION

The objective of this paper is to provide an over all view of the role of the family business in the national economy. Family business plays a significant role in the life of the economy. It is a mistaken idea to think that large corporations are the only maker and shakers in the national economy. Large corporations have their humble beginning. They are the out growth of SMEs that had gone through the natural growth process where formal structure becomes institutionalized. SMEs too are the extension of the success of family businesses. In part 1, we have learned that the family business is the development of a successful enterprise of an entrepreneur. This paper paints the picture of the family business as an active participant in the economy. The significant contribution by the family business to the national economy is an indicator of the economic health of a nation. No matter how advanced is the economy family business always plays a significant role in economic growth and job creation for the community. For the state, family business remains a stable source of tax revenue and an important base for political support.

This paper also attempts to answer these questions: *Is there a theory governing or explaining family business? What is a family business model?* The theory of firm explains the omnipresence of the need for profit maximization; however, in family, business where the structure is less formal and the fiduciary is not as stringent as in a formal corporate structure where the stakeholders include people and institution who do not have direct contact with the enterprise, family business deals with a different demographic of stakeholders: family members, customers, suppliers, distribution channels, and, inextricably---the state. Under these facts, *what is the functional model that helps explain the operations and success of a family business?*

2.0 FAMILY BUSINESS, INNOVATION, AND ECONOMIC GROWTH

Family business refers to a business or a commercial enterprise that is closely held or owned within the family. There is no need to define the term family; it is suffice to accept a broad concept that for purposes of family business, the term 'family' refers to the filial relationship that defines the ownership of the business. Where applicable, the terms 'business' and 'enterprise' may be used interchangeably.

Innovation, as defined in paper 1, refers to the increase in economic output with the same level of input (performance innovation) or maintaining the same output with the decrease in input (input innovation) through the improvement of methods or procedure of the production process. Family business is the master in resource management. Family business, like all organization but more so in family business, is faced with limited resources. Family business uses the available resources to create value. The position taken by this book is *value creation*, not *value additivity*. Value creation refers to the creation of value from an existing resource which is not used and, thus, creates no value in a case of an idled asset. In a case where the asset is not idle, the resources are diverted or converted to other activities or the same activity but under a new and improve procedure to create additional output. This process is known as value creation. Value additivity, on the other, is to add value to an existing product. The addition of value is achieve through adding addition features or function into an existing product, as the result cost increases. With the increased cost, in order to maintain the same level of profit the producer has to increase price. The increasing in rice may draw ire from the market if the introduction of the 'improved' product is not carefully orchestrated.

Economic Growth refers to the growth of the general wealth in the economy. This growth is generally measured in a form of the Gross Domestic Product (GDP). Family business is an indispensable part of the economy. As a significant player in the creation of value, and hence, the national wealth of a country, family business serves as an important indicator for the health of the economy. Both foreign and domestic investors may look to the performance by family business as an indicator for the over all health of the economy and make investment decision accordingly. Since family business plays a significant role in contributing to the economic growth of a country, this paper also explores some state policy issues that may be relevant to family business in the section: *Domestic Direct Investment (DDI).*

3.0 THE FAMILY BUSINESS

Family business is a business or enterprise that is owned by one or more members of the family. It is more organized than an enterprise run by an entrepreneur because it is one stage further in development compared to an entrepreneurship. An entrepreneur's enterprise is a risk taking activity in a sense that the entrepreneur answer to no one. Being his own boss, an entrepreneur is a one man show. As such an entrepreneurship is a risk taking enterprise. As a risk taking enterprise, an entrepreneur wage in at all front and make himself appear to have a specialty affinity for risk. In deed an entrepreneur takes risk and entrepreneurship is a risk taking enterprise. To that end, Cantillon was correct in asserting that an entrepreneur, hence an entrepreneurial enterprise, pays a known sum for an unknown gain. A family business, on the other hand, is more formalized and more structured.

A family business is more formalized than an enterprise run by an entrepreneur. The formal structure of a family business lies in the fact that it has moved from a one-man enterprise to an operation that involved more people. These people include family members and other stakeholders, such as employees, suppliers, distributors, and

Other writers claim that as part of the formality, the family business institutes something akin to a 'council.' Although there is a semblance of formality in a sense that the operation involves more than one man, the entrepreneur, a claim of 'council' or a family 'board' is a fantasia. The head of the family business remains the original entrepreneur who started the business. The decision making process remains unidirectional. The information flow and decision making remained unilateral. There might be discussion or consultation among family members; however, ultimately the decision making remains dictatorial. The idea of a family council is a mental construct by writers who try to make sense of the semblance of formality in what otherwise would have been unstructured.

Structure is an additional feature that appears in a family business. When an entrepreneur operates as a sole proprietor, the enterprise does not have any organization and, therefore, is unstructured. Once the entrepreneur transforms the business into a family business, an organizational structure begins to appear. The structure may appear in a form of shared ownership, shared responsibility, shared risk, and share benefits. The ideas of 'shared' interests and responsibilities increase the layers of stakeholders in the enterprise. The decisions were made instantaneously prior to the introduction of shared interests and shared responsibility would now take longer time and involve more people. The conduct of the family business becomes less *ad hoc* and more formal within a confine of well define structure.

The interest of the family and the interest of the business may not coincide. The family may need money for personal expenses, but the business may require the capital to remain in the business account (Loewen, 2008). The formalization and structure in the family business does not necessarily result in complete coherence. In an entrepreneurial enterprise, the business and personal interests are inseparable because the entrepreneur is the sole proprietor. However, in a family business, although the ownership remains within the family, the ownership of the business may vest in more than one hand. As such, the use of any money in the family business may involve more than one decision makers. Sometimes this decentralization of power may cause internal conflict among group members.

The internal conflict may threaten the life of the family business unless it is resolved. Since family business involves mostly members of the same family, conflicts are considered internal and could be resolved internally. Under such circumstance, it is expected that conflict resolution in a family business may be swift because it is not contentious. This is not to say that the idea of 'family council' exists as a means to resolve internal conflict in a family business because ultimately if the conflict festers, the head of the family business will exert authority and assumes the position of a final arbiter. Although the term 'arbiter' is used, there is no arbitration. The decision is more dictatorial then consultative. Consultation implies the dispensation of knowledge by one who knows more to another who knows less about a certain subject matter. However, this type of knowledge seeking does not exist in a family business. The erroneous claim that a family business has a 'family council' comes from that fact that in case where there is an internal conflict, the group attempts to resolve the issue. However, the resolution does not come from consultation. The decision making authority is still retained by the original entrepreneur, i.e. sole proprietor. Internal conflict occurs when the sole proprietor is indecisive and allows the decision making process to be pluralistic. Where there is chaos, the sole proprietor restores order by reestablishing himself as the ultimate decision maker. This decisiveness breaks the indecision from conflicts within the group. The concept of 'democratic decision making' in a family business is a mental construct of academics who failed to fully credit the sole proprietor or entrepreneur of the family business as the final arbiter of all decisions.

3.1 Family Business as a Source of Innovation

A family business may be a source of innovation. Innovation has been previously defined as the use of existing resources to increase productivity. Five elements must present in order to be successful: (i) defined goal, (ii) align goals to actions, (iii) team participation, (iv) communication, and (v) access to information (O'Sullivan, 2002).

Defined goals exists with both entrepreneurial enterprise and family business, but more so in family business. An entrepreneur lives much of his life in the Cantillon world: known fixed cost and unknown income. However, the world of the family business is more finite. The definiteness of the family business comes from the fact that a family business owner involves more people in the enterprise. For that reason, the action of the family business must be guided by set goals or objectives. With definiteness in goals or objectives, the family business builds for itself a confine within which the enterprise operates. The *advantage of defined goals* allows the family business to stay focus of a certain path in order to achieve an increase in economic productivity for any given level of input. A business focus allows the family business to confine its conduct within a certain core areas. Since it involves many people in the enterprise, the decision to stay within a certain confine of business scope is less arbitrary and more thoughtfully planned. Even if the family business owner may at times be dictatorial in the decision making process, the overall condition under which the decisions are made is less arbitrary in the family business setting than it is in the entrepreneurial enterprise run by a single entrepreneur who answer to no one. Moreover, the defined goals of the family business allows the enterprise to contain risk by not over being expansive in business scope. An entrepreneur takes any thing that comes his way---anything that seems profitable. For an entrepreneur, any risk is worth taking so long as the risk promises some degree of returns that exceeds his initial investment. However, a family business cannot afford to have such a liberal approach to resource utilization.

The *disadvantage of defined goals* is that the goal may be over ambitious. Since the family business faces the first barrier in an entrepreneurial enterprise, that is a structural constraint, it cannot afford to be every where at any time. It needs to confine itself to a certain field of business, within a territorial confine, industry, or product line. Unlike an entrepreneur who may search for opportunities and accept every opportunity that comes his way, a family business lacks that liberty due to the structural constraint of the business. Being a family business means that the enterprise has some semblance of an organization. An organization by definition is the institution of structure. Structure means constraint. Constraint means the lack of complete liberty. With defined goals, the family business may not pursue all business opportunities; it could and would pursue only those opportunities that falls within the family business' goals. These goals are determined by the core competence of the family business. The defined goals limit the family business to roam freely in the market. This lack of freedom to roam may be disadvantageous to the family business.

Align goals to actions requires the family business to channel its resources to the undertaking that would lead to goals achievement. The need to achieve in the family business and in an entrepreneur is not the same. An entrepreneur needs to succeed. Success for an entrepreneur is an increase in wealth no matter from what source. However, the family business adopts a set of goals. Resource utilization is dictated by the objectives of these goals. The goals are defined and determined by the family business' area of concentration or core business.

By aligning resources to goals, the conduct and actions of the family business is more concerted. A concerted effort guided by goals and objectives allows the family business to be more organize. Resource utilization by the family business is more effective and efficient. *Effective* means that the resources used to produce a defined target indeed had achieved the production regardless of how much it cost. *Efficiency* is defined by achieving a target at the lowest cost possible. Under these standards, the family business is efficient in resource utilization. The innovative nature of an entrepreneur makes him resourceful through the re-use of existing, but idled, resources.

In goal-action alignment, the family business breaks a new frontier in capacity limitation. An entrepreneur is limited to one man's ability. A family business is more organized, planned, and approach the business in a more structured fashioned. In so doing, the family business can always predict the outcome of the investment. For this reason, the family business frees itself from the confined built by Cantillon: known cost and uncertain income that is characteristic of an entrepreneur. Since the family business has a defined goal and aligns its action in a direction towards achieving that goal, the family business operates in an environment that has a higher degree of certainty.

Team participation exists both in entrepreneurship and in family business; however, team participation in these two businesses setting is not the same. For an entrepreneur, lacking organization he does not have a team; he acts by and form himself. In a family business, the enterprise conducts itself by concerted effort of group members. The head of the family business must be a team player in order to move things along. However, when conflict occurs or there is indecision, the head of the family business must show his absolute authority to break the inaction of the group. There may be grumbling disagreement among some group members, but the organization moves forward and members of the group would learn to accept the reality of a family business: *despite a semblance of structure, the final decision making still rests on the hands of the business owner*.

Communication is defined as "… any act by which one person gives to or receives information from another person about that person's needs, desires, perceptions, knowledge, or effective states. Communication may be intentional or unintentional, may involve conventional or unconventional signals, may take linguistic or nonlinguistic forms, and may occur through spoken or other modes."(*See* National Joint Committee for the Communication Needs of Persons With Severe Disabilities, 1992). In family business, intra-organization communication is more evident that in the case of an entrepreneur who acts alone. By communicating with members of the organization, family business can maintain effective channel for information flow from outside into the organization, from the organization to the outside, and within the organization among members. This open channel allows the family business to gather and evaluate information prior to making decisions. Decision making is not left to chance or arbitrary response. Open channel communication allows the family business to make informed decision. Informed decision is defined as the decision making resulted from taking all available and relevant facts into consideration. Effective communication allows the family business to reduce risk by reducing uncertainty.

Access to information makes innovation possible because information allows the business owner to know the current market condition and anticipate future condition. A family business is a source of innovation when it has full access to information. There are two types of information: useful information and useless information. Useful information must have the following features: *relevant, timely,* and *accurate*. An entrepreneur is at disadvantage when it comes to access to information because by operating in an unorganized environment and without structure, he is left to his core competence. The information that is available to him is circumscribed by his vision, which sometimes may be myopic. A family business, on the other hand, has better access to information because a family business acts as a group. Members of the group may contribute to the sources and access to information. In so doing, the decision made in a family business is more informed; therefore, a family business has less exposure to risk from misinformation or making decision without adequate information than its entrepreneur counterpart.

4.0 INNOVATION AS A SOURCE FOR ECONOMIC GROWTH

Economic growth may be seen at two levels. At the micro level, growth may be evidenced by the profitable operation of the family business. At the macro level, growth may be seen as the aggregate increase of the economic production of the country. The family business being part of the economy plays a role in contributing that growth. Several questions are presented: *What is the role of innovation in family business? How does innovation contribute to growth of the economy?*

Innovation and family business are connected by the extension of success and development of an entrepreneur whose enterprise has outgrown the one-man operation. As an individual, and by definition of 'entrepreneurship,' the entrepreneur is resourceful and innovative. He is resourceful because he uses idled assets into a productive source of income. He is innovative because an entrepreneur can use the existing resources, idled or not, and produce something new, better and more. This trait of the entrepreneur is carried into the family business. Thus, one source of innovation in the family business comes from the entrepreneur who originated the family business. This is called the *spill-over effect*.

In addition to the spill-over effect, the family business may instill into itself the innovative spirit from within the organization. Family business by its nature is small in size, although some family business may be large and dominate an industry, in order to fully understanding the inner working of a family business it is imperative that we work with a simpler model: a small family business unit. In a small family business unit, the unit is left to fend for itself. Corporations have better access to the market and the institutional support in the market, such as banking and finance. However, a family business does not have that luxury or opportunity due to its small size and informal structure which---according to the formalized market structure---lacks creditability and market standing. Therefore, the family business is left to fend for itself.

By fending for itself, a family business is always take and offensive and defensive stands. Offensively, the family business must break new ground in the market in order to stay alive. The primary goal is to stay alive. The ideas of go ahead and stay ahead for family business is still a distant ideal. In order to stay alive in the market, in face of growing competition and the increasing squeeze from larger and more formidable corporation, a family business is compelled to be even more resourceful than an entrepreneur. By enacting self-defense mechanism, a family business searches for new means of doing the same thing and to do new things with the limited resources that it possesses. In so doing, the family business becomes innovative.

Innovation is the application of the current resources to increase productivity. It is the doing the same thing with the same resources, but producing a higher level of output. An innovative family business is always under pressure to produce more. In order to produce more, with limited resources under its control, the family business must be resourceful. If innovation means efficient production and efficient production means increase the production level with the same level of input, then it is reasonable to posit that the family business contributes o the increase in economic growth. Family business is a significant component of the economy; therefore, this argument is logical and is not a leap pf faith. In some countries, family-owned SMEs may account for as much as 40% of the total GDP.

The second question asks: *How does innovation contributes to economic growth?* Innovation means an increase production with the same input level. Another definition of innovation is efficiency. There are two types of innovation: input innovation and output innovation. Input innovation refers to cost reduction in order to maintain the same level of production. Output innovation refers to the increase of production level with the same level of input. Under these definitions, it is clear that where there is innovation there involves the increase in production, i.e. economic growth.

Economic growth had been explained by many writers. Classical economist explained economic growth as the result of capital accumulation; however, in the 21st century the new theory is *innovation economics*. According to innovation economics, economic growth results from innovation and spur in technological advances (Antonelli, 2003). Under this new theory, the number of patent applications is used as evidence to prove that innovation is the driver for economic growth (Fornmahl *et al.*, 2011). Economic growth does not come from capital accumulation; growth comes from the close link between business and technology (Peilei, 2011). The steady growth of the US economy was a result of relentless pursuit of technology (Steil *et al.*, 2002). Economic growth comes from innovation (Ahlstrom, 2010), not capital accumulation as classical economist had preached. This new theory is particularly relevant to family business because at the heart of family business is the entrepreneurial spirit that spilled over from the metamorphosis of an entrepreneur to a family owned business. As such, the innovative spirit remains active in the family business. Success in family business, in face of keener competition from more formalized and structured corporate producers, is due to its innovative capacity. To that end, because family business constitutes a significant part of the national economy, family business plays a role in economic growth. Since growth comes from innovation---at least under innovation economics school of thought; therefore, the contribution to the over all economy by family business is a further evidence to support the new school of though.

5.0 THE ROLE OF THE FAMILY BUSINESS IN THE ECONOMY

Among listed international firms, 45% are family owned (La Porta and Schleifer, 1999). The family business always has a role to play in the economy. It is central to the inner function and working of the national economy. By definition, family business starts out small and many also remain small, but active in the economy. Since family business requires less capital to operate, the barrier to entry into this type of operational and ownership structure is less restrictive. Therefore, the potential for sector growth is big.

If the life cycle of a business is examined, it is possible to see that family business has a significant role to play in the economy. In the most simples form, an individual entrepreneur engages in an enterprise. Assume that the enterprise becomes successful and grows this growth would naturally lead to the inception of a family business. Not all successful entrepreneurs involve their families and not all of them transform themselves into a family business. There are some successful entrepreneurs who remain unorganized and uninvolved. The alternative route is the second stage where the successful entrepreneur involves his family. In so doing, family members become involved n the enterprise. The enterprise, unlike in the hands of the entrepreneur where structure and organization did not exists, the family business is organized and structured. The size of the operations may also expand to a larger size under the family ownership. The scope of the business may more be focused and risk exposure is reduced. In time, if the family business continues to succeed, it may enter the next stage: SMEs and will ultimately become a corporation. At every stage of the development, the business generates economic activities. These activities contributes to the over all economy.

5.1 The Role of the Economy in Family Business

The previous section speaks to the role of the family business in the economy. The economy also has a role to play in the family business. The operations, i.e. success and failure of family business depend on its environment. That environment is the over all economy. The role of the economy in family business is less explored. This aspect of the study is often overlooked because the economy is a macro picture. As a macro factor, we tend not to consider its role in small business. However, small business operates inside this larger environment. If the health of the economy is ailing, the operations of the family business may also be affected.

Too look at only the role of the family business in the economy is to paint an incomplete picture of the state of affairs. The economy also has a role to play in the family business because the family business operates in the greater operating environment, i.e. the market and the market is the economy. As stated in the previous section, the growth of the economy also depends on the growth of family businesses. If the economy slows down, the family business will be adversely affected.

The owner must take this point into consideration in the management of the family business. This point becomes more relevant in the context of growth and development. Family business is not the ultimate developmental climax of a business. A successful family business will grow into SME and from SME the business will reach a corporate structure. As the economy grows, the family business would also grow with it; with that growth, it will enter a new stage of its life cycle. As the economy slows down, this too will also affect the family business.

The question then arises: *in time where the economy recedes, can family business regress to an unstructured enterprise, i.e. unorganized entrepreneurship?* In the worst case scenario, that would be the natural trajectory of the business. If the adverse effect from the economic recession forces the family business to scale down, the natural path of the shrinkage is to revert to being an unorganized enterprise run by an entrepreneur. This directional movement is worth exploring because not too many type of organization can be such flexible. When a corporation fails, it shuts down and goes out of business. However, when a family faces hard time, it can scale down and ultimately survive by its bare bone form: entrepreneurship. Entrepreneurship is a fall back position for the family business. However, for a corporation failure leads to bankruptcy and ultimately dissolution. To that end, the family business is more flexible in structural adjustment.

The role of the family business is more enduring that the corporation. A failed corporation has no where to run or hide. A corporation moves in one direction. A corporation does not have too many choices; there is no fall back position if it faces an enduring recession. The family business, on the other hand, retains the flexibility of having entrepreneurial enterprise as a cushion against external economic shock. Under this perspective, the role of the economy in the family business is vital, but not fatal. In times of success and growth, the family business rides along on the rising wave of that growth. In time of recession, the family business may scale down to its bare bone origin of entrepreneurship. As the economy recovers, the entrepreneur will pick up the operation and continue his business. The cycle continues. The economy exerts its forces upon the family business. The family business is in a response mode when the economy is bad. In time of growth, the family business may be on the proactive mode in putting itself forward in the market and expand its operation to propel itself to the next stage of development: SME and ultimately a corporation.

5.2 Family Business and Direct Investment

The term direct investment is usually referenced to “foreign direct investment” or FDI. However, in this section, direct investment refers to the fact that in family business, since the structure of the ownership is retained within the family, the investment generally comes from the family fund. The capital structure of the family business is not as complicated as common found in the corporate setting. Family business and direct investment go hand-in-hand. Generally, family business grows out of the success of an individual entrepreneur who then involves other family members in the enterprise. For that reason, the capital used in the family business generally consists of funds that are pooled from family members. In such a closely held situation, there are both advantages and disadvantages. This section explores the source of capital as a source of direct investment in the family business and how pooled fund among family members contribute to potential conflict within the group.

Pooled fund is a form of joint contribution among family members. The money is collected from family members who contribute to the family business. The contribution to the pooled fund may be in a form of loan or direct investment. As a loan, the family business would have to repay the loan. As a pooled fund for direct investment, generally the owner of the money becomes involved in the family business, such as a employee of that business. In both situations the pooled fund is raised outside of the conventional banking channel. For this reason, family business is often looked upon as an *informal sector* of the economy.

Family business is considered part of the informal economy because its capital is raised outside of the conventional banking system. In addition, the ownership of the business is closely held and the size of the operation is generally small in comparison to other forms of businesses, i.e. those who had succeeded to SMEs or corporation. Moreover, the structure of the family business is also informally organized. The ownership, control, and operation of the business are kept inside the family. Lacking general public participation in the ownership structure and small size, family business remains part of the informal sector.

5.3 The Role of Family Business in the Economy *Revisited*

Despite the fact that family business is part of the informal sector, family business plays a significant role in the economy. For that reason, the performance of family business may be used as the indicator for the economic sentiment in the industry, sector or the economy as a whole. In most developing and undeveloped nations, family business comprised a larger share of the economy. In the advanced and more developed economies, family business also plays a significant role in the economy.

In addition to making contribution to the economic production of the national economy, family business also indirectly provides important information to outsiders. Foreign investors looking for investment opportunities in a country may assess the economic environment of the country by looking at how family business and the rest of the informal sector's performance as part of the decision making process. If family business is succeeding, larger corporation may see unfulfilled needs in the market and might considered such a market as a target for penetration. Moreover, failure of family business also provides useful information to foreign investors. The failure of family business may suggest that the business environment is competitive and not conducive to small scale operation. There are many possible conclusions that could be drawn from the condition and status of family business.

Family business is a useful indicator for foreign investment. Foreign investment in a country generally does not come directly to family business. Foreign investors do not seek partnership among family businesses. However, they use the performance of family business as part of the decision of whether to penetrate the market or not. Family business is a risk indicator for foreign investors. This beneficial role of family business has never been recognized. It has been overlooked because the general economy still treats family business and part of the informal sector.

The perception of family business as part of the informal economy also limits the growth and pace of change among family business. Since family businesses are generally small and possess smaller amount of assets, they not as attracting to the leaning market. This perception further contributes to the limitation of expansion as the result of lacking access to the capital market. Consequently, the capital structure of a family business is inward looking and limited to the availability of personal fund among members of a small circle.

The concept of pooled fund among family members forces family business to be more conservative in the use of the fund. This limited fund further forces the family business to be financially disciplined in selecting the field of its investment, direction of business expansion, and in general its resource utilization. In so doing, the family business is forced to adopt more stringent rule in resource allocation and risk exposure. His is part of the process that transforms the family business from an informal and less structured entity to the SMEs with more formality and structural constriction. *Under such circumstances, what is the role of the entrepreneurial spirit among the family business owner?*

As the family business succeeds and develops, and the structure of the business becomes even more formalized, the family business moves to the next stage of development: SMEs. The entrepreneurial spirit is put under the constraint of the organizational structure. Formalization means the lost of liberty. The liberty to think and explores is further constrained by the organizational structure and rules. The entrepreneurial is not dead but remains dormant until it is awaken. The entrepreneurial spirit will be awakened when the family business is threatened with failure or competition. The topic of SMEs is reserved for Part 4 of this 4 parts series.

5.4 Contributing Factors for Direct Investment

The positive performance of family business in a larger picture has a positive effect on foreign investment. This fact is less talked about. No foreign companies want to go into a country and invest where there are many failures among companies in the informal sector, i.e. family business. Family business is a contributing factor to foreign direct investment (FDI).

Why family business has never been recognized for this role it plays in the national economy? In the US, the government general pays attention to the health of the economy. In so doing, the government also uses the grass root economy at the local and state level to assess the health of the national economy. Large corporations failed in the US. However, the failure of these large corporations generally disappear from state policy the soon the bankruptcy proceedings are over. However, the failure of small businesses, such as SMEs or family owned business reverberate more among the American policy makers because these are the people who holds the political mandate for the next election. For that reason all presidential candidates solicit the support from small businesses.

5.5 Investing in Family Business

The conventional definition of investment is the putting of money into a project or enterprise with the expectation of return of the initial capital invested plus profit. Investment in family business occurs in two contexts: (i) the money put into the family business by the stakeholders is considered an investment, i.e. the pooled fund is a direct investment; and (ii) the infrastructural provision by the government through state policy is a form of indirect investment.

Direct investment is the putting of cash or kind which could be valued in money into the project or enterprise of the family business. The pooled fund is the most common form of direct investment. The family business owner may borrow money from outside of the family circle and uses that money for the business operation. This loan is treated as a liability in accounting; however, in economic term, it is an investment because the use of that money is the utilization of resource for the purpose of making more money. However, direct investment in family business is not attractive to investors because family business is in the informal sector. As such the family business does not attract many outside investors. Moreover, formal lending institutions traditionally see family business as a high risk client. It is not until recently that banks in developing countries see family business as potential clients. Even so banks would consider family business as a client only it has injected itself into the formal economy, i.e. the banking system. When the family business moves from cash economy to a cashless and account-full economy, it graduates itself from the informal to formal sector of the economy. Having seen the trend of the money movement in the account, the bank may assess the family business' risk and extend its banking product and services according. The willingness of the bank to extend credit to the family business is also a form of investing in the family business. With the availability of capital, the family business can now move forward into the next stage of development: SMEs.

Indirect investment is general accomplished by a third part or entity, such as the government which brings benefits to the family business directly. These investments may not be in a form of money; it may be in a form of policy which leads to the increase productivity of the family business, such as tax exemption in certain types of business. The returns received by the government are the increase in revenue from other sources. For instance, if tax exemption for the family business leads to the reduction in cost, with that savings the family business passes on the savings to consumers in lower cost and thus stimulating consumption ---which in turn leads to higher GDP growth. The government in the process also collects additional revenue from tax collection. This type of investment is indirect and is not often seen by direct observation. The benefits of this type of investment generally appear one fiscal quarter or year later after the implementation of the policy.

5.6 Family Business as an Indicator of the Health of the Economy

Earlier discussion about the role of the family business as an indicator of the health of the economy focuses on the success of family business. There might be instances which the family business fails due to foreign investment in the country. For instance, the introduction of hypermarkets in Thailand resulted in keener competition against local retailers who are small. Larger hypermarkets, such as Tesco Lotus and Big C can compete on the basis of price and aim to secure market share through price cutting. Consumers rightfully flock to these hypermarkets and left the local mom-and-pop shops facing the cold reality of 'natural selection.' Although these local shops are family owners, they are neither the subject nor the focus of this book. These local shops are not competitive in the market; they represent a defect of pricing and imperfect competition. There threatened existence foretells a bigger story: economic evolution.

As these local shops fail, they open opportunities for larger firms to enter the market. Generally, these hypermarkets are foreign owned or foreign subsidiaries. In this case, it is antithetical to the earlier assertion that the failure of family business is an indicator of poor economic performance of the country. However, in this case, the failure of these "family businesses" signals opportunities for growth for foreign companies and increase utility for consumers who would otherwise have to deal with price hackling with local merchants. Therefore, this case demonstrates that failure of local businesses could make the country attractive to foreign investment.

5.7 Domestic Direct Investment (DDI) & Foreign Direct Investment (FDI)

The pooled fund used in the family business is a direct domestic investment (DDI). This type of investment often occurs in the informal sector: family business. As such, the amount of such an investment may escape public recordation. The actual amount invested in the family business sector may be larger than what may be reported.

DDI in the domestic economy is an evident of the self sufficiency of the country. The money invested in the family comes from private savings of family members. If the family business is successful and generates more income and further investment into the business, the informal sector may play a larger role in the economy than what we originally though. How big a role does the family play in the economy, we may not know for certain.

If DDI exists, the question then follows: *How can DDI be measured?* It can be measured through the tax system. In advanced economies where the tax system can capture business income and expenses through the income tax system, DDI may be determined with high level of precision. In fact, if the DDI rate could be compared to FDI rate, the number could forecast a new trend in the economy. However, research in family business has not yet progressed this far. Many researchers are still intoxicated with the lies of 'trans-generational transfer of ownership' and the decision making process of family business through the so-called 'family council.' These topics do their job well in filling up spaces in books and journals; they contribute nearly nothing to the advancement of knowledge in the field for lack of quantitative proof.

FDI is foreign direct investment. This investment depends on the health of the economy of the country. If the economy performs poorly, FDI inflow may be less. ***How can the health of the economy be measured?*** One means of that measurement is the GDP growth rate. However, the GDP is summarized every quarter at most and annually to be more accurate. Investment decision needs facts that are more expeditious. The GDP may be a poor indicator for foreign investors. The alternative may be DDI. However, the problem with DDI is that it is a new concept, a concept introduced by this book. If it could be compiled and published country-by-country, it would be a useful tool to supplement the decision making process for FDI.

5.8 Business Models and their Implications for Family Business

Family business is the outgrowth of an entrepreneurial enterprise of an enterprise. An entrepreneurial enterprise of an entrepreneur generally is a one man show. The entrepreneur takes risk in an enterprise by investing with known cost or expenses for the return of uncertain income. As time passes, the enterprise becomes successful, the entrepreneur involves other people within his circle. The closes associates of an entrepreneur are the family members. By incorporating family members into the enterprise, the entrepreneurial enterprise is transformed into a semi-structured business. In time, the family business may also grow into SMEs and finally reach the stage of becoming a corporation. This model of growth is a linear in form.

Can there be an alternative model where the family business starts out as a family business unit without going through the entrepreneurial path? There may be instances which the family business starts out as a 'family business.' In such case, the family entity generally is endowed with assets or liquid assets which could be employed in the enterprise. Having bypassed the natural growth process, the family business under this alternative model has greater risk exposure. *Risk* is defined as uncertainty of event occurrence that affects the business enterprise. Unlike the family business that had gone through the entrepreneurial growth as the first stage, the family business starting out as a family business unit at its inception has little knowledge or experience in the business; therefore, it has greater exposure to risk in the operation. In fact, many family business failed due to the lack of knowledge in the business. The availability of financial assets may allow the family business to start off with confidence and greater degree of involvement of family members; however, at the same time, the business is exposed to uncertainty.

Knowledge gained through experience by the entrepreneur renders the family business that followed a greater degree of leverage from the inventory of knowledge gained through years of experience. A family business that bypassed the natural path of business growth does not enjoy the same degree of leverage from experience and knowledge gained through prior operation. *Experience* is the practical knowledge gained through past operation which can be reused or shared within the organization for purposes of increase economic productivity and risk reduction. *Knowledge* is the inventory of 'know-how' retained by the agent through learning or experience that could be reused or stocked as inventory for future use. A family business that starts out at the second stage without going through the first lacks both experience and knowledge.

In case where the family business was acquired or transferred through succession in interest, the same rule applies. By inheriting the business or receiving the business through transfer, the successor in interest does not necessary also acquired the experience and knowledge of that business. Knowledge sharing and knowledge experience transfer may not take place unless the succession process is well prepared. Succession in interest as a model for family business is treated in the later paper.

6.0 The Theory of Firm

The theory of firm describes the firm's organization, structure, behavior and its relationship to the market (Kantarellis, 2007). In explaining how firms operate, the following theories had been used in the mainstream academic: (i) transactions theory, (ii) managerial and behavioral theory, (iii) Williamson's approach, and (iv) firm's economies. Other theories will also be explored in this section.

Transaction theory looks at the transaction cost. Firm arises as the result of cost differential among different source of production. When the cost of production outside of the firm is lower than if the firm produces the product for itself, there is a demand that a firm concentrating on producing that product. In words, through imperfect information and the imperfection of market, there will always be some firm who can produce a product to meet the needs of others. This creates a demand for assigned production to firms. Firms exist as the result of market imperfection. This imperfection allows some firm to produce at lower cost level and thus concentrate on that product and sell to though who cannot produce the product---as cheaply as the seller (Coarse, 1937).

Managerial and behavioral theory is the second approach to explain firm. In response to the challenged lodged against the transaction theory of William Coarse, other theorists, such as William Baumol (1959 and 1962) (Baumol, 1962), suggests that managers attempt to maximize their utility. This is not the same as maiximization of profit. The focus of managerial behavioral is on utility maximization, not profit maximization. The focus is on the individual managers who try to maximize personal gains, such as high salary, compensation package, and prestige. Under the behavioral approach to firm, in a situation of uncertainty the decision of firm is an outcome of compromising all interests within the firm (Cyert and james, 1963).

Williamson's approach to the firm theory claims that the existence of the firm depends on the asset. This is known as asset specificity. Each firm is endowed with a certain assets. These assets are specific for a certain production. Firms that do not own the asset must negotiate with firms that possess the assets (Williamson, 1975). Firms that possess the assets can produce, but they themselves do not have the order or needs for production. Through market imperfection and imperfect access to information, forms with information for the needs of certain products negotiate with firms who own the assets but do not have market knowledge. Under the state of imperfection, each party wants to be opportunistic in the deal, i.e. attempting to maximize gains for itself. However, there is a check-and-balance mechanism which keeps all parties at bay. Each party will not allow itself to be so opportunistic as to damage its own reputation and, thus, handicap its future dealings (Oliar *et al.*, 2008). Each party will optimize its gain with the bound of reason.

Firm's economies explain the objective of firms' attempt to return to scale. Through various combinations of capital and labor, the firm will maximize its utility and profit at a point where the average cost of output is lowest. The optimization may be achieved through economies of scale or economies of scope. *Economies of scale* is the reduction of per unit cost with increase in output. This per unit cost reduction may be achieved through learning and concentration. The second means to reduce cost is through economies of scope (Archibald, 1987[2008]; Panzar and Willig, 1981; Tirole, J., 1988). *Economies of scope* refers offering of multiple product lines. Instead of offering one product, the firm may offer a portfolio of products. In so doing, it may reduce the risk of not selling one product while making profits by satisfying the needs of buyers with other products in the portfolio.

In light of these theories, which one can best explain family business model? There is no single theory that can explain family business enterprise. The transaction theory can provides some explanation for the existence of the family business. The family business fulfills a certain needs in the market, i.e. it can provide some products to the market a cheaper cost and, therefore, selling at a lower price. There is a certain degree of pride involved in owning a business; this emotional element also draws on the manager's behavioral theory. A family business is very asset specific. Once a family is settles on a particular business, it tends to stay in that line of business because its assets are limited and specific for a certain productive output. This asset-specific model falls within the Williamson's approach to firm. As for economies of scale and economies of scope, the application may not be uniform; they may be applicable to some family businesses and to others they may not.

6.1 Profit Maximization vs. Value Creation

Profit maximization is the behavior of firms. It cannot be said that the family business does not want to maximize profit; however, profit maximization is not the overwhelming goal of the family business. Profit maximization in the firm is the overwhelming goal of a firm because of the fiduciary owed by the firm to the shareholder. In a family business, this fiduciary does not exist. Family business is more concerned with self sufficiency and survival than in optimizing its share value. For this reason, profit maximization is not the overwhelming goal of the family business.

Profit maximization is defined as the optimal level of owner's equity divided by the number of share in the firm. This issue is not common in the family business because by its nature the family business is co-owned by family members. Being a closely held entity, the family business is more concerned with the maximization of value. The goal of the family business is value creation. *Value creation* is the innovative use of the existing resources to create value. For instance, the family business may have an unused asset; value creation is to turn that idle asset into a productive asset thus making money for the business. Family business wants to optimize its value through value creation.

Value creation is not value added. Value additivity is the increasing in cost in the production process thereby leads to the increase in the final price to the consumer. If the sale is maintained at the same level, the value added would create additional profit. However, in reality value additivity generally leads to the loss of competitive advantage of the firm. By increasing price, the sales generally suffer.

6.2 Blue Fish Swimming in the Red Ocean

Recall that the family business generally grows out of the success of an entrepreneur and his enterprise. As an entrepreneurial enterprise, the family business seeks and exploits opportunity to optimize its value. Through value creation the family business sustain its business and carries on its operation. As an opportunity seeker, the family business may be called 'blue fish.' However, there is a limitation as to how much opportunity can the family business seek and exploit. Unlike the entrepreneurial who acts for and by himself, the family business is not structured and involved many people. Having additional stakeholders in the operation limits the freedom of the family business to act freely.

The market in which both the entrepreneur and the family business exist is one filled with competition. There is no business that can guarantee against assault from competition. All businesses face competition. Success invites competition. If the family business is successful, its success will attract other players to enter the market. For that reason the market is always a 'red ocean.' Some success may be short lived others may have a longer life span. A family business is akin to a 'blue fish swimming in the red ocean.'

In order to survive in the market, the family business must innovate its business in order to stay ahead of the competition. Innovation leads to value creation. That value creation is the seed for further success in family business. The threat of competition to family business may be keener than other formalized businesses because of its limited capital and expertise. Unlike the corporation or larger sized companies in which the availability of funds may be more flexible, family business must maintain profitable operation. Larger companies may sustain loss over a period of time and can still make a return to profitability. However, the family business cannot afford that type of loss over a long period of time. This inability to sustain loss comes from the fact that a family business is limited by size and resources. Many family businesses go out of business because they cannot sustain loss during the period of economic down turn.

6.3 Key Elements for Success: Size, Scope, Speed, and Strategy

Many writers point to the product mixed of 4Ps as the key for success in business. However, this old concept may not hold persuasion in today's business environment. What sets a successful business from a failed business is not 4Ps but something else. Failed business had product, price, promotion and place. If the 4ps explains success in marketing mixed, then companies with these 4Ps would not fail. However, all failed businesses had followed these 4Ps concept, but they still failed. An alternative explanation is needed. Corporate success may come from other sources: convenience, commodity, cost, communication, channel, consumer, circumstances (Shimizu, 2003, 2009; Solis, 2011). These 7Cs may also be applied to family business.

While other writers talked about 4Ps and 7C that contribute to the success of business, this book proposed threat factors that may contribute to the business failure: 4Ss which contributes to the competition and failure of family business. These 4S' include: *size, scope, speed,* and *strategy*. Family business is small in size. In today's economy, success comes through hypercompetition. Large size means the company can absorb shock from the system and sustain unprofitable operations longer than small-sized businesses. A family business is small and is at a disadvantage.

The second element that leads to competitive advantage is scope. Large corporation can engage in a variety of businesses. These businesses serve as a portfolio component to help spread the risk of operations. If one product line does not perform, other products will perform and make up for the losses. The family business cannot afford this luxury. Due to limited capital and experience, the family business is concentrative in a particular business line and is completely exposed to system shock in times of keen competition or economic down turn.

The third element of success for large corporation and a potential threat to a family business is speed. Despite the availability of technology and information, the family business still operates in the informal sector and is disconnected from the mainstream market. As part of the informal sector, the family business does not have the advantage of a larger corporation in exploring and exploiting market information. Unable to move at a quicker speed may work against the family business. In order to maintain success, the family business owner must keep abreast with market changes and plan according to avoid being left behind.

Lastly, the fourth element that allow large corporation to succeed and may threat family business is strategy. Strategy is defined as planning and matching the available resources to the set goals. Corporations have the resources to engage in short-term, medium-term and long-term planning. It has the resources to match with these plans. The planning allows the corporation to stay focus. The family business lacks the resources to engage in multiple ranges planning. Many family businesses lack long-term planning. Success comes from daily operations. Lacking strategic planning, the family business is always faced with the threat of competition from larger firm in the market who can afford to engage in strategic actions.

6.4 Effective Family Business Model

What is a successful business model for the family business? There does not appear to be a single model that can explain the success of a family business. The various theories of firms explored in this paper may all apply to family business at different stages and in different aspect of the family business.

The performance of the family business must be looked at in context. It is an outgrowth of the entrepreneurial enterprise. As such, the family business retains that entrepreneurial spirit in the owner of the business. As an entrepreneurial enterprise, the entrepreneur explores and exploits the system at the same time. As a family business, the family business owner has already known what contributes to its successful operation. By having additional stakeholders into the business, the family business seeks to be system protector. The family business limits itself to a certain scope of business; this scope limitation is akin to business concentration or focus. The family business succeeds with focus, but at the same time, it also faces a threat from external shock. Changes in the market may exert threats to the family business unit, i.e. changes in technology or demographics, in order to maintain profitable operation, the business must adapt accordingly.

Two elements may help explain the success of a family business: value creation and adaptability. The family business strives to create value. Value creation comes from setting idle resources to create economic benefits or increase economic productivity through the use of existing resources. By retaining the inventive spirit from the entrepreneurial stage of its development, the family business may strive well as a value creator. Secondly, the small size and limited stakeholders in the organization allows the family business to shift operations and adapt to the changing environment in order to maintain profitable operations.

6.5 Men & Women Family Business Owners as Creators of SMEs

Entrepreneurship is gender blind. Business operations should also be gender blind. Success is measured by the level of profit. In family business, gender does not determine success or failure. However, this is not to say that discriminatory practices among relevant players in the system, such as banks and other lending institutions may use gender as an indictor for decision making. Discrimination of any kind, gender or otherwise is unclean and not green.

Gender issues may be a research issue in entrepreneurship and family business. However, in reality success in the family business is determines by the performance of the business. The performance of the business depends on the resources inside the organization and the use of that resource to exploit the market. As a system, the market is gender neutral. As market participants, economic agents (men and women, more male than female) are gender discriminatory. To raise gender consciousness is a positive thing if it contributes to the betterment of the lot of all market participants. However, if gender issue is raised as an obstacle to the path of success of the family business, it has no place in our discussion. Such research may do more damage than conferring benefits to society.

6.6 Destructive Entrepreneurship & Family Business

All businesses are system exploiter. Businesses exist in order to make profit for its owners. However, certain businesses profit comes at the expense of other people. These types of businesses are called destructive entrepreneurship. Certain businesses exist in a parasitic form, i.e. it depends on the exploitation of other businesses. Copycat businesses in the developing countries, for instance, are good examples. These copycat companies engage in the illegal copies of protected products, i.e. products protected by copyrights, patents and trademarks. Although these copycat companies make large amount of profits, they are not seen as successful. In business success should come from the sweat of the brows; stealing and pilfering the rights of others is a destructive behavior. Such ill-gotten gains, no matter how large, remain a loot from destructive behavior.

A family business partially depends on goodwill for its success. It cannot afford to soil its good name and reputation through destructive behavior, such as illegal bootlegging of protected products. 'Business' of that type is an illegal activity, and cannot be classified as a family business or entrepreneurship. A "thief" does not qualify himself as a businessman just be the mere fact that he maintains an office and has a sign hanging at the front door saying "Open for Business." In order to quality to use the word business to describe its operation, the enterprise must govern itself by a certain code of conduct or business ethics. 'Thou shall not steal" is equally applicable to business owner as to any church goers (Exodus 20:1-21, Deuteronomy 5:1-23).

7.0 CONCLUSION

The theme of this part 2 of 4 of *'Entrepreneur and Entrepreneurship'* series is the role of the family business in the economy. Family business is a further step in development from the informal and unstructured operation of the entrepreneurial enterprise by the entrepreneur who engages in a one man show. An entrepreneur takes anything that comes his way. As an opportunist, an entrepreneur is a true system exploiter. However, the family business is more structure. The involvement or more stakeholders in the operations confine the family business to a particular boundary of operation. With a clearly defined scope of business, the family business may concentrate on a particular type of business and engages in value creation. This characteristic of a family business: value creation, sets it apart from the conventional firm which engages in profit maximization. Value creation looks to innovative spirit of the entrepreneur that is stilled ingrained in the family business owner. The inventive spirit of the entrepreneur in the family business always looks for means to turn idle assets to production assets. Value creation is achieved through turning a 'source' into resource. The circle of stakeholders in the family business is small. The fiduciary is closely regulated within a close circle of family members; this close nit organization sets it apart from a larger and more formally organized corporation.

The last section of this paper considers the issue of gender in business and concludes that sexism in any form, gender treatment or otherwise, is neither green nor clean in business. There are researchers who try different degrees of success among male and female business ownership. If there is a difference in the degree of success, it is not due to the difference in gender; the inequity may come from discrimination. Discriminatory practices among lending institution, for instance, may contribute to the different degree of success among male and female owned businesses. This difference in the degree of success does not come from the difference in gender; it comes from gender-based treatment.

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