Contingencies versus External Pressure: Professionalization in Boards of Firms Affiliated to Family Business Groups in Late-Industrializing Countries

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We examine the antecedents of professionalization in boards of firms affiliated to family business groups, increasingly recognized in the literature as the dominant form of big business organization in many late-industrializing countries. Dimensions of board professionalization that we include in our study are board size, ratio of salaried executives and outsider presence. We compare predictions on board composition derived from contingency, institutional and power perspectives. Turkish family business groups, considered as an archetypal example of this form of organization, provide the empirical setting for the study, with data on 299 firms affiliated to ten different family business groups. Our results provide greater support for institutional and power perspectives, showing that, relative to internal and external complexity facing affiliate firms, institutional pressures and the presence of joint venture partners better predict board professionalization.

There has been a growing recognition lately of the significance of the business group as a generic organizational form (e.g. Granovetter, 2005). Interest in business groups emerged as attention turned to economic organization in East Asia (e.g. Whitley, 1990). With expanding research, it became increasingly clear that this particular form of big business organization dominated the economies of a broad range of late-industrializing countries (Kock and Guillén, 2001; Young *et al.*, 2008). Defined as a collection of 'legally independent firms, operating in multiple (often unrelated) industries, which are bound together by persistent formal (e.g. equity) and informal (e.g. family) ties' (Khanna and Yafeh, 2007, p. 331), business groups were also shown to differ with respect to ownership, authority structure, diversification and size. A particular variant that has attracted considerable attention has been the family-controlled, centrally directed, diversified and often large business group prevalent in many late-industrializing economies. Families have significant stakes in these groups, often exceeding 50% of the equity, and actively take part in their governance and management, although outside investors and foreign or local partners may also be involved typically at the affiliate firm level (Khanna and Yafeh, 2007; Young *et al.*, 2008). The coexistence of family-based concentrated ownership, unrelated diversification through legally separate firms and central coordination and

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control set family business groups (FBGs) apart from the multi-divisional form, the conglomerate and the stand-alone family business as well as laterally linked networks of firms (Guillén, 2000; Whitley, 1999; Young *et al.*, 2008).

Much of the research interest in FBGs has been motivated by concerns with their emergence, evolution and sustenance in particular national contexts and the performance of affiliate firms relative to independent companies (e.g. Chang, 2003; Guillén, 2000; Khanna and Rivkin, 2001). Apart from general characterizations often confined to the South Korean *chaebol* (e.g. Whitley, 1999), little empirical research exists on the ways firms affiliated to FBGs are governed. This is particularly notable at a time when many of the so-called 'emerging economies' where business groups of one kind or another are dominant have been moving towards a more marketized and open economy (Hoskisson *et al.*, 2000), coupled with initiatives for reforming corporate governance (Tsui-Auch and Lee, 2003; Young *et al.*, 2008).

Our study addresses this gap by focusing on the boards of FBG-affiliated firms. Although some direct or indirect ownership by a controlling family constitutes the basis of the link to an FBG, as separate legal entities, affiliate firms have their own shareholders and boards of directors (Khanna and Rivkin, 2001). Some of these firms may be entirely controlled by the family, whereas others may be publicly listed or include other foreign or local companies as joint venture partners. In formal terms, the boards are governance bodies with legal accountability and responsibilities to their respective shareholders. Yet at the same time, affiliate firms are located in an overarching group structure, which is led by the founder or a later generation family member together with a central administrative body (Khanna and Rivkin, 2001; Tsui-Auch and Lee, 2003; Yiu *et al.*, 2007). Some of the earlier studies on FBGs have therefore portrayed affiliate firm boards as typically small, inactive and dominated by members of owner families (e.g. Buğra, 1994; Chang, 2003; Young *et al.*, 2008). The controlling family has both the interest and often the power to monitor affiliate firms, including those in which external owners or partners may be involved (Lane *et al.*, 2006). Moreover, the desire to retain control has to do with preserving the power to exercise authority and shape strategy in one's own businesses (Gedajlovic, Lubatkin and Schulze, 2004). Nevertheless, variably across affiliate firms, boards may need or ought to be formed in ways that extend beyond family directors and, perhaps, a few close associates. Indeed, at a more general level, FBGs in late-industrializing countries have also been characterized as a form of big business organization that blends a kinship framework with the managerial enterprise (Kock and Guillén, 2001). Thus, the central research question guiding this study is 'when do boards of firms affiliated to FBGs become more professionalized?' Following recent calls for taking a multi-theoretic approach in studies of boards and governance (e.g. Daily, Dalton and Cannela, 2003; Huse, 2000; Lynall, Golden and Hillman, 2003) we address this question by empirically comparing contingency, institutional and power perspectives, which offer distinct theoretical rationales with respect to the antecedents of board composition.

By examining boards within the framework of a form of big business organization typically found in late-industrializing countries, the study also responds to calls for research on corporate governance that goes beyond US firms (e.g. Huse, 2000; Zahra and Pearce, 1989). Studying FBGs provides a contrast to the US-based literature on large corporations that, after Chandler (1977), has come to take the managerial enterprise for granted. By examining big business organization under family control, the study adds to the debates around the transition to more professionalized governance now largely confined to small family businesses or the entrepreneurial 'threshold' firm (cf. Fiegener *et al.*, 2000; Gedajlovic, Lubatkin and Schulze, 2004; Voordeckers, Gils and den Heuvel, 2007; Zahra and Filatotchev, 2004). Moreover, the focus on antecedents provides an opportunity to contribute to the meagre literature on the way boards come to be formed, as opposed to the preoccupation with their performance outcomes (see for example Corbetta and Salvato, 2004; Gabrielsson, 2007; Huse, 2000; Pearce and Zahra, 1992).

Turkish FBGs, considered as an archetypal example of large and diversified FBGs (see for example Guillén, 2000; Khanna and Rivkin, 2001; Khanna and Yafeh, 2007; Yiu *et al.*, 2007), provided the setting for the empirical investigation. As previous studies have indicated, FBGs constitute most of the largest economic units in this country (Buğra, 1994; Gökşen and

Üsdiken, 2001; Khanna and Yafeh, 2007; Yurtoglu, 2000). Turkey also offers an opportune setting for the study with the transitional context that it exemplifies. Following a long period of state-guided import-substituting industrialization, the country embarked in the early 1980s on a process of liberalizing and opening up its economy (cf. Young *et al.*, 2008). This was accompanied by major institutional reforms including the introduction of a corporate governance code in 2003 very much along the lines promulgated by the OECD (Jesover and Kirkpatrick, 2005; Ugur and Ararat, 2006).

The next section of the paper provides an overview of contingency, institutional and power perspectives on the antecedents of board composition. We then put forth the hypotheses we derive from each of these perspectives on the professionalization of boards in firms affiliated to FBGs. Description of the empirical methods, presentation of results and a concluding discussion follow.

Antecedents of board composition: contingency, institutional and power perspectives

With a primary focus on large public corporations in the USA, mainstream research on boards has been largely informed by agency theory. There have also been calls, however, for taking a multi-theoretic approach that complements or extends beyond agency theoretic explanations, given the variety of roles that boards perform and the multiplicity of factors that may influence their composition (Daily, Dalton and Cannela, 2003; Lynall, Golden and Hillman, 2003; Peng, 2004; Zahra and Pearce, 1989). Family business research has been particularly wary of the possibility that considerations and recommendations relevant for large public corporations may be inappropriate for family-owned small and medium-sized firms (Corbetta and Salvato, 2004; Lane *et al.*, 2006). This has had to do mainly with the primary emphasis on the resource role of boards in such firms, coupled with the premise that the ability to monitor firm actions may thereby be enhanced. Similar concerns have been shared by researchers of larger businesses under concentrated family ownership in emerging economies, notably in view of the limited empirical support that agency theory has garnered in such settings (Khanna and Yafeh, 2007; Peng, 2004; Peng, Buck and Filatotchev, 2003).

Driven by such concerns, various studies in the corporate governance literature (e.g. Finkelstein and Hambrick, 1996; Pearce and Zahra, 1992) and, particularly, the family business literature (e.g. Corbetta and Salvato, 2004; Gabrielsson, 2007; Huse, 2000; Voordeckers, Gils and den Heuvel, 2007) have proposed a contingency perspective for examining the antecedents of board composition. In doing so, they have invoked a variety of theoretical ideas in accounting for variations in the way boards come to be formed. These have included agency theory (e.g. Corbetta and Salvato, 2004; Gabrielsson, 2007), resource dependence (e.g. Gabrielsson, 2007; Pearce and Zahra, 1992), structural contingency (Pearce and Zahra, 1992), organizational lifecycle (e.g. Fiegener *et al.*, 2000) and family-based (e.g. Corbetta and Salvato, 2004; Voordeckers, Gils and den Heuvel, 2007) arguments. Although variant in their theoretical reasoning and the antecedents that they consider, uniting these studies are two core ideas. First, boards are viewed as functional entities (Gedajlovic, Lubatkin and Schulze, 2004). Thus, the ways in which they are composed is likely to have performance consequences. Based on this techno-economic rationale and as is typical of contingency perspectives (Pennings, 1992), the second major claim has been that board configurations should be expected to vary with organizational characteristics and the environmental conditions in which firms operate (Pearce and Zahra, 1992). Firm properties and the operating conditions they face generate varying demands for their management as well as governance (Fiegener *et al.*, 2000; Zahra and Filatotchev, 2004). Thus, like other structural arrangements, boards need to be formed in ways that match situational requirements. Aligning their composition with situational demands promises greater competitive advantage and superior performance, whilst not doing so could be survival threatening (Carney, 1998; Zahra and Filatotchev, 2004). In brief, according to the contingency perspective, firms form their boards in ways that will make them perform better.

Some of the mainstream literature on corporate governance (e.g. Lynall, Golden and Hillman, 2003) and, more so, research extending to emerging economies (e.g. Douma, George and

Kabir, 2006; Peng, 2004) has suggested that performance considerations may not be the only factor at play in shaping board composition. These studies have recognized that the way boards are formed may be influenced by the social and the regulatory conditions surrounding firms, especially in late-industrializing countries which have recently been undergoing policy and institutional changes for liberalizing and internationalizing their economies (Young *et al.*, 2008). An institutional perspective has therefore been brought in as a complement and, possibly, as an alternative to the efficiency-based, functionalist theoretical rationale underpinning the contingency perspective. From an institutional perspective, boards are entities that are shaped by firms' quest for legitimacy by conforming to external formal or non-formal expectations (Lynall, Golden and Hillman, 2003). Such institutional pressures may take the form of legal requirements, normative demands or widespread adoption of particular governance practices (Peng, 2004). Thus, board composition becomes a response not to functional needs but to these regulatory and social influences. An institutional perspective would also imply, however, that conformity to institutional prescriptions could be more in appearance and entail ways that are not discordant with underlying ideologies (Davis and Marquis, 2005; Young *et al.*, 2008).

Both earlier (e.g. Zahra and Pearce, 1989) and more recent (e.g. Daily, Dalton and Cannela, 2003) corporate governance literature has also recognized that board composition involves issues of power, though with an interest confined to power relations between the board and the CEO. This has implied a power perspective that considers the conflicts of interest and power differentials between boards and company executives (Daily, Dalton and Cannela, 2003). In an extension of the power perspective, research on small firms and family businesses has gone beyond this limited concern to consider the involvement of other owners with significant stakes, recognizing that this may serve to alter the dominant coalition within the firm (Chua, Chrisman and Sharma, 1999; Fiegener *et al.*, 2000). The board in these conceptions becomes a representational entity, the composition of which is negotiated on the basis of the relative power of the parties that have a significant ownership stake. This is likely to be particularly the case when these other owners are not external parties only with financial interests in the firm but are involved as joint venture partners (Kumar and Seth, 1998). Such partners will have a strong motivation to partake in governance not only for monitoring management and the other powerful parties but also for aligning the strategies of the joint venture with their own objectives. The board is then likely to become a body primarily for strategizing and for monitoring strategy implementation (Kumar and Seth, 1998). It is where the dominant coalition is represented and is therefore likely to be shaped by the relative powers of the parties in the coalition, based on their ownership stakes and the knowledge or relational resources that they bring to the venture.

Professionalization in boards of firms affiliated to FBGs

The corporate governance literature on large public corporations has typically treated board size and the ratio of outside directors as the most salient aspects of board composition (e.g. Dalton *et al.*, 1999; Zahra and Pearce, 1989). As recognized in some of the literature on small and medium-sized family businesses, however (e.g. Chua, Chrisman and Sharma, 1999; Fiegener *et al.*, 2000; Voordeckers, Gils and den Heuvel, 2007), the primary concern confronting these firms is professionalization, which relates to sharing with or relinquishing authority and control to those from outside the family. Board professionalization is a central issue for large and diversified FBGs in late-industrializing countries too, as it entails a major transformation in their governance (cf. Gedajlovic, Lubatkin and Schulze, 2004). In addition, FBGs are different from stand-alone family businesses in that they are composed of a multitude of firms, which places greater strain on the capacities of the controlling family to take part in the boards of affiliates.

In operational terms, board professionalization in FBG-affiliated firms may be assessed through three separate dimensions, namely board size, the ratio of salaried executives and the presence of outside directors. For family-controlled firms in particular, larger board size has been considered as an indicator of more active and influential boards, as opposed to the image of small, family-dominated and thus passive bodies (Corbetta and Salvato, 2004; Gabrielsson, 2007; cf. Dalton *et al.*, 1999). The extent to which salaried executives are appointed to directorship positions also shows how much the board moves away from being a family board (Voordeckers, Gils and den Heuvel, 2007). Differently from stand-alone family firms, however, salaried executives in boards of FBG-affiliated firms may come not only from inside the respective firms but, possibly more so, from the central administrative body at the group level or from other group-affiliated firms (Gökşen and Üsdiken, 2001). The latter two categories of executives, therefore, are not strictly speaking insiders as they are not managers of the particular affiliate firm. They are not exactly outsiders either due to the executive positions they hold within the group. Thus, another dimension of professionalization is the presence of outside directors, which can be further divided, as in the corporate governance literature, into affiliated and non-affiliated outsiders (Lynall, Golden and Hillman, 2003; Pearce and Zahra, 1992). Affiliated outside directors are those with some kind of an extant or potential business link with the firm (or, in the particular case of FBGs, the group) while non-affiliated outsiders are those whose only tie is their director role in one of the affiliate firms (Anderson and Reeb, 2004). Emanating from agency theory, this division is deemed important because the former are regarded as being constrained in performing their monitoring function over managers of the firm or the families which may be holding a significant portion of equity (Anderson and Reeb, 2004; Lynall, Golden and Hillman, 2003).

Put broadly, a contingency perspective suggests that professionalization of boards in family-controlled firms is dependent upon the governance demands arising from the conditions in which the firm operates (Gedajlovic, Lubatkin and Schulze, 2004). Although, as indicated in the preceding section, contingency perspectives have drawn upon a variety of theoretical ideas, more typically they have combined a structural contingency-cum-resource dependency rationale (Pennings, 1992; Pfeffer and Salancik, 1978) in formulating how governance issues are likely to vary across firms (e.g. Pearce and Zahra, 1992; Voordeckers, Gils and den Heuvel, 2007). The main theme in this approach has been that complexity of operations and the environment surrounding the firm, as well as the resource acquisition problems that the latter may generate, are likely to make the governance task more demanding (Daily and Dalton, 1992; Gedajlovic, Lubatkin and Schulze, 2004).

Internal complexity, in these studies, has been typically associated with firm size (Fiegener *et al.*, 2000; Gabrielsson, 2007). Environmental complexity, on the other hand, has been linked with firm strategy and, particularly, with diversification (Finkelstein and Hambrick, 1996). As a form of diversification, internationalization through exporting to foreign markets or running subsidiary operations abroad implies even greater environmental complexity (Gabrielsson, 2007; Sanders and Carpenter, 1998). Operating in foreign markets also entails confronting unfamiliar environmental conditions, making access to critical resources more problematic (Sanders and Carpenter, 1998). This is especially likely to be the case in those late-industrializing countries where FBGs have expanded around a strong domestic orientation (Yamak and Üsdiken, 2006).

According to the contingency perspective, greater internal and environmental complexity and the concomitant need to gain access to critical resources, in turn, necessitate more professionalized governance. This is because of the wider range of capabilities, external contacts and more sophisticated management and organizational systems needed in those conditions (Daily and Dalton, 1992; Gedajlovic, Lubatkin and Schulze, 2004; Voordeckers, Gils and den Heuvel, 2007).

Boards need to be made larger, for example, as they can then be a source of greater expertise and diversity of viewpoints as well as external contacts that firms may lack internally (Fiegener *et al.*, 2000; Gabrielsson, 2007). Indeed, the few available studies on stand-alone family businesses have reported a positive relationship between firm size and the size of the board (e.g. Fiegener *et al.*, 2000). Likewise, Gabrielsson (2007) found a similar relationship between export activity and board size in a sample of small Swedish firms.

Firms facing greater complexity also need to expand their management capabilities, which rest, it has been argued, on the introduction of more advanced managerial systems and more specialized, formalized and decentralized structural arrangements (Carney, 1998; Gedajlovic, Lubatkin and Schulze, 2004; Zahra and Filatotchev, 2004). The unwillingness typically associated with founders or owner-family members to install more formal routines and to share decision-making powers may serve as a barrier to the establishment of such systems and structures (Gedajlovic, Lubatkin and Schulze, 2004). These barriers may be overcome by moving towards more professionalized governance. Not only are salaried managers likely to be more receptive to more sophisticated methods and structures, but they will also be better equipped, because of their technical managerial abilities and skills, to direct the setting up and implementation of elaborate organizational and managerial systems.

As the conditions facing firms become more complex internally or externally, the greater will also be the need to opt for board members from outside the firm with required competencies and external linkages (Pearce and Zahra, 1992; Peng, 2004; Voordeckers, Gils and den Heuvel, 2007). In the case of FBGs this will entail extending to outside the group. These may be individuals with some prior or existing ties to the FBG or with no such relationships to the group at large. Both types of outside directors may be included when, given the context in which the affiliate firm is operating, the resources and contacts that are needed cannot be obtained from within the FBG.

Altogether these considerations suggest the following contingency hypotheses.

H1: Affiliate firm size will be positively associated with (a) board size, (b) the ratio of salaried managers and (c) the presence of affiliated and non-affiliated outside directors on the board.

H2: Affiliate firm internationalization will be positively associated with (a) board size, (b) the ratio of salaried managers and (c) the presence of affiliated and non-affiliated outside directors on the board.

From an institutional perspective, professionalization in boards will occur not because families controlling FBGs recognize the value of professionalizing governance in view of situational demands facing affiliate firms, but rather when they perceive themselves as being obligated to do so (Tsui-Auch and Lee, 2003). Such outside influences emanate from normative and regulatory frameworks around firms (Lynall, Golden and Hillman, 2003). They are likely to be particularly pertinent for businesses in late-industrializing economies as currents enjoying acclaim as 'modern' (or 'good') governance practices spread worldwide (Peng, 2004). Embodied in these normative claims is the belief that within the present day global context strengthening professionalism will contribute to greater international competitiveness of indigenous firms (see for example Ugur and Ararat, 2006). More influential in these contexts, however, are likely to be the pressures from national authorities, as they take on the role of promulgating these international 'standards' locally (Jesover and Kirkpatrick, 2005).

Such regulatory influences may be one of two kinds with possible effects on particular types of FBG-affiliated firms. One of these relates to publicly listed firms, which have been the primary target in national level endeavours towards governance reform. Based very much upon ideas derived from agency theoretic premises (Luo and Chung, 2005; Peng, 2004), regulatory frameworks related to these firms aim to promote boards that are more active and influential as governance bodies. The central concern is to urge the adoption of mechanisms that will purportedly enable better monitoring of managers and, even more so, the controlling families (Young *et al.*, 2008). A key element in this respect has been to push for the placement of 'non-executive' and 'independent' directors on boards by offering specific guidelines with regard to their 'proper' proportions, though these provisions may be, as in the Turkish case, in the form of softer 'comply or explain' requirements (Jesover and Kirkpatrick, 2005; Peng, 2004; Ugur and Ararat, 2006). The second type of institutional pressure mediated by the state and its agencies can be sector-specific, involving stricter legal requirements with respect to governance, because of a greater concern with closer regulation of particular sectors (Luoma and Goodstein, 1999). In Turkey, for example, separate laws exist for banking and insurance, which also include stipulations that relate to the governance of firms operating in these sectors such as the number of board members and their educational and professional backgrounds (Ugur and Ararat, 2006).

From an institutional perspective, it is these kinds of pressures that will drive FBG-affiliated firms towards greater professionalization in their boards. This will be mainly due to the concern with gaining and maintaining legitimacy *vis-à-vis* public authorities by conforming to their normative and regulatory requirements (Tsui-Auch and Lee, 2003). Boards, for one, are likely to be larger because board size is a highly visible feature and larger size signals a more active and independent board. Likewise, they should be expected to a have a higher ratio of salaried executives and to include outside directors.

However, the institutional perspective also suggests that, when the underlying motive is conformity to external pressure, adoption of governance structures may take forms more in line with owner families' tendencies to retain control rather than the intentions carried in normative and regulative prescriptions (Peng, 2004). So, under pressure to make boards more professionalized, families controlling FBGs are likely to turn first not to outsiders but to their closest professional associates. These will probably be salaried executives from within the group with whom the family has had long-standing ties. Sharing authority even with those executives is not an easy transition for controlling families. Nevertheless, it may be facilitated to some degree by trust relationships that can develop often with a smaller group of managers as a result of long years of service and loyalty to the FBG (Luo and Chung, 2005). Including complete outsiders into governance structures is a much more difficult step. Therefore, if external pressures call for outsider presence, these will probably be affiliated outside directors (Filatotchev, Lien and Piesse, 2005; Tsui-Auch and Lee, 2003). Selection of directors in these ways is possible even in publicly listed firms as small shareholders are likely to have little influence *vis-à-vis* the controlling family over decisions as to who will be offered seats on the board (Tsui-Auch and Lee, 2003; Yurtoglu, 2000). In emerging country contexts institutional investors are not likely to have much weight either. Domestic ones without links to FBGs are few and the foreign ones often tend to show little interest in obtaining board representation, as their involvement is primarily of a financial nature (Douma, George and Kabir, 2006; Yurtoglu, 2000).

These considerations suggest the following hypotheses.

> *H3*: Affiliate firms that are publicly listed are more likely to have (a) larger boards and (b) a higher ratio of salaried executives and affiliated outside directors and (c) less likely to have non-affiliated outside directors on the board.

> *H4*: Affiliate firms in closely regulated sectors are more likely to have (a) larger boards and (b) a higher ratio of salaried executives and affiliated outside directors and (c) less likely to have non-affiliated outside directors on the board.

Within the context of firms within FBGs, as well as in other family firms (Fiegener *et al.*, 2000), power issues in governance emerge more explicitly when engagement with external capital takes the form of partnership with a foreign or a domestic corporation (Yurtoglu, 2000). Involvement of such partners needs to be distinguished from shareholding by financial institutional investors, as the former will have strategic interests in such joint ventures (Douma, George and Kabir, 2006; Yan and Gray, 2001). Given the weak institutional environments that often characterize late-industrializing countries, the most important way available to external partners for monitoring firm management as well as the family controlling the business group could be to have seats on the board of the joint venture (Chang, 2003). Moreover, the strategy-making role of the board will probably be enhanced as the strategies of the partnership will need to be coordinated with respect to the aims of all the major parties involved, be they, in addition to the FBG, a foreign or a domestic parent (Kumar and Seth, 1998; Yan and Gray, 2001). These considerations point to a board that will need to be made larger and more active relative to those of affiliate firms in which the controlling family remains as the single large owner.

Engagement in a joint venture will also shape the ways in which the directorship positions other than those allocated to the external partner are filled. One likely outcome is a lower ratio of salaried managers from the FBG side. The rationale for this prediction is twofold. First, within the tripartite relationship in these joint ventures involving the controlling family, the external partner and salaried management within the FBG, the professional managers are the least powerful. Their chances of getting board seats are likely to be undermined therefore when the two more powerful parties confront one another and negotiate allocation of directorships (Yan and Gray, 2001). Second, for FBGs, entry into joint ventures with another foreign or domestic company is not likely to be motivated solely by concerns for financing but also by benefits to be obtained from the business and managerial competencies of the partner (Douma, George and Kabir, 2006). The directors that the latter will be providing may be seen as expanding the board's resource and monitoring capacities, thereby reducing the significance of the expertise and contacts that salaried executives from within the group may bring to the board.

Determining who will represent the FBG on the boards of joint venture affiliates will largely be at the discretion of the FBG itself, as it will be for the partner company (Douma, George and Kabir, 2006). Appointment of any outside directors, on the other hand, will require joint agreement. It is not likely that the other partner to the venture will accept affiliated outsiders with a close relationship to the family or the affiliate firm, as it may imply shifting the power distribution within the board in favour of the FBG. Neither would the partner see much benefit in having non-affiliated outsiders especially as a mechanism for monitoring the controlling family, as this particular role can be more effectively carried out by the partner's own representatives.

Hence the following hypotheses are proposed.

> *H5*: Affiliate firms that have a foreign or domestic partner are more likely to have (a) larger boards and (b) a lower ratio of salaried managers and (c) less likely to have affiliated or non-affiliated outside directors on the board (excluding directors representing external partners).

Data and methods

The research setting and the sample

FBGs in Turkey are identifiable through a 'holding' company that constitutes the apex of the group and houses the central administration. Although FBGs structured in this manner are numerous, many resemble stand-alone family businesses and are likely to have adopted the 'holding' label for normative and mimetic reasons (Buğra, 1994). Large and diversified ones, on the other hand, approximating the generic form, are not many (cf. Khanna and Rivkin (2001) who could identify only nine business groups in their Turkish sample). So, for inclusion in the study, the FBG had to have affiliate firms in five or more sectors (according to the two-digit International Standard Industrial Classification), a minimum of three listed firms, and at least one firm in the Istanbul Chamber of Industry's listing (in 2004) of the 500 largest companies in the country. Altogether ten FBGs satisfied all the three criteria. In all these FBGs, like the others in the country, the person at the very top (the chairperson of the 'holding' board) was a family member, although the generation s/he came from varied. In four cases the founder was still the head of the group. Of the remaining, four were headed by a second- and two by a third-generation family member.

Only 'main' firms in each business group were included in the study. Thus, firms that were a subsidiary (within the country or abroad) of an affiliate firm and those in which the family, the holding company and other affiliate firms, altogether, had less than 10% equity ownership were excluded. So were the few firms that were not incorporated as a *société anonyme*, the legal form in Turkey whereby firms are required to have a board (of a minimum of three members for all businesses other than banks and insurance companies for which the minimum is five directors). This resulted in a sample of 299 firms affiliated to the ten business groups included in the study. The number of firms per group varied between five and 60.

Affiliated firms in the sample operated in a wide range of sectors including manufacturing, agro-business, mining, construction, retailing, tourism, telecommunications, financial services, insurance and the media. As is typical of FBGs, there was large variation in the size of affiliate firms, ranging from less than ten employees to a workforce of above 10,000, with a sample average of 655.4 employees. Although direct shareholding by family members in affiliate firms was not high (around 9% on average; Table 1, later), through shares held by the holding company and, to a lesser degree, by other firms in the business group, the owner families controlled, on average, 79% of the equity of the affiliate firms in the sample. Only 18% of the affiliates were publicly listed. In these firms, on average, 28% of the shares were publicly held. Exactly one-quarter of the firms had a foreign and 12% a domestic partner, which respectively owned, on average, 43% and 34% of the equity in these joint ventures.

Data collection

Data were obtained from a variety of sources. The yearbook of the Istanbul Stock Exchange was the main source of data on publicly listed affiliate firms. For firms that were not listed, data were obtained from the records held at the chambers of commerce. Additional data came from the yearly publication listing of the largest 1000 industrial companies in Turkey. When available, annual reports and websites served as supplementary data sources. Finally, for data that could not be obtained from these public sources the business groups were approached and all agreed to take part in the study. All the data collected pertain to the end of the year 2004.

Variables and measures

Dependent variables. Of the variables used to gauge professionalization, *board size* was measured as the total number of directors. The *ratio of salaried executives* was calculated by dividing the total number of non-family managers on the board (occupying an executive position within the FBG) by board size. An executive position in the group could be at the central administrative body or any affiliate firm including the focal one. Board members other than family directors, salaried executives from within the business group, and representatives of any joint venture partners were considered as outsider directors. An outside director was coded as an *affiliated outsider* if s/he was a retired executive from the group, had any prior or current business relationship with the FBG or was a board member in more than one affiliate firm. *Non-affiliated outsiders*, on the other hand, had no prior employment relationship with the FBG and were a board member only in the respective focal firm. Coding to distinguish between these two types of outsiders was based on biographical data and done separately by the two authors. Discrepancies which occurred in a very few of the cases were resolved by discussion. As the number of affiliated and non-affiliated outside directors was often small in the boards that had them, we assessed their presence rather than ratio in the analyses (see Peng, Buck and Filatotchev, 2003).

Independent variables. Affiliate firm *size* was measured by the number of employees. The natural log of this measure was used in the analyses to account for non-linear effects of size (Kimberly, 1976). Two indicators were employed for *internationalization* (Sullivan, 1994). One of these measured the ratio of exports in the total sales of the affiliate firm. The second aimed to measure the extent of foreign operations by identifying the number of countries in which the affiliate firm had operating subsidiaries. As there was little variation in this count among firms with international involvement of this kind, the measure was employed as a dummy variable that distinguished between firms that had at least one operational unit abroad and those that had no foreign operations.

Of the two indicators for assessing the extent to which affiliate firms were under institutional prescriptions concerning their governance systems, one was based on whether or not the firm was *publicly listed*. The other distinguished, again with a dummy variable, between financial and all other sectors. The former represented a closely *regulated sector*, as in Turkey banks and insurance companies are subject to separate laws and regulations as well as the surveillance of a regulatory body (Ugur and Ararat, 2006).

The presence of a *foreign* or *domestic partner* was measured by separate dummy variables. The threshold for treating an external party as a major partner was set at 10%, a level deemed appropriate given the scale of direct and indirect family ownership in FBG-affiliated firms in Turkey (Yurtoglu, 2000).

Control variables. The direct ownership stake of the members of the controlling family (or families) in the affiliate firm and the firm's age were included in the analyses as control variables. *Family share* was operationalized as the proportion of equity held directly by family members. *Firm age* was computed from the year the affiliate firm was established or, in a few cases, acquired by the FBG. Earlier literature suggests that these two variables may be related to the readiness of owner families to share governance roles with salaried managers or outsiders. Higher proportion of equity held by family members, for example, has been associated with tendencies to avoid interference at the board level (e.g. Fiegener *et al.*, 2000). Firm age, on the other hand, has been identified as a source of inertia and linked with the tendency to preserve established practices pertaining to board composition (Peng, 2004).

Table 1. Descriptive statistics and bivariate correlations[a]

Variable	Mean	SD	1	2	3	4	5	6	7	8	9	10	11	12
1. Board size	5.70	1.89												
2. Ratio of salaried executives	0.58	0.28	−0.19											
3. Affiliated outsiders (yes = 1)	0.34	0.47	0.31	−0.15										
4. Non-affiliated outsiders (yes = 1)	0.08	0.27	0.22	−0.09	0.09									
5. Firm size[b]	5.07	1.76	0.34	−0.23	0.17	0.23								
6. Export ratio	0.13	0.24	−0.01	−0.11	0.05	−0.01	0.27							
7. Foreign operations (yes = 1)	0.11	0.31	0.18	−0.10	0.11	0.30	0.36	0.06						
8. Publicly listed (yes = 1)	0.18	0.39	0.38	−0.17	0.25	0.22	0.46	0.16	0.33					
9. Regulated sector (yes = 1)	0.16	0.37	0.18	0.21	0.13	0.11	−0.07	−0.22	−0.01	−0.02				
10. Foreign partner (yes = 1)	0.25	0.43	0.25	−0.29	−0.15	−0.08	0.07	0.02	−0.03	0.01	−0.00			
11. Domestic partner (yes = 1)	0.12	0.33	0.08	−0.13	−0.03	−0.03	−0.04	−0.01	−0.03	0.04	0.16	−0.10		
12. Family share	0.09	0.21	−0.08	−0.13	0.03	0.11	0.13	0.11	0.05	−0.05	−0.07	−0.13	−0.09	
13. Firm age	18.2	14.1	0.27	−0.15	0.24	0.09	0.41	0.23	0.18	0.32	−0.15	0.05	−0.08	0.17

[a]Correlation coefficients above 0.12 are significant at 0.05, and those above 0.15 at the 0.01 level.
[b]Logarithm. Average firm size is 655.43 with a standard deviation of 1484.03.

Analyses

In testing the hypotheses, we used ordinary least squares (OLS) regression for board size and the ratio of salaried executives and logistic regression for affiliated and non-affiliated outsider directors, since the latter variables were operationalized by dichotomous measures. Given that the firms in the sample were affiliated to FBGs, clustering was implied in the data. Indeed, analyses of variance results showed significant differences among business groups in board size, ratio of salaried executives and affiliated outside directors. We therefore employed a fixed effects model in both types of analyses (Cohen *et al.*, 2003). Dummy variables were used for each of the FBGs. The largest and the oldest FBG served as the base group. For each dependent variable, we first ran models that included the FBG dummy and the control variables. We then estimated models that added the independent variables of the study.

Descriptive analyses suggested no major correlation problems among the independent variables. Neither did the multicollinearity checks in the OLS regression models indicate any serious problems, as the variance inflation factor did not exceed 1.73 and the largest condition index was 12.85 (cf. Cohen *et al.*, 2003).

Results

Descriptive statistics for independent, dependent and control variables and bivariate correlations are shown in Table 1. Notably, the average board size in this sample was 5.70 (with a range from three to 13 members of which, on average, one-fifth were family members). As expected, the average ratio of salaried executives (0.58) on boards was much higher than the ratio of affiliated (0.07; present in 34% of the firms) and non-affiliated outside directors (0.02; present in only 8% of the firms).

In Tables 2 and 3 we present the outputs of the OLS and logistic regression analyses. Only a few of the hypotheses based on the contingency perspective received support. As predicted (H1a), a significant positive relationship was obtained between affiliate firm size and the size of the board. However, neither of the two measures of internationalization was associated with board size (H2a). Predictions with respect to the ratio of salaried executives were not supported either. In fact, the result obtained for affiliate firm size was contrary to what was expected (H1b). The ratio of salaried executives was lower in larger affiliate firms. Internationalization of affiliate firms was not associated with this variable either (H2b). Hypotheses 1c and 2c predicted, respectively, that firm size and internationalization will be positively associated with the presence of both types of outside directors. We found no empirical confirmation for these predictions in relation to affiliated outsiders. Support was obtained, however, for non-affiliated outsider presence. As predicted, firm size was positively associated with the presence of the latter type of outside directors. So was the foreign

Table 2. Results of fixed effects OLS regression analyses for board size and the ratio of salaried executives[a,b]

Variables	Board size		Ratio of salaried executives	
	Model 1	Model 2	Model 3	Model 4
Family share	– 0.10†	– 0.03	– 0.02	– 0.08†
Firm age	0.21***	0.11*	– 0.16**	– 0.13*
Firm size		0.22***		– 0.12*
Export ratio		– 0.04		0.02
Foreign operations		0.05		– 0.01
Publicly listed		0.20***		– 0.07
Regulated sector		0.21***		0.19***
Foreign partner		0.22***		– 0.42***
Domestic partner		0.15***		– 0.21***
Adjusted R^2	0.27	0.48	0.17	0.40
Adjusted R^2 change	0.27	0.21	0.17	0.23
F change	11.07***	16.72***	6.54***	16.60***

[a]Standardized coefficients are reported; n = 299.
[b]All analyses include nine dummy variables for the FBGs. Results for these variables have been omitted.
†p < 0.10; *p < 0.05; **p < 0.01; ***p < 0.001.

Table 3. Results of fixed effects logistic regression analyses for affiliated and non-affiliated outside director presence[a,b]

Variables	Affiliated outside directors		Non-affiliated outside directors	
	Model 1	Model 2	Model 3	Model 4
Constant	– 1.13**	– 1.76*	– 2.93***	– 4.92***
Family share	– 0.00	– 0.02	1.60†	1.74†
Firm age	0.04***	0.03*	0.02	– 0.02
Firm size		0.15		0.42*
Export ratio		1.14		0.04
Foreign operations		– 0.27		1.58*
Publicly listed		0.95*		0.52
Regulated sector		1.53***		0.84
Foreign partner		– 1.09**		– 1.03
Domestic partner		– 0.22		– 0.53
Chi-square	71.41***	104.79***	12.76	43.55**
Chi-square change		33.38***		30.79***

[a]Logistic coefficients are reported; n = 299.
[b]All analyses include nine dummy variables for the FBGs. Results for these variables have been omitted.
†p < 0.10; *p < 0.05; **p < 0.01; ***p < 0.001.

operations measure of internationalization. Affiliate firms that had operations in at least one foreign country were more likely to have non-affiliated outsiders on their boards. No significant relationship was obtained, however, for the export ratio measure of internationalization.

Hypotheses based on an institutional perspective, on the other hand, received more support. As expected (H3a), we found that affiliate firms that were publicly listed had boards that were larger. Likewise, the boards of firms operating in the closely regulated finance sector were likely to be larger relative to those in other sectors (H4a). We also obtained support for the predicted positive relationship between close regulation of a sector and the ratio of salaried executives as well as the presence of affiliated outsiders on boards (H4b). Public listing, on the other hand, was not positively associated with the ratio of salaried executives from within the business group, though it was, as predicted, related to the presence of at least one affiliated outside director (H3b). Findings on affiliated outside directors lend support to the institutional view that, under pressure to conform to institutional prescriptions, FBGs tend to allocate board directorships to closer associates that formally appear as outsiders. The predictions (H3c and H4c) that FBG linked firms that are publicly listed or operate in closely regulated sectors are also less likely to have non-affiliated outside directors, however, was not confirmed. As shown in Table 3, no relationship was found between the institutional contexts of firms and the presence of non-affiliated outsider directors.

Most of the predictions based on the power perspective were supported. As hypothesized (H5a), joint venturing with other firms was positively associated with board size irrespective of whether the partner was foreign or domestic. In both cases boards were likely to be larger than those of other affiliate firms. Again as expected (H5b), partnering with foreign or domestic firms had negative effects on the extent to which salaried managers from within the FBG obtained seats on affiliate firm boards. It is also notable that the negative relationship is stronger in cases where foreign firms are involved in the joint venture. Predictions regarding outsider presence (H5c), however, were confirmed only in the case of affiliated outsiders in foreign partnerships. As hypothesized, when partnering was with a foreign company, FBG linked firms were less likely to have affiliated outsider directors on their boards. The finding for non-affiliated outsiders was also in the predicted direction but did not reach an acceptable level of statistical significance. Nevertheless, the latter finding is a further indication that joint ventures with foreign partners are not particularly conducive to the inclusion of any kind of outsiders from the local setting. Neither of the expected relationships was found, however, for affiliate firms that had domestic companies as their partners.

Of the two control variables, firm age emerged as a more influential factor on the ways in which boards were composed. Older firms had larger boards in which affiliated outsider directors were also likely to be present. On the other hand, firm age was negatively associated with the ratio of salaried managers on the board. A similar but weaker relationship with the ratio of salaried managers was also obtained for direct family share in ownership. Interestingly, the latter variable was also positively and strongly associated with the presence of non-affiliated outside directors on the board. This finding may be indicative of the controlling family substituting salaried managers with knowledgeable or well-networked outsiders unrelated to the FBG when they have higher direct stakes in affiliated firms.

Discussion

The theoretical implications that can be derived from this study are fourfold. First, and foremost perhaps, in the context of FBGs in a late-industrializing country, our study provided greater support for institutional and power perspectives relative to a contingency perspective on board composition. Whether boards were more or less professionalized depended more on institutional pressures and the presence of joint venture partners than it did on organizational or environmental complexity confronting affiliate firms. Contingency effects were, for the most part, limited to the presence of non-affiliated outside directors. That the latter findings are partly in line with some of the research on small stand-alone family businesses in very different settings (e.g. Fiegener *et al.*, 2000; Gabrielsson, 2007) and, indeed, on large US corporations (e.g. Pearce and Zahra, 1992) is notable. Still, the results of this study are significant in view of some of the recent claims that going beyond efficiency-based perspectives is likely to prove more useful in studying strategic, organizational and governance phenomena in transitional late-industrializing countries (Hoskisson *et al.*, 2000; Peng, 2004).

Second, the weaker support obtained for the contingency perspective also relates to the broader issue of 'modernizing' the business enterprise in countries where industrialization and, indeed, marketization have been late coming (Tsui-Auch and Lee, 2003). The central claim of the contingency perspective is that organizational and environmental conditions are likely to lead firms to adopt more 'modern' board structures due to perceived performance benefits. The findings of this study have provided limited empirical support to this argument and thus to the alleged effects of efficiency concerns on the professionalization of governance in FBGs. Indeed, there is even some evidence contrary to what would be expected based on a contingency perspective. A negative relationship was observed, for example, between firm size and the ratio of salaried executives on boards. Coupled with parallel results for firm age and family share in ownership, it appears that controlling families are still hesitant about including salaried managers on boards of affiliate firms which may matter most to them. A higher ratio of salaried executives is more likely on the boards of firms that are probably less significant within the FBG, i.e. those which are smaller, younger and where there is less direct ownership by family members.

Third, that organizational and environmental exigencies were found to be influential only to some degree may be indicative of the limited impact that macro-level institutional and market reforms in late-industrializing countries may be having on the core features of their national business systems. Views have diverged on the pace and the extent to which liberalization and internationalization attempts may be leading to alterations in governance and management practices. For example, those adopting a comparative business systems perspective (e.g. Whitley, 1999) have argued that the impact of reforms on enterprise change is likely to be slow and limited. Others, on the other hand, have attributed greater causal significance to macro-level alterations in leading to changes in strategy and structure (e.g. Hoskisson *et al.*, 2000). Empirical studies on the effects of the post-1980 Turkish liberalization experience have also pointed to ensuing strategy and management changes in business firms (e.g. Yamak and Üsdiken, 2006). Together with the latter findings, the results of this study may be pointing to a possible reconciliation of the opposing views on the impact of economic and institutional reform on business enterprises. It may well be that governance systems are most resistant. On the other hand, adaptation to the new conditions generated by liberalization and internationalization may be taking place more readily at the level of management practices. Indeed, adopting more 'modern' management methods may actually be contributing to the sustenance of the FBG as the dominant form of enterprise in late-industrializing countries.

Finally, and along similar lines, our results show that the impact of internationalization in 'emerging economies' in the form of receiving foreign direct investment does not lead to outcomes that are indicative of convergence towards some kind of a global standard. Internationalization of financial markets and the entry of multinational firms into these economies have often been hailed as an impetus for the 'modernization' of governance and management systems (e.g. Khanna and Palepu, 2000). In support of views that have been sceptical about such convergent effects (e.g. Davis and Marquis, 2005), our study suggests that these claims need to be received with caution, at least in relation to governance and within the context of the FBGs. Indeed, partnering with foreign firms appears to be not very different from having domestic partners. Our results do show that in both cases boards become larger (model 2 in Table 2) and that they include outsider directors of the 'owner' or 'owner-representative' kind (not reported). In the case of partnering with foreign firms, this possibly implies that there is more professionalization of boards, though only through the presence of foreign managers. Indeed, this may have a role to play in increased adoption of 'modern' management systems. It does not, however, lead to 'modernizing' boards through greater presence of native salaried managers or outside directors. In fact, our findings show effects to the contrary. This may be because the multinational firm at large and its representatives on the board, often themselves professional managers, may enjoy a greater power base and prestige as possessors of more advanced managerial knowledge relative to their local counterparts (Douma, George and Kabir, 2006). Thus, the FBGs may perceive the presence of these foreign managers as professionalizing the governance of affiliate firms that are operating as joint ventures, indeed possibly as a more effective way to do so. It has been claimed that partnering with foreign multinationals helps to sustain family control (Buğra, 1994). Our findings complement this claim by showing that foreign firm involvement does not lead to a greater role for salaried FBG managers and outsiders in the governance of affiliate firms.

Our study has policy implications too. Institutional reforms in 'emerging economies' are also geared towards 'modernizing' corporate governance by making boards of enterprises more active and professionalized. Our findings show that regulatory interventions to this end do have notable effects. They also demonstrate that effects may vary with weaker and stronger institutional impositions. Weaker institutional pressures of the 'comply or explain' kind on listed firms turned out to be less influential relative to tighter regulation through legal enforcement. The former did have the overall effect of enlarging boards, but not in a way that it was accompanied by a higher ratio of salaried managers and 'independent' directors. That the relationship between both public listing and tighter regulation and the presence of non-affiliated outsiders was positive but not statistically significant suggests perhaps that there is also a rudimentary move in the direction promoted by public authorities. Indeed, overall, this study implies that for those pursuing an agenda of reform in corporate governance, the way forward, for the foreseeable future, may lie in regulatory frameworks rather than claims based on efficiency appeals or the influx of foreign direct investment. Our findings also serve, however, as yet another warning that there may be a gap between institutional templates and the kind of conformity that they generate (Davis and Marquis, 2005; Tsui-Auch and Lee, 2003).

Clearly, this study is limited by examining FBGs in a single country. Although the Turkish version of the FBG has been considered as archetypal, it has its own history, bred, as it was, in the context of a late-coming, state-led, autarkic industrialization. Likewise, although the post-1980 liberalization and internationalization project has constituted one of the early examples, it has been coupled with a slow development of capital markets, backed up only more recently by regulatory reforms pertaining to corporate governance. Another limitation is that our study has been cross-sectional and only examined the more 'elite', as it were, among the FBGs in the country, though it is those that better approximate the generic form. However, this also constrained the study with respect to examining the effects of controlling family characteristics such as generational differences and family size as well variables like overall business group size, diversification and age. Indeed our analyses of variance results, as noted above, pointed to significant FBG effects, implying that one or more of these variables may be influencing the ways in which the boards of affiliate firms are composed. A systematic assessment of such effects, however, will require studies in contexts where a larger number of business groups exist that represent the generic organizational form examined in this study.

Our study is also limited by the small number of variables that we could include to examine each of the theoretical perspectives that we considered, constrained as we were by the availability of archival data. Considering additional contingency variables such as environmental turbulence, product diversification and prior performance as well as the relative power of joint venture partners may prove useful in future research. An accompanying limitation is the inevitably crude nature of some of the operationalizations, as we have had to employ categorical rather than continuous measures in assessing foreign operations, public ownership and joint venture partnerships. Nevertheless, that we were able to obtain significant results despite using coarser variables lends further credence to our findings, as these kinds of measures are likely to yield more conservative estimates.

Despite these caveats, our study has shed some further light on governance within this widespread form of big business organization. Similar research in other late-industrializing countries should help to refine and expand its propositions and findings. Most notable in this respect, perhaps, is to pursue and re-examine the relative contribution of contingency, institutionalist and power perspectives in understanding and explaining governance systems. Indeed, the usefulness of such a multi-theoretic approach may well extend beyond 'emerging economies' to study governance in the already economically more advanced ones.

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