



Perspectives

Governance implications of attracting external equity investors in private family firms

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3 GOVERNANCE IMPLICATIONS OF ATTRACTING EXTERNAL EQUITY INVESTORS IN
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5 PRIVATE FAMILY FIRMS
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8 Abstract
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11 While research commonly assumes business-owning families are concerned about the
12 preservation of control, more and more families seek cooperation with external investors to
13 accomplish firm- and/or family level-goals. In this paper, we provide a conceptual configuration
14 of the different governance scenarios that may arise when family owners attract outside capital.
15 Combining two important family objectives - its objective to provide liquidity either to the
16 family or to the firm, and its objective to cede or to retain long-term family control - we identify
17 four scenarios with different governance implications and preferred types of external investors.
18 Our analysis contributes to an increased understanding of the evolving structures of ownership in
19 private family firms, the effectiveness and efficiency of governance arrangements in family firm-
20 external investor cooperations and the increasingly heterogeneous private equity funding
21 landscape.
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37 *Keywords:* corporate governance, family firms, private equity, alternative investors,
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39 governance configurations
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GOVERNANCE IMPLICATIONS OF ATTRACTING EXTERNAL EQUITY INVESTORS IN PRIVATE FAMILY FIRMS

While it is commonly assumed that family firms are reluctant to hand over control to outside investors (La Porta, Lopez-De-Silanes, & Shleifer, 1999; Mahéroul, 2004; Poutziouris, 2001; Wu, Chua, & Chrisman, 2007), more and more private family firms open their capital for external investors (Battistin, Bortoluzzi, Buttignon, & Vedovato, 2017; Dawson, 2011; Wessel, Decker, Lange, & Hack, 2014). This evolution is driven by trends in both the demand and supply of capital. Family firms increasingly consider equity investments because more stringent capital and liquidity regulations such as Basel III have made longer term bank lending to these firms, which are often smaller, less attractive (OECD, 2012). Furthermore, many business owners who are reaching retirement age seek investors to diversify their wealth or to accomplish transgenerational successions. At the same time, new ‘players’ such as family offices and high net worth individuals (HNWIs) increasingly invest in private family firms (Rottke & Thiele, 2017), in addition to established investors such as private equity (PE) firms¹. For example, European family offices nearly doubled their direct investments in private companies between 2008 and 2014 (Campden Research & UBS, 2015).

The role of external investors in private family firms has only received limited attention in the academic literature. Some studies examined PE buyouts of family firms (Howorth, Westhead, & Wright, 2004; Scholes, Wright, Westhead, & Bruining, 2010) or external ownership transitions of family firms more generally (Wennberg, Wiklund, Hellerstedt, &

¹ PE is defined as risk capital provided by professional investors to mature, unquoted private businesses (Invest Europe, 2017). PE involves medium to long-term investments (generally three to seven years), characterized by active ownership. Investors in PE funds are principally institutional investors, such as insurance companies and pension funds.

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3 Nordqvist, 2011; Wiklund, Nordqvist, Hellerstedt, & Bird, 2013), whereby the family fully exits
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5 the firm and control is ceded to new owners. However, few studies examined scenarios where
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7 families do not cede full control but instead seek cooperation and thereby share control with
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9 investors to accomplish their goals. Similarly, the PE literature mainly focuses on PE-backed
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11 buyouts, often of public firms, but much less on investments in private firms, including minority
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13 investments. Additionally, the important role of alternative investors such as family offices in
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15 ownership transitions of private family firms has largely been neglected.
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20 The question how investors can contribute to private family firms is not only empirically
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22 relevant but also theoretically intriguing. Following the management and finance literatures,
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24 investors and family owners may not be the best partners as they are assumed to hold
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26 considerably different objectives. Investors such as PE firms invest in a portfolio of firms and
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28 focus on the maximization of a economic value in the medium term (Kaplan & Strömberg, 2009;
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30 Wood & Wright, 2009). Family owners, in contrast, typically have their wealth concentrated in
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32 one firm and have long-term objectives that are not always economic in nature (Berrone, Cruz, &
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34 Gómez-Mejía, 2012; Chrisman, Chua, Pearson, & Barnett, 2012). These different objectives
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36 might lead to principal-principal conflicts (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008).
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38 Therefore, more insights in ownership transitions and related governance mechanisms in private
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40 family firms are key to better understand transitions or cooperations between families and equity
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42 investors (Uhlener, Wright, & Huse, 2007).
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48 To enrich our understanding of the role of different investor types for private family
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50 firms, this paper provides a conceptual configuration of the governance scenarios that may arise
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52 when a family decides to attract external shareholders alongside the family shareholders. We
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54 propose that two family objectives will strongly govern such transaction: the family's motivation
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3 to provide liquidity either to the firm or to the family, and the family's degree of
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5 transgenerational intent. The first objective distinguishes transactions that increase the equity
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7 capital of the firm and where family shareholders keep their equity and transactions that involve
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9 a transfer of some, but not all, shares from the family to an external equity investor. The second
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11 objective distinguishes between scenarios where a family aims to exit the firm in the foreseeable
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13 future, and scenarios where a family aims to keep the firm within the family over generations.
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15 Combining these two objectives, we configure external investments in family firms into four
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17 scenarios. For each scenario, we provide examples, discuss governance implications for firm
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19 ownership and the level of fit with different types of investors. Regarding governance
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21 implications, we discuss the wealth concentration and investment time horizon of the remaining
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23 family, the family's focus on socioemotional wealth (SEW), the focus on efficiency and/or
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25 growth as drivers of firm performance, the use of debt to structure the transaction, family
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27 involvement in management, and the importance of relational governance. We thereby take a
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29 configurational perspective, proposing that these governance attributes and the type of investor
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31 (such as independent PE, government-funded PE or family offices) interact in complementary
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33 ways as part of unique configurations to facilitate successful ownership transitions (Meyer, Tsui,
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35 & Hinings, 1993). The notion of configuration is used to theorize what governance mechanisms
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37 are likely to lead to the fulfilment of desired objectives of family owners on the one hand and
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39 investors on the other hand.
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47 We make several contributions to the research literature. First, our configurational model
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49 increases understanding about the evolving structures of ownership in private family firms.
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51 Ownership in private firms is theoretically intriguing because it is relatively illiquid and owners
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53 tend to be deeply involved in and identify with their firms. The insights also call for research that
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3 takes new theoretical perspectives to study owner dynamics in private firms. While research in
4 this area is largely dominated by agency theory (Battistin et al., 2017; Chrisman, Chua, Steier,
5 Wright, & McKee, 2012; Daily, Dalton, & Cannella, 2003), our model calls for better
6 integrations with alternative theoretical perspectives. Second, our study contributes to the family
7 business literature by examining gradual transitions from a family to a non-family firm. To date,
8 scholars have paid substantially more attention to the minority of family firms that transition to
9 another generation of family members than the majority of family firms that does not (Wennberg
10 et al., 2011), leaving substantial gaps in our understanding of ownership transition in family
11 firms (Wiklund et al., 2013). Third, our framework increases understanding about the increasing
12 heterogeneity among PE investors and the role of alternative investors such as family offices and
13 HNWIs. Despite their practical relevance, these investors only received limited attention in the
14 research literature so far (Neckebrouck, Manigart, & Meuleman, 2017; Wessel et al., 2014).

31 THEORETICAL BACKGROUND

34 Family Firm Objectives and Decision-Making

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37 Family firms are characterized by the existence of individuals, related by family ties, who
38 exert substantial influence on the company, either via ownership stakes or important
39 management positions (König, Kammerlander, & Enders, 2013). Although exact numbers for the
40 prevalence of family firms vary, research consistently shows that family firms dominate
41 economies around the world (La Porta et al., 1999).

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44 The governance and conduct of family firms has been studied from a variety of
45 theoretical perspective including mainstream management theories such as agency theory,
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3 stewardship theory, and the resource-based view.² Agency theory implies that family firms have
4 higher performance because they have lower agency costs related to the separation of ownership
5 and control (Demsetz & Lehn, 1985; Fama & Jensen, 1983). Yet, agency theory also asserts that
6 family owners are risk-averse because they typically hold concentrated wealth positions (La
7 Porta et al., 1999; Morck & Yeung, 2003), misuse their power to expropriate minority
8 shareholders (Claessens, Djankov, & Lang, 2000), and are prone to nepotism (Chrisman,
9 Sharma, Steier, & Chua, 2013), executive entrenchment (Volpin, 2002), and intra-family conflict
10 (Schulze, Lubatkin, Dino, & Buchholtz, 2001). Stewardship, in contrast, suggests that family
11 owners act as farsighted stewards of their business (Le Breton-Miller, Miller, & Lester, 2011;
12 Neckebrouck, Schulze, & Zellweger, 2018) and care about the long-term wellbeing of all
13 stakeholders (Davis, Allen, & Hayes, 2010). The resource-based view maintains that family
14 firms possess unique resources, which they leverage to benefit performance (Nordqvist, 2005;
15 Sirmon & Hitt, 2003).

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34 Next to these mainstream theories, over the last decade, the socioemotional wealth (SEW)
35 perspective developed as a dominant theoretical paradigm in the family business field. Profit
36 generation is rarely the exclusive goal for controlling-ownership families. Meeting the
37 nonfinancial social and emotional needs also is an inherent goal of family firms. This is referred
38 to as the unique family firm phenomena called SEW. SEW encompasses a variety of aspects
39 including the employment of family members (Firfiray, Cruz, Neacsu, & Gomez-Mejia, 2017;
40 Gómez-Mejía, Cruz, Berrone, & De Castro, 2011), enjoyment of family influence over the
41 business (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007),
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54 ² Other theoretical perspectives include transaction cost theory (Gedajlovic & Carney, 2010; Verbeke & Kano,
55 2012), identity theory (Cannella, Jones, & Withers, 2015; Miller, Le Breton-Miller, & Lester, 2011), and
56 embeddedness (Aldrich & Cliff, 2003; L. P. Steier, Chua, & Chrisman, 2009).
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3 reputational advantages from being associated with the firm (Deepphouse & Jaskiewicz, 2013),
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5 and the preservation of benevolent ties among family members (Cruz, Gómez-Mejía, & Becerra,
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7 2010).

10 The key assumption of the SEW perspective is that the preservation of SEW represents a
11
12 primary driver of family firm decision making (Gómez-Mejía, Makri, & Kintana, 2010). For
13
14 example, family firms invest less in R&D (Gómez-Mejía et al., 2011) and engage less in
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16 corporate diversification (Anderson & Reeb, 2003; Gómez-Mejía et al., 2010) because such
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18 decisions entail losses of SEW, for instance because they require the family to attract outside
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20 managerial talent thereby reducing family control over the enterprise. More recent refinements
21
22 nuance the view that family firms are foremost concerned with SEW goals arguing that family
23
24 owners weigh implications of their decisions on financial wealth and SEW in tandem (Gómez-
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26 Mejía, Patel, & Zellweger, 2018; Kotlar, Signori, De Massis, & Vismara, 2018).

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32 Importantly, family firms are heterogeneous in the extent to which they pursue SEW
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34 objectives. Conceptually, SEW is inherently linked to the extent of family control over the firm
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36 and the degree of familial identification with the firm (Gómez-Mejía et al., 2007). Smaller,
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38 privately held family firms focus more on SEW than larger publicly listed family firms because
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40 familial identification, influence and personal investment is generally higher in the former
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42 (Gómez-Mejía et al., 2011). Control of the firm is critical because it is what allows the family to
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44 pursue its interests through the firm (Carney, 2005).

47 48 **Family Firms and Financial Decision-Making**

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51 Early studies on family firm financing have drawn from normative capital structure
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53 theories such as the pecking order theory or the trade-off theory (King & Santor, 2008; López-
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55 Gracia & Sánchez-Andújar, 2007). When applied to family firms, however, traditional capital
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3 structure theories often lead to inconclusive results because their assumptions about rational
4 economic behavior may not apply to family firms in which decision making is frequently
5 influenced by non-economic family goals (e.g., Koropp, Grichnik, & Kellermanns, 2013).
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10 Studies with a background in the strategic management literature suggest that capital
11 structures may reflect the diverse personal goals of decision makers (Barton & Gordon, 1987,
12 1988). Several studies find that the financial logic in family firms is influenced by personal
13 preferences of family decision makers, leading to differences between family firm financing and
14 nonfamily firm financing (Gallo, Tàpies, & Cappuyns, 2004; Romano, Tanewski, & Smyrniotis,
15 2001). Family firms, for instance, are less likely than nonfamily firms to relinquish control to
16 outside investors because families not only derive financial but also socioemotional value from
17 their firms (Gómez-Mejía et al., 2007).
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29 While informative, the analysis of differences between family and nonfamily firm
30 financing policies ignores the heterogeneity of financing decisions within the population of
31 family firms. More recent research shows that a family firm's usage of debt is influenced by
32 family governance characteristics such as ownership dispersion (Schulze, Lubatkin, & Dino,
33 2003a), generational stage (Molly, Laveren, & Jorissen, 2012), managerial succession (Amore,
34 Minichilli, & Corbetta, 2011), and owner-manager attitudes (Koropp et al., 2013). However,
35 these studies have primarily focused on the usage of debt and largely neglected equity as a form
36 of financing. This is surprising, as raising equity from non-family members has significant
37 implications for control and governance.
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50 Research on the role of PE as equity provider for family firms is in its infancy. PE
51 investments are traditionally viewed from an agency perspective with emphasis on obtaining
52 efficiency improvements (Renneboog, Simons, & Wright, 2007); although, PE can also be a
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3 vehicle for strategic renewal that fosters upside entrepreneurial growth (Wright, Hoskisson,
4 Busenitz, & Dial, 2000).

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8 Studies on the role of PE in family firms mostly examine buyouts of family firms wherein
9 the family sells its full ownership stake to PE (Howorth et al., 2004; Scholes et al., 2010). Some
10 studies analyze the selection criteria used by PE when investing in family firms (Dawson, 2011)
11 or valuation particularities of family firms (Ahlers, Hack, & Kellermanns, 2014). Other studies
12 analyze the process of professionalization of family firms post buyout (Howorth, Wright,
13 Westhead, & Allcock, 2016), and the resulting impact of PE buyouts on the performance and
14 growth of former family firms (Battistin et al., 2017; Croce & Martí, 2016; Scholes et al., 2010).

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25 Limited attention, however, has been given to scenarios in which private family firms do
26 not cede full control to investors but instead seek cooperation with investors to accomplish their
27 goals (Neckebrouck, Manigart, & Meuleman, 2016). Investors hereby may acquire a minority
28 stake in the family business, while the family remains the majority shareholder. This is in
29 contrast with full buyouts, where PE investors typically acquire a controlling majority stake. A
30 key question in this scenario is how potentially divergent goals may lead to principal-principal
31 conflicts (Martin, Gómez-Mejía, Berrone, & Makri, 2017; Young et al., 2008). Villanueva and
32 Sapienza (2009) suggest that the identity of formal, financially oriented investors, such as PE
33 firms, is unlikely to fit well with family firms. Because family owners often value the
34 preservation of SEW next to the maximization of financial wealth, conflicts between PE
35 investors and the family may arise. Such conflicts might be limited when the firms perform well
36 but can be especially prevalent when the firm underperforms (Martin et al., 2017).

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53 Even if partnering between private family firms and financial investors involves a risk of
54 conflict, recent evidence indicates that more and more private family firms open their capital to
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3 investors (Battistin et al., 2017). A key question, therefore, is what are the governance
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5 implications of a transition from a fully-owned family business to a multiple ownership structure
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7 involving outside equity investors (Uhlener et al., 2007), and what type of investors are most
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9 likely to provide a good fit? Using a configurational approach to corporate governance (Meyer et
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11 al., 1993; Miles & Snow, 1978), we propose that ‘bundles’ of governance practices exist that are
12
13 consistent with family preferences, firm needs and types of investors (Misangyi & Acharya,
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15 2014; Rediker & Seth, 1995). Each configuration is a gestalt of multiple, interlinked, and
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17 mutually reinforcing organizational and structural characteristics that are complementary with
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19 each other and commonly occur together (Meyer et al., 1993; Miller, Friesen, & Mintzberg,
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21 1984). Complementarity implies that governance mechanisms mutually reinforce the
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23 effectiveness of one another (Schiehll, Lewellyn, & Muller-Kahle, 2017). In the remainder of
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25 this paper we use the notion of configurations to reflect on the effectiveness and efficiency of
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27 different governance constellations in collaborations between family firms and investors.
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32 33 **CONFIGURATION MODEL** 34 35

36 We now focus on transactions in which a traditional PE investor or an alternative
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38 investor, such as a family office or HNWI, acquires a shareholding next to the family. Figure 1
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40 illustrates our configurational framework. The horizontal axis differentiates between transactions
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42 in which an investor increases a firm’s capital while family owners retain their shareholdings
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44 (liquidity for the firm) and transactions in which investors replace family equity and, therefore,
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46 some family members decide to sell all or a proportion of their shares (liquidity for the family).
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48 The vertical axis differentiates between families who are looking to cede ownership in the
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50 medium term (ceding family ownership) and families who aim to retain ownership (enduring
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52 family ownership). The evolution of a firm’s equity structure over time is illustrated for each
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3 quadrant. The entry (t1) and exit (t2) time of the investor are marked. In Quadrant 3 and 4, the
4 family remains shareholder after the investor exits at t2; in Quadrant 1 and 2, the family exits at
5 t2, often together with the investor.
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11 **--- Please insert Figure 1 about here ---**
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13 In the subsections that follow, we describe different transaction types related to these four
14 quadrants, provide examples, and discuss governance implications. We use the notion of
15 configuration to theorize about the ideal constellation of governance characteristics in each
16 quadrant. Specifically, for each quadrant, we reflect on the combination of formal and informal
17 governance mechanisms that will be most efficient and effective in fulfilling the specific
18 economic and/or non-economic objectives of the family and the investor. Following a
19 configurational approach, governance mechanisms in such “ideal deals” must show high levels
20 of fit with the overarching goals and resources of the family and with each other.
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32 Most configurational research defines governance performance solely in terms of
33 efficiency, typically firm profitability (e.g., Misangyi & Acharya, 2014). In our context,
34 however, it is critical to also assess performance in terms of effectiveness. While efficiency
35 focuses on the relationship between inputs and outputs, effectiveness in our context relates to the
36 extent to which an investment helps a family to achieve its idiosyncratic economic and non-
37 economic goals. Assessing performance as achievement of goals is particularly important in
38 family firms because of the non-economic goals family firms possess (Chua, 2018).
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49 Our framework is shown in Table 1. In terms of governance implications, we include
50 different factors highlighted in the literature. From a *family perspective*, we consider the wealth
51 concentration of the remaining family, the family’s investment time horizon and the extent to
52 which family owners focus on SEW-objectives. First, the wealth concentration of the remaining
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3 family is important because owning families, due to their relatively undiversified wealth
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5 position, are generally more risk averse toward growth (La Porta et al., 1999). This risk aversion
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7 might be a source of conflict with investors who typically have more diversified portfolios and,
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9 therefore, a higher risk propensity. Second, owners might have differing time horizons
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11 concerning their involvement in a firm potentially causing conflicts of interest (Arthurs,
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13 Hoskisson, Busenitz, & Johnson, 2008). For example, traditional independent PE investors
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15 generally seek an exit after three to five years whereas family owners might have a long-term
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17 horizon without clear exit intentions. Third, the focus on SEW may direct the family to prioritize
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19 non-economic objectives over the objective of wealth maximization that is commonly prioritized
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21 by investors (Zellweger, Nason, Nordqvist, & Brush, 2013). SEW-considerations will influence
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23 the family's preference for certain investor types and governance arrangements.
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29 From a *firm perspective*, we consider a focus on efficiency and/or growth as a main driver
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31 of value creation post-investment, the use of debt to structure the transaction and the likelihood
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33 that the family will reduce its involvement in firm management. First, increasing efficiency has
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35 been one of the central mechanisms for investors such as traditional PE firms to create value
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37 (Cumming, Siegel, & Wright, 2007). However, efficiency-enhancing interventions might involve
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39 restructuring activities such as reducing the workforce or replacing family employees that might
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41 be detrimental to the family's reputation or SEW and, therefore, be a source of owner conflict.
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43 Second, traditional PE investors increasingly focus on growth to generate returns (Hoskisson,
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45 Shi, Yi, & Jin, 2013; Wright, Hoskisson, & Busenitz, 2001). However, family firms might be
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47 reluctant to pursue risky growth strategies which could lead to conflicting objectives and,
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49 therefore, requires appropriate governance. Third, a key element of PE governance is the use of
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51 debt instruments versus equity (Wright, Amess, Weir, & Girma, 2009). While all transaction
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3 types discussed in Table 1 will generally involve the use of equity instruments, some investors
4 might combine traditional equity with debt and debt-like instruments to structure the transaction.
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6 Debt instruments typically have few rights of control unless the firm becomes insolvent (Jensen
7 & Meckling, 1976). From a family perspective, debt-like instruments have the advantage that
8 they require less involvement of investors. However, an excessive use of debt will also increase
9 the likelihood of financial distress and endanger the family's SEW. Fourth, we discuss the
10 likelihood that the family will reduce its involvement in firm management as part of the deal, for
11 instance by giving up the CEO position. The decision to decrease involvement in management
12 may relate to structural family-level considerations (for instance when a family-member CEO is
13 reaching retirement age) but may also relate to economic considerations. The willingness to give
14 up control over management is important because it may influence the type of investor that can
15 be attracted, and the extent to which family owners can derive SEW from their firm following
16 the transaction.
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33 Finally, we discuss the type of investor that is most likely to provide a good fit, and how
34 important relational governance will be in driving the family-investor relationship. Different
35 types of investors clearly have different objectives including investment time horizon, preferred
36 risk profile, the pursuit of non-economic goals (such as investor reputation), active involvement
37 in portfolio firms, and so forth (Cumming, Schmidt, & Walz, 2010; Drover et al., 2017;
38 Hoskisson, Shi, et al., 2013; Manigart & Wright, 2013). Following a configurational approach,
39 the performance of outside investments in private family firms will be highest when investor
40 objectives are consistent with the family and firm-level governance factors discussed earlier. A
41 key question that arises in this respect is what type of governance will drive the investor family
42 collaboration. Given the embeddedness of family relationships in family firms, many scholars
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3 depict family firms as a context in which relational governance based on mutual trust, a shared
4 vision and identity dominates over contractual governance as stipulated in shareholder
5 agreements, incentives and monitoring systems (Arregle, Hitt, Sirmon, & Very, 2007; Chrisman,
6 Chua, Le Breton-Miller, Miller, & Steier, 2018; Eddleston, Chrisman, Steier, & Chua, 2010;
7 Steier, 2001). Compared to nonfamily firms, family firms may be more inclined to establish
8 trusting relationships because they are concerned about long-term stability and the preservation
9 of a favourable reputation (Eddleston & Morgan, 2014; Stanley & McDowell, 2014). In contrast,
10 PE investors traditionally rely on formal shareholder agreements to create alignment on
11 economic objectives and to regulate the execution of voting rights or the transfer of shares
12 (Chemla, Habib, & Ljungqvist, 2007). Even though contractual governance will be essential in
13 all transaction types, contractual governance is ill-suited to address questions that are of
14 managerial and non-economic nature (such as a firm's strategic position, growth aspirations, as
15 well as the preservation of the family's SEW) (Schulze et al., 2001). Overall, relational
16 governance may be key for investors and family owners to work together successfully and,
17 therefore, is a key element of firm governance.

38 **Quadrant 1: Gradual Exit**

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40 Families in Quadrant 1 (Figure 1) seek a gradual exit from their family business.
41 Therefore, they may engage in cooperation with an external investor to diversify some of their
42 wealth in the short term (time t1), while aiming to simultaneously maximize firm value before a
43 final exit (time t2). We define these transactions as *gradual exits*. Families in this quadrant have
44 no transgenerational intent. The equity investment only involves a partial change in ownership
45 and does not provide extra capital to the firm.
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3 An example of a gradual exit is the buyout of La Buvette, a French agricultural
4 equipment manufacturer owned by the fifth generation of the Gustin family, in 2003 (Schmohl,
5 2010). The family felt that their firm still had value creation potential, but they needed a partner
6 to professionalize further. Because there were no successors in the family and because they were
7 concerned about the long-term independence of the firm, the family started negotiations with
8 external investors. The family retained Alliance Entreprendre, a local mid-market bank-affiliated
9 buyout fund, as an investor given its value adding potential, cultural fit, and attractiveness of the
10 financial offer. Following the deal, the family gave up the CEO position and retained a minority
11 stake. Alliance Entreprendre monitored the cash flows of the business closely, introduced more
12 systematic management processes and prepared the business for a joint exit with the family.
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26 Table 1 summarizes key governance implications of transactions in this quadrant and the
27 potential fit with different investor types. From a family perspective, next to family owners who
28 sell all their shares in the transaction, remaining family owners may decide to diversify their
29 wealth by selling some of their shares. This reduces their wealth concentration in the firm and
30 increases the likelihood that the risk profile matches that of investors reducing agency conflicts.
31 Additionally, before investing, investors typically verify which family members want to remain
32 involved in the firm and which want to quit. Investors will buy out family members who do not
33 commit to a joint strategic plan. This will reduce the likelihood of principal-principal conflicts
34 between remaining family members (Schulze, Lubatkin, & Dino, 2003b). Second, remaining
35 family owners often seek an exit in the medium term when the business has been
36 professionalized. While remaining family owners may have concerns about the preservation of
37 SEW, family owners who do not have intentions for transgenerational control generally have
38 reduced SEW perceptions (Chrisman, Chua, Pearson, et al., 2012; Zellweger, Kellermanns,
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3 Chrisman, & Chua, 2012). Reduced expectations about future SEW increase the disposition of
4 family owners toward the maximisation of financial wealth (Kotlar et al., 2018). The
5 maximization of firm value becomes the dominant goal and should lead to a climate in which
6 investors and family owners find a common ground (Villanueva & Sapienza, 2009). Family
7 owners also become more likely to prioritize economic considerations in their selection of an
8 investor. They may, for instance, prefer an investor who has great value adding skills or a strong
9 reputation, but who does not have a strong familial identity (Cannella, Jones, & Withers, 2015).

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20 --- Please insert Table 1 about here ---
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23 From a firm perspective, because these investments do not bring new money in the firm,
24 value will mostly be created by focusing on efficiency gains rather than on growth. Opportunities
25 to increase efficiency are likely present because private family firms frequently base decision-
26 making on non-economic personal motives (Gómez-Mejía et al., 2007; Gómez-Mejía, Nuñez-
27 Nickel, & Gutierrez, 2001) and are vulnerable to poor leadership (Schulze et al., 2001). Investors
28 can help family owners professionalize the governance and financial management of the firm,
29 optimize the business model, cut costs and prepare the business for sale by streamlining
30 organizational processes. We anticipate that families may go a long way in supporting such
31 governance and operational engineering. Nevertheless, when investors do not acquire dominant
32 control over the firm, they might still need to make compromises. Compromises, for instance,
33 may be needed when an investor would want to divest a historically important business division
34 or dismiss underperforming employees who have close emotional ties with the family. Debt
35 financing can be used in these transactions as efficiency improvements should free up cash that
36 can be used to pay off debt and boost returns for the remaining shareholders. Debt provides
37 incentives to implement efficiency-enhancing initiatives (Jensen, 1989).
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3 Because family owners have a lower focus on SEW, reducing family involvement in
4 management by attracting an external CEO is a viable option in this scenario. Whether or not the
5 family brings in an external CEO will depend on the balance of SEW and economic objectives
6 they wish to pursue after the investment. On one hand, attracting an external CEO implies
7 accepting a greater loss in SEW (Chrisman, Chua, Pearson, et al., 2012). On the other hand,
8 external CEOs will bring external experience and may be more willing to make changes in the
9 firm. Also, family owners who hire an external CEO send a strong signal toward investors that
10 they will direct resources toward financial performance rather than toward the preservation of
11 SEW (Jaskiewicz, Combs, Shanine, & Kacmar, 2017; Naldi, Cennamo, Corbetta, & Gomez-
12 Mejia, 2013). Accordingly, the appointment of an external CEO may further reduce principal-
13 principal problems and allow the family to attract a high-quality investor (Bertrand & Schoar,
14 2006).

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16
17 Overall, deals in Quadrant 1 fit relatively well with the traditional PE-model including
18 independent PE firms and bank-affiliated PE firms. In the traditional model, PE firms are value-
19 enhancing because they increase the managerial focus on the realization of efficiency gains
20 (Jensen, 1993), and bring financial engineering skills which lead to increased leverage (Kaplan,
21 1989). Independent PE firms have a medium-term investment horizon of three to five years
22 (Wright et al., 2009) which should provide sufficient time to professionalize the firm and
23 implement efficiency-enhancing initiatives. Bank-affiliated PE firms might have an advantage to
24 conduct these type of transactions as they could have obtained private information about their
25 clients through previous banking relationships and may provide them an opportunity to extend
26 more leverage. An important benefit a PE firm could bring to remaining family owners is to
27 provide “cover” for efficiency enhancing actions which might break longstanding implicit
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3 contracts with, for example, incompetent employees or suppliers (Villalonga, 2012). By
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5 monitoring the underlying target and implementing sound corporate governance practices, PE
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7 firms will help family firms to transition and ultimately facilitate a successful exit (Di Toma &
8
9 Montanari, 2012). We anticipate that transactions in this quadrant will be mainly managed with
10
11 contractual governance and that relational governance will be relatively less important. Because
12
13 of the family owners' objective to maximize firm economic value and the relatively low focus on
14
15 SEW, most value the family and the investor will expect to generate from the cooperation will be
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17 of a contractable nature.
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22 **Quadrant 2: Extend the firm**

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25 In Quadrant 2, families seek a cooperation with an investor to provide capital to the firm
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27 (time t1) allowing to jointly maximize firm value before an exit in the medium term (time t2). At
28
29 time t2, the family and the investor may jointly exit the firm, the investor can take over the
30
31 family's stake, or the family may simply sell its stake to another third party. We define these
32
33 transactions as *extend the firm* deals. Families are looking to prepare their firm for sale but
34
35 realize that more resources can help to fully develop their firm. While deals are somewhat like
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37 deals in Quadrant 1 because family members plan a medium-term exit, family members retain
38
39 their shareholding and the investment provides extra capital to firm.
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44 An example of a transaction in this quadrant is the investment of the Business Growth
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46 Fund (BGF) in Molecular Products Group, a UK-based manufacturer of advanced chemistry-
47
48 based products, in 2014 (Private Equity Wire, 2017). At that time, the second-generation family
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50 firm had just started to internationalize. BGF helped the family to realize the firm's growth
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52 potential by providing additional capital, strengthening the management team and appointing a
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54 chairman with relevant experience in acquisitions and major growth initiatives. After the
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3 operating profits had almost doubled, the family and the investor successfully exited the business
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5 with a sale to another PE player in 2017.
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8 Table 1 lists key governance implications. From a family governance perspective,
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10 because all family members retain their shareholding, the wealth concentration of family owners
11
12 remains constant. As such, the family and the investor will differ more in their willingness to
13
14 take risk than in Quadrant 1. However, like in Quadrant 1, family owners should have somewhat
15
16 reduced concerns about SEW preservation and will therefore be aligned with investors in their
17
18 objective to maximize firm value in the medium term. From a firm perspective, because
19
20 investments in this quadrant bring new money in the firm, investors can create value by focusing
21
22 on growth next to the realization of efficiency gains and professionalization. To support growth,
23
24 investors can provide family owners with industry expertise, international relationships, expertise
25
26 regarding mergers and acquisitions, and so forth (Meuleman, Amess, Wright, & Scholes, 2009).
27
28 We anticipate that conflicts between family shareholders and investors will be relatively rare
29
30 because a focus on growth (rather than efficiency gains) will require fewer changes in existing
31
32 operations. Nevertheless, investors may need to make compromises when growth-related
33
34 initiatives involve significant risks. Family owners will generally have higher levels of wealth
35
36 concentration and therefore a lower risk tolerance. The use of significant debt financing is less
37
38 likely as the financial obligations associated with debt limit the flexibility needed to pursue
39
40 growth. Compared to Quadrant 1, families may be somewhat more likely to appoint an external
41
42 CEO. Because the investor provides extra capital to the firm, value creation will depend on the
43
44 achievement of profitable growth. Rather than continuing the business ‘as usual’ and building on
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46 the traditional mechanisms, such as financial engineering, to improve performance, value
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48 creation should depend more on strategic revitalization (Berg & Gottschalg, 2005). Family
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3 owners may look for a new CEO with an entrepreneurial orientation and an attitude toward
4 innovation if the existing family-member CEO does not have the required skill set (Wright et al.,
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6 2000).
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10 Overall, deals in this quadrant fit relatively well with the traditional PE-model including
11 independent PE firms and evergreen PE firms. Evergreen PE firms involve funds in which
12 realized investment returns are recycled back into the fund rather than distributed to limited
13 partners and, therefore, the capital committed is permanent. The key benefit of such structure is
14 that it allows for more long-term holding periods compared to traditional PE (Brown & Kraeusl,
15 2012). As such, evergreen PE may be especially relevant for families whose exit horizon extends
16 beyond the 3 to 5 years horizon of traditional PE. A longer investment horizon will help to reap
17 the full benefits of the growth scenario, which typically takes longer to achieve compared with
18 efficiency gains as in Quadrant 1. Like in Quadrant 1, family owners and investors will largely
19 align with each other using contractual governance. Relational governance including trust may
20 be somewhat more important, however, because ownership and shareholder agreements are ill-
21 suited to ensure alignment on growth-related objectives.
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38 **Quadrant 3: Replacement Capital**

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41 Families in Quadrant 3 want to cash (some of) their investment, but also have
42 transgenerational intents. Family owners for instance may seek investors to solve
43 intergenerational transfers with several siblings or other family members. Parents often want to
44 treat their children (or cousins) equally when passing on their firm. But when some family
45 members want to become or remain owner and others do not, investors may help to overcome
46 stalemates by buying the shares of the latter. In this scenario, the succeeding generation has a
47 long-time horizon that likely extends beyond the time horizon of the investor (time t2).
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3 An example that illustrates this scenario was the buyout of Market Basket, a New
4 England-based supermarket chain owned by the Demoulas family, in 2014. The deal settled a
5 life-long conflict between two family cousins that almost led to the demise of the company. In
6 the deal, one branch of the Demoulas family acquired the 50.5% stake they did not already own
7 from the other branch with funding from the Blackstone Group and significant amounts of debt
8 (Forbes, 2014).
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17 From a family governance perspective, the wealth concentration of the remaining family
18 will either stay constant or increase. It may increase if the remaining family invests some of its
19 personal wealth to acquire a stake of the selling party. A higher level of wealth concentration
20 might limit the willingness to take risk. Additionally, because family owners may seek to regain
21 full control over their firm in the long-term, they are likely to hold positive expectations about
22 future SEW. Such positive expectations increase the disposition of family owners toward the
23 minimization of SEW losses when considering an investor and related governance arrangements
24 (Kotlar et al., 2018). Family owners will prefer an investor who increases the probability for the
25 family to recover SEW in the long-term (Kotlar et al., 2018).
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39 Because there is no extra capital in the firm, investors need to focus on the realization of
40 efficiency gains to create value. However, because cost reductions often require changing old
41 habits and the family may be more focused on continuity (Allio, 2004), the potential to realize
42 such cost efficiencies may be limited. Given the limited value creation potential, investors will
43 often limit their risk by using a financial structure that emphasizes debt over equity and that
44 guarantees a minimum required return (e.g., mezzanine financing). As family owners will seek to
45 minimize SEW losses when ceding partial ownership, they will be unlikely to appoint an
46 external CEO as part of the transaction.
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3 Overall, deals in this quadrant do not fit well with the traditional independent PE-model
4 with a closed-end fund. Traditional PE investors and remaining family owners will differ in their
5 concern about SEW, in investment time horizon and risk-willingness. Families will likely prefer
6 investors with a longer time horizon who allow the remaining family to remain in the driving
7 seat and regain control. As highlighted, mezzanine investors may be a good fit, as they will
8 typically not take an active position on the board and will employ financial covenants that tend to
9 be less strict compared to banks (Torpey & Viscione, 1987)³. Initial owners frequently buy out
10 mezzanine investors through the accumulated profits generated by the business or a
11 recapitalisation with inexpensive senior debt. Alternatively, bank-affiliated PE funds or
12 government-funded funds might also be well positioned to invest in this quadrant. Bank-
13 affiliated PE investors might provide funding alongside traditional senior loans provided by the
14 affiliated banks. As bank-related PE investors have lower return expectations than independent
15 PE investors (Manigart et al., 2002), they will also be more willing to provide a debt-like
16 structure. Government-funded PE might sponsor these types of transactions to anchor companies
17 in the local economy and to preserve regional employment.

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38 Lastly, in recent years family offices and private investors with a family firm background
39 increasingly seek direct investments in private family firms (Rottke & Thiele, 2017). These
40 investors might fit well with transactions in this quadrant as they possess values and identities
41 consistent with those of a family firm. Family offices, just like family firms, are affected by
42 family influence. While the main objective of a family office is to preserve the family's wealth
43 and maintain its legacy, many family offices also place priority on objectives such as family
44 harmony, cohesion and general continuity (Rivo-López, Villanueva-Villar, Vaquero-García, &

55 ³ To protect their interests, mezzanine investors will typically restrict the family's latitude to execute capital
56 reductions, alter dividend-policies, increase CEO compensation or attract more debt (Thompson & Cusmano, 2013).
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3 Lago-Peñas, 2017). As such, they take a long-term view on investment and understand the
4 importance of the continuation of family legacy and values. Furthermore, family offices that are
5 not professionalized may have less formal control mechanisms (Wessel et al., 2014). This will
6 resonate well with family owners who are concerned about the preservation of family influence
7 over the firm as a source of SEW (Rottke & Thiele, 2017). Overall, family offices might be the
8 preferred choice for family firms seeking replacement capital as they have a more consistent
9 business philosophy and similar understanding of the needs of the family business (Brueckner,
10 2014).

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12 The importance of relational governance in the family-investor relationship will vary
13 dependent on the type of investor. For mezzanine investors, who face lower risks than equity
14 investors, contractual agreements rather than relational governance will guide relationships.
15 Alternatively, for pure equity investors, relational governance with a focus on trust will play a
16 key role (Rottke & Thiele, 2017). Given the family owners' focus on transgenerational
17 succession and preservation of SEW, a large part of the value the family will expect to generate
18 from the cooperation will be of a non-contractible nature. The long-term horizon of family
19 owners and their concern about the protection of family reputation provide increased incentives
20 and ability to establish long-term trusting relationships (Arregle et al., 2007; Eddleston &
21 Morgan, 2014).

22 **Quadrant 4: Strategic Investment / Turn-Around**

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24 In Quadrant 4, families are looking to strengthen the firm's capital and have a long-term
25 investment time horizon. We distinguish between two scenarios. In one scenario, families seek a
26 strategic partner to realize growth ambitions. We define these deals as strategic investments. In a
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3 second scenario, families may seek an investor to strengthen the firm's financial structure in a
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5 distress situation. We define these deals as turnarounds.
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8 **Strategic investments.** In this scenario, families collaborate with an external investor to
9
10 raise capital for the firm (time t1 in Figure 1) and have no immediate intention to exit.
11
12 Transactions in this scenario take place when the firm perceives strategic investment
13
14 opportunities that go beyond its immediate financing capacity. At the same time, the family has
15
16 no wish to exit the firm, so typically the family will seek to buy out the outside investor when the
17
18 growth has been realized.
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22 A recent deal illustrating this scenario is the investment of LNK Partners (a New-York
23
24 based PE firm) in Dogfish Head (a family owned and managed craft brewery in Delaware) in
25
26 2015 (Whipp & Daneshkhu, 2016). Dogfish Head needed money and expertise to continue
27
28 growing in an increasingly competitive market. Initially, however, the family owners were very
29
30 sceptic about giving up control. The deal crystallized only after LNK agreed they would treasure
31
32 DogFish Head's culture, the company would pursue "smart growth over fast growth," and the
33
34 deal would not be a path to taking the company public. LNK acquired a 15 percent stake and got
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36 one seat on Dogfish Head's four-member board of directors.
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41 From a family governance perspective, deals in this quadrant do not alter the family's
42
43 level of wealth concentration. Furthermore, while investors and family owners will be aligned on
44
45 the objective to pursue growth, conflicts may still occur because investors will generally be less
46
47 concerned about SEW, be more willing to take risks, and have shorter time horizons. Because
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49 families are concerned about the retention of long-term family control, deals will typically
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51 involve minority investments.
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3 From a firm perspective, investors will focus on the realization of the firm's growth
4 potential. The use of significant debt financing is less likely as the financial obligations
5 associated with debt will limit the flexibility needed to pursue growth. Like in Quadrant 3,
6 family owners will be unlikely to appoint a new external CEO. Family owners are in a strong
7 position to negotiate and will prioritize the preservation of SEW including the continuation of
8 family control over decision-making.
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11 Deals in this quadrant only have limited fit with the traditional PE-model because
12 families will generally prefer an investor with a long-term horizon. However, over the past years,
13 some PE-firms have set up dedicated long-term funds for 20 years that can invest in companies
14 for up to ten years. PE firms are rethinking old structures, giving themselves more time, and
15 targeting returns of 10 to 12 per cent that are well below the 20 per cent returns usually aimed for
16 by ten-year funds (The Economist, 2016). Some of these long-term oriented funds might be well
17 suited for this type of transaction. Evergreen funds may also prove to be a good partner.
18
19 Alternatively, if SEW-objectives are particularly pertinent, family offices and private investors
20 with a family business background could provide a good fit. We anticipate that relational
21 governance will be important in these transactions that involve long-term partnerships. The
22 monetary incentives that come from equity ownership will not guarantee the alignment of family
23 owners and investor on growth and SEW-related objectives.
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27 **Turnaround.** Lastly, business-owning families may seek an equity investment because
28 their firm is facing financial difficulties. Given the unpredictable outcome and the time and effort
29 that might be needed to rescue the company, an exit will not be foreseen in the short term.
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33 An example of a turnaround is the investment of Gimv (a quoted evergreen European PE
34 firm) in Vandemoortele (a Belgian producer of bakery products) in 2009. The investment
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3 strengthened the balance sheet of Vandemoortele, which had suffered from a failed acquisition
4 and lower revenues after the financial crisis. Supported by the investment, which involved
5
6 subordinated debt with warrants, and after the divestment of an important business division, the
7
8 fourth generation of the Vandemoortele family turned the tide. After seven successful years of
9
10 growth and increased profitability, Gimv executed its warrants and sold its share to the
11
12 Vandemoortele family who had pre-emption rights.
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17 In turnarounds, the wealth concentration of family owners will remain constant or
18
19 increase if they invest some of their private wealth along with the investor. Following the tenets
20
21 of the behavioral agency model (Wiseman & Gómez-Mejía, 1998), the likelihood of conflicts
22
23 between outside investors and family shareholders may depend on the performance evolution of
24
25 the firm. When the firm is in distress, investors and family owners will be aligned on a common
26
27 objective, i.e. to increase the firm's profitability. Indeed, as the economic risks facing a family
28
29 firm increase, the likelihood that economic considerations precede SEW considerations increases
30
31 (Gómez-Mejía et al., 2007).⁴ Nevertheless, family owners and investors may still disagree about
32
33 strategic alternatives, e.g. when considering laying off employees (Neckebrouck et al., 2016;
34
35 Sraer & Thesmar, 2007) or selling a division. Furthermore, conflicts between investors and the
36
37 family will become more likely when firm performance increases. Relieved from financial
38
39 distress, families may want to regain control over their firm and, if investors do not hold
40
41 sufficient control rights, the latter will become vulnerable to expropriation. Concerning CEO
42
43 replacement, attracting a new external CEO is a likely option and might be a condition imposed
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45 by the investor. Family owners are in a weak position and are forced to accept losses in SEW to
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55 ⁴ Financial peril ultimately threatens the survival of the firm, which is the source of both the family's financial
56 wealth and SEW (Chrisman & Patel, 2012; Gómez-Mejía, Patel, & Zellweger, 2018).
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3 guarantee firm survival. When selecting a new CEO, skills and experience with turnarounds will
4
5 be most important.
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8 PE investors specialized in distress will provide a good fit with this type of transactions.
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10 Their focus on efficiency improvements and cost-cutting initiatives, combined with experience in
11
12 divestments, can help to solve financial distress (Hotchkiss, Strömberg, & Smith, 2014). For
13
14 family offices with a focus on the preservation of family wealth turnaround transactions might
15
16 pose too much risk (Rottke & Thiele, 2017). Relative to shareholder agreements and the
17
18 monetary incentives that stem from ownership, relational governance mechanisms will only have
19
20 a subordinate role. Given the focus on firm survival, most value of the cooperation will be of an
21
22 economic nature.
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26 27 **CONFIGURATIONS AS IDEAL TYPES** 28 29

30 While we focused our analysis on four distinct configurations, in practice, hybrid forms
31
32 of transactions that cross the boundaries of individual quadrants may occur. Family owners, for
33
34 instance, may seek external equity to provide liquidity for both the firm and the family.
35
36 Following the foundations of configurational theory (Miles & Snow, 1978), a real transaction
37
38 does not need to be classified into one single quadrant however. Configurations should be
39
40 interpreted as ideal-type organizations rather than as nominal categories. The ideal-type
41
42 organization is an important theory-building device that can serve as "an abstract model so that
43
44 deviation from the type can be noted and explained" (Blalock, 1969, p. 32). In our context, the
45
46 degree of deviation between a real transaction and each ideal-type configuration can be used to
47
48 predict governance performance. The performance of a particular configuration should decrease
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50 the more that configuration deviates from the ideal types (Drazin & Van de Ven, 1985).
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3 Most configurational research in governance examines how different governance
4 constellations lead to the same overarching objective of maximizing financial performance (e.g.,
5 Bell, Filatotchev, & Aguilera, 2014). In such an approach, configurations are often derived
6 empirically and scholars spend a lot of effort on inductively reasoning about the origin of the
7 boundaries between the configurations. Our approach in contrast creates configurations that are
8 more detached from each other. Each configuration originates from different, rather than one
9 common, performance objectives: aiming for the continuation of family control rather than a
10 family exit and providing liquidity for the family or for the firm. This implies that deals that
11 overlap with multiple quadrants involve transactions in which the family has mixed objectives.
12 For instance, family owners may wish to buy out other family members (as in Quadrant 3),
13 whilst at the same time also increasing the firm's capital (as in Quadrant 4). In such a scenario,
14 high-performing governance constellations will need to combine characteristics of different
15 scenarios: an ideal investor should not only have high value-adding skills that support the
16 realisation of profitable growth (as in Quadrant 4) but also allow the family to regain firm control
17 over time (as in Quadrant 3).

37 38 **THEORETICAL PERSPECTIVES**

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41 To study the investment cycle involving private family firms and external equity
42 investors, including the selection of investors, screening, deal structuring, deal management, and
43 deal performance, a wide variety of theoretical perspectives seem relevant. Given the
44 heterogeneity in family-level objectives and resources, these investments are best understood by
45 applying a multi-theoretic approach. Agency theory, stewardship theory and SEW perspectives
46 may be complemented with multiple agency, resource dependence, strategic entrepreneurship,
47 social identity, and trust-based perspectives. The configurational approach represents an ideal
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3 opportunity to bring to bear these perspectives while paying attention to organizational variations
4 and the rich characterization of types and processes (Chrisman et al., 2018). Our configurational
5 analysis shows how the relevance of individual governance perspectives varies across the
6 different configurations. Below, we briefly discuss agency theory, multiple agency theory,
7 resource dependence, strategic entrepreneurship, stewardship, social identity, SEW, and trust-
8 based perspectives. Table 2 depicts the most relevant theoretical perspectives for each quadrant.
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17 First, traditional *agency theory* will be relevant for different types of transactions as it
18 focuses on the role of agency costs in family-owned firms and how investors implement
19 governance structures to reduce those costs (Uhlener et al., 2007). In most academic research on
20 value creation in PE deals, researchers have focused on agency-based explanations arguing that
21 PE firms increase efficiency by limiting managerial discretion (Jensen, 1989). While this view
22 may be less relevant to private firms in which owners have strong incentives and ability to
23 monitor management (Chung, 2011), the pursuit of SEW-objectives and associated inefficiencies
24 likely increase the potential for efficiency gains in private family firms (Chrisman, Chua, Steier,
25 et al., 2012). We anticipate that external investors will be able to focus most on the realization of
26 efficiency gains in gradual exits in Quadrant 1.
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41 Next to traditional agency theory, we lack applications of *multiple agency theory*
42 including principal-principal agency theory. Multiple agency theory moves beyond a simplistic
43 principal-agent dichotomy and considers multiple governance roles as agents and principals of
44 the same participants in a transaction (Allcock & Filatotchev, 2010; Arthurs et al., 2008;
45 Deutsch, Keil, & Laamanen, 2011). This may cause ambiguity in terms of whose interests are
46 served (Hoskisson, Arthurs, White, & Wyatt, 2013; Peng & Sauerwald, 2013). For example,
47 principal-principal conflicts might be prevalent when investors take a minority position in a
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3 family firm, which will be common in Quadrant 4a (Villalonga & Amit, 2006). Additionally, in
4 family firms involving outside investments, family members may play multiple roles as owner
5 (principal), manager (agent), and potentially governor of the overall family wealth (agent and
6 principal) which will lead to potentially conflicting incentives. Overall, more research is needed
7 to examine the extent, heterogeneity and impact of principal-principal relationships in family
8 firms involving outside investors. For example, what is the impact of the type of investor on the
9 extent of principal-principal conflict and how will certain governance arrangements (e.g. CEO
10 incentives) moderate this relationship.
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22 While agency theory focuses on the efficiency of governance arrangements, *resource-*
23 *dependence theory* assumes that power dependencies will take precedence in establishing
24 governance arrangements (Pfeffer & Salancik, 1978). From this perspective, investors in
25 turnaround deals will have significant power in establishing government arrangements because
26 firm survival depends on their provision of financial capital. Alternatively, when family owners
27 are in a stronger position to negotiate, they will consider the resource dependencies investors
28 impose on the family business when selecting a preferred investor. Families who prioritize the
29 retention of long-term family control (as in Quadrant 3) might pick investors who exercise the
30 least power, irrespective of the value creation potential. In this scenario, independent PE firms
31 will probably be less preferred as potential partners given their typical use of formal control
32 mechanisms including specific contracts and board representation.
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48 A *strategic entrepreneurship perspective* recognizes that access to resources and
49 capabilities are important drivers for family firms success (Ireland, Hitt, & Sirmon, 2003). From
50 this perspective, investors will help to address the dual challenges of sustaining current
51 competitive advantage while pursuing new opportunities to contribute to the longevity of the
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3 family firm. Investors may provide complementary resources and capabilities that may be
4 missing in the family business (Zahra & Filatotchev, 2004). A key question is how investors
5 impact the unique resource and resource-orchestration advantages of private family firms
6 (Habbershon & Williams, 1999; Sirmon, Hitt, Ireland, & Gilbert, 2011). Overall, we anticipate
7 that strategic entrepreneurship will be most relevant for Quadrants 2 and 4, i.e. deals with growth
8 perspectives.

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17 In contrast to agency theory, which assumes owners and managers are motivated by self-
18 interest, *stewardship theory* describes owners and managers as stewards who act in trustworthy,
19 collectivistic and pro-organizational ways (Davis, Schoorman, & Donaldson, 1997). Stewardship
20 theory has been frequently applied to family firms (Corbetta & Salvato, 2004; Le Breton-Miller
21 et al., 2011). Stewardship theory implies that the family agenda includes the satisfaction of the
22 goals of investors as a source of personal satisfaction (Davis et al., 1997). An intriguing question
23 is how stewardship behavior may arise in the relationship between family owners and investors.
24 Villanueva and Sapienza (2009) anticipate that stewardship behavior is more likely to arise when
25 both family owners and investors have a broad agenda including both economic and non-
26 economic objectives. In that case, principles of reciprocity may govern the relationship and
27 family owners and investors may tolerate each other's non-economic goals for common benefit
28 (Villanueva & Sapienza, 2009). These ideas suggest the need to examine how deal-making
29 between family owners and investors may support the mediation of competing objectives.⁵
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50 Overall, stewardship theory may be most relevant for deals that build on relational governance
51 and that involve long-term partnerships such as strategic investments (Quadrant 4a).

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56 ⁵ We thank an anonymous reviewer for this suggestion.
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3 Research recently applied *social identity theory* and *organizational identification*
4 concepts to family firm decision-making (Cannella et al., 2015; Zellweger et al., 2013). Due to
5 the role of the family business for the family's biography and the difficulty of the family to leave
6 the firm, family members typically maintain a deep identification with their organizations (Dyer,
7 2006). Organizational identification may provide a relevant framework to examine the
8 investment cycle involving family firms and outside investors. Family owners who strongly
9 identify with their firm prefer family offices or private investors with a family business
10 background as investors rather than PE sponsors because the former are less likely to disrupt the
11 identity of the family (Neckebrouck et al., 2017). Social identity theory might be most relevant
12 when families derive high levels of SEW from their identification with the firm as in Quadrants 3
13 and 4a.
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29 The SEW perspective gained great traction amongst family business scholars in the last
30 decade with recent studies providing deep insights to how family firms balance economic and
31 SEW objectives in their decision making (Gómez-Mejía et al., 2018; Kotlar et al., 2018). While
32 family firm research traditionally assumes that ceding control involves strong losses in SEW
33 (Gómez-Mejía et al., 2007), an intriguing question is whether replacement-capital deals that
34 enable transgenerational successions (Quadrant 3) may actually increase SEW expectations
35 (Kotlar et al., 2018). Overall, while SEW considerations may be prevalent across all quadrants,
36 we anticipate they will be particularly influential when families have transgenerational intentions
37 as in Quadrants 3 and 4 (Zellweger et al., 2012). We especially encourage research which
38 disentangles the role of the different dimensions of SEW (Berrone et al., 2012) and which
39 examines the relationship between specific family structures and SEW (Jaskiewicz et al., 2017).
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Lastly, we agree with Eddleston et al. (2010) and others (Arregle et al., 2007; Cruz et al., 2010) about the value of *trust* as a promising theoretical construct to advance understanding of family business governance. Trust represents the confidence that another party will refrain from exploiting the other's vulnerabilities even though the other has no control over it (Mayer, Davis, & Schoorman, 1995). Cruz et al. (2010) argue that trust provides "a middle ground where agency theory and others-oriented theories can meet. Trust scholars do not assume that selfish opportunistic behavior is an always present danger, as conventional agency theory suggests, but "neither do they assume that opportunism is negligible, as stewardship theory proponents and other scholars suggest" (Cruz et al., 2010, p. 71). While research examined the unique value of trust *within* family firms (Steier, 2001), few studies focus on the role of trust in relationships of family firms with external stakeholders such as investors (Eddleston & Morgan, 2014). Some studies imply that family firms have an advantage in establishing trusting relationships because they have higher standards of maintaining a favourable reputation (Craig, Dibrell, & Davis, 2008). An intriguing question is whether and how trust-based governance mechanisms may interact with contractual governance mechanisms in family owner-investor relationships (Poppo & Zenger, 2002). Overall, trust-based perspectives may be particularly relevant in deals characterized by long-term horizons and non-economic goals, such as in Quadrant 3 and 4a.

CONCLUSION

Scholars examining the role of external investors for family firms mostly examine PE buyouts of family firms but pay limited attention to scenarios in which private family firms cooperate with investors to accomplish their goals. Recognizing the diversity in objectives that may lead family firms to cede ownership to external investors, we developed a conceptual configuration model of four governance scenarios that may arise when family owners attract an

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3 external investor. Doing so, our model improves understanding about the evolving structures of
4 ownership of private family firms, the increasingly heterogeneous PE funding landscape, and the
5 role of alternative investors such as family offices. Our model also supports calls to take a more
6 holistic configurational approach to research on family firm governance (Chrisman et al., 2018).
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8 To understand the consequences of external equity investments in private family firms, scholars
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10 may need to integrate multiple theoretical perspectives and direct attention to how various
11 governance mechanisms combine effectively with each other, rather than merely considering
12 governance mechanisms in isolation. We hope our insights stimulate future research on how
13 external investors can contribute to private family firms, which constitute the world's most
14 dominant form of organization.
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Table 1
Governance implications and investor type

	Quadrant 1	Quadrant 2	Quadrant 3	Quadrant 4a	Quadrant 4b
	Gradual exit	Extend the firm	Replacement capital	Strategic investment	Turnaround
Governance implications					
<i>Family perspective</i>					
Wealth concentration remaining family	Constant or decrease	Constant	Constant or increase	Constant	Constant or increase
Investment time horizon	Medium term	Medium term	Long term	Long term	Medium term
Family's focus on socioemotional wealth	Low	Low	High	Medium	Low
<i>Firm perspective</i>					
Focus on efficiency	High	Medium	Low	Low	High
Focus on growth	Low	High	Low	High	Low
Use of debt	Medium	Low	High	Low	Low
Reduced family involvement in management	Possibly	Possibly	Unlikely	Unlikely	Likely
Focus on relational governance	Low	Low	Medium	High	Low
Investor type	Independent PE, Bank-affiliated PE	Independent PE, Evergreen PE	Mezzanine PE, Bank-affiliated PE, Government PE, Family office	Evergreen PE, Long-term PE, Government PE, Family office	Turnaround PE

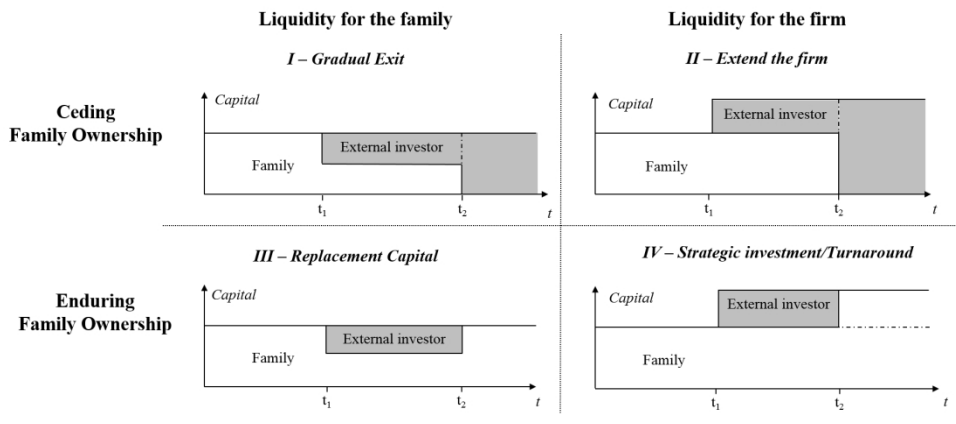
Table 2

Most relevant theoretical perspectives

	Quadrant 1	Quadrant 2	Quadrant 3	Quadrant 4a	Quadrant 4b
	Gradual exit	Spruce-up the firm	Replacement capital	Strategic investment	Turnaround
Most relevant theoretical perspectives	Agency theory	Strategic entrepreneurship	Stewardship, socioemotional wealth, social identity, trust	Strategic entrepreneurship, multiple agency, socioemotional wealth, social identity, trust	Resource dependence theory, agency theory, multiple agency theory

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7 *Figure 1. Configurational Model for External Equity Investments in Family Firms*
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