

The Impact of Outsiders on Small Family Firm Performance: Evidence From Italy

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In this study we examined the relationship between small family firms (SFFs) performance and one much-debated aspect of corporate governance: outsiders. We also consider generational effect. A regression analysis of 950 Italian private SFFs during the period 2007-2009 indicates a positive and significant relationship between SFFs performance and outsiders. Specifically, our findings indicate that: 1) inside directors (founder and/or heirs) have a positive effect on firm performance only in the first generation; 2) outsiders have a positive effect on SFFs performance; 3) this effect is positive and significant in every generation.

Research Area: Management

1. Introduction

Over the last decades, several studies have been devoted to better understand the relationship between firm performance and one much-debated aspect of governance structure: outsiders (Anderson & Reeb 2004; Huse 2000; Corbetta & Tomaselli 1996; Garcia-Ramos & Garcia Olalla 2011; Zahra & Pearce 1989).

However, these studies mainly focus on medium and large firms, while only a small number of authors pointed out that a specific analysis is required to evaluate this relationship in small firms. According to Daily and Dollinger (1993): “this may be, in part, because one of the greatest barriers facing researchers is the difficulty in identifying and defining” the small family firm. Moreover, these studies often uncritically adopt concepts that were developed for large corporations, without adjusting them to the unique contexts of small firms (Arosa, Iturralde & Maseda 2010a, 2010b; Daily & Dalton 1993; Huse 2000).

This lack of studies is significant because of the economic importance of these firms. SFFs represent the most prevalent form of firms (Daily & Dollinger 1993; Kirchoff & Kirchoff 1987) and are a vital part in the economy of every country (Berger & Scott 2007; Morrison et al. 2003). In fact, although family firms are found in all size, the majority of them are small firms. In Italy today more than 60 percent of family firms are small and employ over 80 percent of the workforce. In addition, SFFs have markedly different characteristics if compared to that of medium and large enterprises. According to Ciampi and Gordini (2012), SFFs are known to be able to react quickly and to find creative solutions when faced with the increasing turbulence in the global markets, and with the wide range of ensuing problems regarding competitiveness, social, cultural issues and technological innovation. They are able to effectively provide products and services for market segments, which may be too difficult, or not sufficiently profitable, for large firms to attain. The real strength of SFFs is their

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essentially “personal” character. Founders, owners and managers are often one and the same people (Ciampi & Gordini 2012) and tend to be personality driven and opportunistic or instinctive in approach (Burke & Jarrat 2004). Especially in the first generation, SFFs growth is a result of clear, positively motivated business intentions and actions on the part of the founders, driven by the belief that the owner-manager can produce the desired outcomes (Morrison, Breen & Ali 2003).

The downside is that SFFs are typically much more informationally opaque than large corporations. Founders find it difficult to keep on top of the huge amount of information available (and necessary), and to consciously take all the many, and frequently complex, decisions that have to be taken. Often they are endowed with highly specialized production skills, but one of the hardest tasks they face is how to cope with all the multifaceted skills they have to acquire, that are not directly related to production.

These characteristics a) make the board structure and the relationship between outsiders and small firm performance more difficult to identify; and b) justify attempts to better understand the relationship between small family firms performance and outsiders.

Thus, in this paper, we argue that:

- a) the presence of insiders in small family businesses have a positive and significant effect on firm performance, but only in the first generation;
- b) outsiders have a significant and positive effect on firm performance in every generation, and this effect is ever stronger and increasing in family firms run by subsequent generations, while their absence can explain a performance decline.

This paper contributes to the debate around the performance of small family firms and the importance of board structure in such firms in several ways.

Firstly, our findings confirm the pivotal role that outsiders play in SFFs.

Secondly, they shed new light on an under-researched topic such as the generational effect. The effect of outsiders is stronger in SFFs run by subsequent generations rather than in SFFs run by first generation. In fact, later-generation family firms face different challenges that require a more professionalised style of management (Dyer 1998, 2006; Gersick et al. 1997; McConaughy & Philips 1999; Sonfield & Lussier 2004), typically associated with external managers.

Thirdly, unlike the bulk of empirical researches focused on medium and large corporations primarily from the USA (Anderson & Reeb 2004; Dalton et al. 1998), our research focuses on small private family firms from Italy. This is important because SFFs represent a significant part of the economy of virtually every nation. Our study begins to close this gap by focusing on private small family firms in Italy. In addition, previous studies have shown that SFFs’ characteristics differ across countries. Thus, further research should investigate if the impact of outsiders on firm performance varies, not only across firm size, but also across countries.

The paper is divided into five sections. After this introduction, the second section reports a review of the main literature on the relationship between the board of

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directors and small family firms' performance and our three hypotheses. The third section describes the methodology: the first sub-section is about construction of data set; in the second sub-section the procedure of variables selection is described, while in the third sub-section we illustrate the statistical methodology used. The fourth section reports the results of the analysis. Finally, in the fifth section some final considerations conclude the paper.

2. Literature Review

Over the last three decades, corporate governance structure and family firm performance have been receiving an ever growing interest among the scholars and practitioners of management (Anderson & Reeb 2003, 2004; Baysinger & Butler 1985; Baysinger & Hoskisson 1990; Chrisman, Chua & Sharma, 2005; Chrisman et al. 2010; Chua, Chrisman & Sharma 2003; Dana & Smyrniotis 2010; Huse 2000; Gabrielsson & Huse 2005; Sharma 2004; Sharma, Chrisman & Chua 1997; Villalonga & Amit 2006; Zahra & Sharma 2004). Scholars have been also devoting considerable time to addressing the question if outsiders, one of the most debated aspect of corporate structure, increase or decrease firm performance, while also considering generational effect. These scholars (Corbetta & Salvato 2004; Daily, Dalton & Cannella 2003; Hillman, Cannella & Paetzold 2000; Hillman & Dalziel 2003; Miller & Le Breton-Miller 2006) have developed a plethora of heterogeneous research perspectives in order to investigate this issue. In particular, attention has been mainly given to two main perspectives: (1) those relating to agency and stewardship theory; and (2) those relating to procurement of resources as the central role of a board (resource based theory and resource dependence theory).

However, the results of these studies are still fragmented and inconclusive. Some studies suggest a positive relationship between outsiders and firm performance (Caselli, & Di Giuli 2010; Daily 1995; Daily & Dalton 1993, 1994; Mueller & Barker III 1997; Perry & Shivdasani 2005; Stearns & Mizruchi 1993). Others found a negative relationship (Agrawal & Knoeber 1996; Baysinger & Butler 1985; Baysinger, Kosnik & Turk 1991; Cho & Kim 2007; Giovannini 2010; Goodstein & Boeker 1991; Hermalin & Weisbach 1991) or no relationship at all (Daily & Dalton 1992; Dalton et al. 1998; De Andreas, Azofra & Lopez 2005; Jackling & Johl 2009; Kesner & Johnson 1990).

Moreover, these studies are all focused on medium and large corporations, while very few scholars (Arosa, Itturalde & Maseda 2010a; Caselli & Di Giuli 2010; Johannisson & Huse 2000) focus their efforts on small family firms. This is a significant deficiency, because small firms represent a vital part of the economy of virtually every nation, and in Italy most family firms are small. This is mainly due to their financial opacity and, consequently, to their greater difficulty in being identified. Hence, this study focuses on small firms beginning to close this gap.

While a conclusive link between outsiders and firm performance has been elusive (Dowell, Shackell & Stuart 2011), specifically in the small family firms where this topic is very rarely studied and there is not enough literature, we argue that outsiders have a positive and significant impact on small family firms' performance, especially in firms run by subsequent generations. In fact, according to agency theory (Fama 1980; Fama & Jensen 1983; Jensen & Meckling 1976), the greater the number of outsiders on the board of directors, the more that they will be able to challenge the founder and/or to

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encourage changes even in the face of ownership reluctance (Daily & Dalton 1994; Dowell, Shackell & Stuart 2010). Following stewardship theory (Davis, Schoorman & Donaldson 1997), Judge and Zeithaml (1992) argue that boards with a greater proportion of independent directors are more likely to become involved in setting, evaluating and advising a company's strategy. Finally, according to resource-based (Prahalad & Hamel 1990; Teece, Pisano, & Shuen 1997) and resource dependence (Pfeffer & Salancik 1978) perspectives, outsiders bring access to different resources and capabilities and create alignment with external environment. In fact, "one would expect that as the potential environment pressures confronting the organization increase, the need for outside support would increase as well" (Pfeffer & Salancik 1978). Following these perspectives our first hypothesis proposes that outsiders are positively associated with firm performance. Accordingly:

Hypothesis 1: The presence of outsiders on the board of directors increases firm performance.

Research on family businesses suggests several differences between first-generation family firms and subsequent generations (Aronoff 1998; Gersick et al. 1997; Sonfield & Lussier 2004; Westhead, Howorth & Cowling 2002). In the first generation the decision making structure is centralized (Dyer 1988) due to founder centrality, that is, "the powerful influence of the founder on firm development present in the first generation family firms" (Brun de Pontet, Wrosch & Gagne 2007). This may be the right composition for this phase of the firm's life where the company equity is in the hands of the founder and the founder's knowledge of the firm's strategic planning is required, given the long-term perspective of these firms. Moreover, the founder may facilitate the process of succession in the firm, offering advice and conveying knowledge to the CEO on the day-to-day operations of the firm. Therefore, in this phase of the firm's life, the family board has a positive effect in increasing firm performance, while outsiders are less involved in their work. However, the family firm's management and structures change as the family firm progresses from one generation to the next (Lansberg 1999). Later generations have to face different and more complex challenges in maintaining the business (McConaughy & Philips 1999; Sonfield & Lussier 2004). They need to have a more external orientation (Cruz & Nordqvist 2010) and to do things in new ways after ownership is passed on (Kepner 1991), if they want to move beyond the founder centrality present in the first generation (Handler 1992). This requires the adoption of a more professional style of management. Thus, we expect that the later the generation, the greater the advantage of having outsiders. Accordingly:

Hypothesis 2: Insiders (founder and/or heirs) have a positive effect on firm performance only in the first generation, while they have a negative effect in the second and later generations;

Hypothesis 3: Outsiders have a positive effect on firm performance in every generation and this effect is ever stronger and increasing in family firms run by subsequent generations.

3. Methodology

3.1 Dataset

Our sample consists of 950 Italian small family firms during the period 2007-2009. Given the lack of an official database for these firms, our sample was constructed from the CERVED database (which comprised all Italian SMEs). Firms were selected by way of proportional stratified random sampling. They were made up of all Italian private small firms operating in northern, central and southern Italy and in the manufacturing, retail and services sectors. 4,614 firms were selected. From CERVED database we obtain economic-financial data (ROA, ROI, sales, equity, debt, leverage).

To be considered a SFF, the founder or a member of the family by either blood or marriage must hold at least 20% of the firm's equity (Shleifer & Vishny 1986); the founder or a member of the family must be an officer, a director, a CEO and, consequently, participate actively in monitoring the firm, and the ownership will most likely be passed to heirs. We obtained this data by a mail survey conducted in 2010 and it was sent to all 4,614 firms where we asked specific information about ownership composition (percentage of common stock held by founders and/or heirs, name and surnames of shareholders, number of heirs), board structure (the number of insiders and outsiders, whether the CEO is a family or non-family member), age, and generational effect (the ownership pass to heirs or not). The response rate was 54,3% (2,505 firms). According to these criteria, our final sample consists of 950 small private family firms. Table 1 gives the breakdown of our final sample.

Table 1: Overall Sample (number)

Geographical Area	
North	38,8% (369)
Central	32,7% (311)
South	28,4% (270)
Business Sector	
Manufacturing	44,5% (422)
Retail	28,5% (271)
Services	27,0% (257)
Total Number of Firms	950

In terms of geographical location, 38,8% of the firms in the overall sample (369 companies) belongs to the northern part of Italy, 32,7% (311) to the center, and 28,4% (270) to the south. Finally, 44,5% (422 firms) belongs to the manufacturing industry, 28,5% (271) to the retail industry and 27% (257) to the service industry.

Table 2 shows our sample analyzed for each generation (first, second, third and later). We have 230 SFFs run by first generation, 340 run by second generation and 380 run by third or later generations.

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Table 2: Sample by Generations (Number of Firms)

	First Generation	Second Generation	Third and Later Generations
Geographical Area			
North	36,4% (84)	38,9% (132)	41,5% (158)
Central	32,2% (74)	35,3% (120)	38,1% (145)
South	31,4% (72)	25,8% (88)	20,4% (78)
Business Sector			
Manufacturing	41,2% (95)	41,6% (141)	42,2% (160)
Retail	30,8% (71)	31,6% (107)	32,8% (125)
Services	28,0% (64)	24,8% (84)	25,0% (95)
Total Number of Firms	280	340	380

3.2 Variables

Based on previous studies (Adams, Almeida & Ferreira 2009; Anderson & Reeb 2003; Caselli & Di Giuli 2010; Villalonga & Amit 2006, among others), we include in our analysis the following variables:

- Firm Profitability. The firm's profitability was taken as dependent variable. As a measure of performance we use both ROA and ROI ratios. The ROA has been defined as EBIT to total assets, not taking into account the financial performance of the firm. ROI has been defined as operating income to capital invested only in core business activities;
- Outsiders. They are individuals who are not otherwise affiliated with the company through employment or economic exchange relationships, and whose business relationship to the firm is only their directorship. Our primary measure of the outsiders is the number of outsiders divided by the total board size;

We also include the following control variables:

- Insider Ownership. Following Anderson and Reeb (2003) and Villalonga and Amit (2006), we also created a variable to reflect insider ownership. This variable measures the percentage of ownership in the hands of the founder or heirs and was created to take into account the possible effects of incentives resulting from the proportion of ownership in the hands of the founder or heirs;
- Board Size. This was measured using the natural logarithm of the total number of members of the board of directors (Anderson & Reeb 2003; De Andres, Azofra & Lopez 2005; Jackling & Johl 2009);
- Employee. The number of employees as a proxy for size;
- Leverage. It was measured as debt to the equity of the firm to capture liquidity constraints and the fact that debt can play a role in limiting minority shareholder expropriation by removing corporate wealth from family control (Villalonga & Amit 2006);
- Firm Age. This was measured as the natural logarithm of the number of years since the founding of the firm;

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- Geographical location (North/Center). A dummy equals 1 if the firm is located in the north/center of Italy, and 0 otherwise (south). We decided to split our sample into firms operating in the north/center and firms operating in the south because, normally, firms in the north/center have superior infrastructure, more propensity to entrepreneurship and innovation, and they are better developed than firms in the south. In this way, we analyze if the firm's location affects the performance of SFFs (e.g. outsiders of firms operating in the north/center might benefit from better infrastructures, etc.).

Finally, we control for industry effect by introducing a dummy variable. The industries' dummies are manufacturing, retail and services. The industry dummy omitted used as a benchmark is the manufacturing dummy. In Tables 3 and 4, we present the descriptive statistics for the variables studied for the overall sample (table 3) and for each generation (table 4).

Table 3: Descriptive Statistics of the Variables Studied

	Mean	Standard Deviation
ROA (%)	6.63	6.08
ROI (%)	6.54	6.43
Outsiders (%)	46.07	41.98
Control Variables		
Insider Ownership (%)	50.32	48.26
Board Size (Number of Directors)	10	8
Employee	24.39	19.17
Leverage	1.81	1.52
Firm Age	48	45.6
North/Center (%)	73.6	70.7

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Table 4: Descriptive Statistics of the Variables Studied for Each Generation

	First Generation	Second Generation	Third-Later Generations
	Mean (S.D.)	Mean (S.D.)	Mean (S.D.)
Number of Firms	230	340	380
ROA (%)	6.53 (6.01)	6.65 (6.20)	6.72 (6.42)
ROI (%)	6.45 (6.245)	6.62 (6.51)	6.67 (6.56)
Outsiders (%)	42.74 (38.60)	47.93 (42.31)	49.01 (46.34)
Control Variables			
Insider Ownership (%)	81.61 (78.05)	59.14 (55.51)	56.71 (54.02)
Board Size (Number of Directors)	9 (7)	11 (10)	11 (10)
Employee	12.71 (10.38)	25.95 (23.41)	32.18 (30.07)
Leverage	1.64 (1.32)	1.93 (1.68)	2.15 (2.03)
Firm Age	18.91 (15.86)	40.63 (36.06)	45.16 (42.81)
North/Center (%)	80.15 (76.73)	84.32 (80.09)	86.18 (82.71)

Note: (S.D.) = standard deviation

We note that outsiders increase from first to second to third and later generations (from 41.74% to 46.93% to 49.01%), while insider ownership decreases. In line with our hypotheses, both the ROA and ROI increases across generations. For the purpose of selecting only those variables that had the lowest possible correlation levels, multicollinearity analysis was carried out through the variance inflation factor (VIF) method. According to Myers (1990) ratios with a VIF higher than 10 were not included. As shown in Table 5, our results indicate that all of the independent variables had VIF values of less than 10. Consequently, although some correlations are statistically significant, we do not incur the multicollinearity issue.

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Table 5: Variance Inflation Factor (VIF) and Correlation Matrix

Variables	VIF	1	2	3	4	5	6	7	8	9	10	11	12
Firm's Profitability	-	1											
Outsiders	1.68	0.74***	0.060***	1									
Insider Ownership	1.18	-0.14***	-0.09***	-0.015***	1								
Board Size	1.08	0.04**	0.02	-0.01	0.00	1							
Employee	1.06	0.03	0.07	-0.04**	0.06	0.20***	1						
Leverage	1.56	0.03	0.12	0.04	0.14***	-0.03	0.05**	1					
Firm Age	2.06	0.07	0.05	-0.14***	0.02	0.04	-0.03	-0.07***	1				
North/Center	1.34	0.18****	-0.08***	-0.04***	-0.09***	-0.03	-0.01	-0.08***	-0.02	1			
Manufacturing	1.22	0.01	0.11***	0.02	0.06***	0.00	0.04	0.09***	0.28***	-0.06**	1		
Retail	1.56	0.09***	-0.01	-0.04*	-0.10***	-0.02	-0.01	-0.14***	-0.08***	-0.02	0.00	1	
Services	1.14	0.16***	0.14***	0.56***	0.01	0.14***	0.18***	0.01	0.06	0.56	-0.28***	-0.10**	1

*Significance at the 10% level **Significance at the 5% level ***Significance at the 1% level

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3.3 Methodology

The first question we address (hypothesis 1) is the impact of outsiders on firm performance (hypothesis 1). We run the following regression:

$$\text{Performance}_i = \alpha + \beta_1 \text{Outsiders}_i + \beta_2 \text{Insider Ownership}_i + \beta_3 \text{Board Size}_i + \beta_4 \text{Employee}_i + \beta_5 \text{Leverage}_i + \beta_6 \text{Firm Age}_i + \beta_7 \text{North/Center} + \varepsilon_i \quad (1)$$

with $i = 1, \dots, 950$.

The dependent variables used are ROA, as in Adams, Almeida and Ferreira (2009) and in Anderson and Reeb (2003), and ROI. The independent variable is outsiders. Following Adams, Almeida and Ferreira (2009) and Villalonga and Amit (2006), we control for insider ownership, board size, employee, leverage, firm age, north/center and industry effect. We expect a positive and significant coefficient for firm performance and outsiders. In addition, for insider ownership and leverage we expect a negative effect on ROA. We have no expectations regarding board size, employee and firm age, but we expect a positive effect for the north/center and industry dummies. Table 6 describe the variables in regression (1) and their expected signs.

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Table 6: Variables of Regression 1: Description and Expected Signs

	Description	Expected Sign
Dependent Variables		
ROA (%)	Ratio of EBIT to total assets	
ROI (%)	Ratio of operating income to capital invested in core business activities	
Independent Variables		
Outsiders	It is the number of outsiders divided by total board size	+
Control Variables		
Inside Ownership	This variable measures the percentage of ownership in the hands of founder or heirs	-
Board Size (Number of Directors)	It was measured using the natural logarithm of the total number of members of the board of directors	?
Employee	The number of employee as a proxy for size	?
Leverage	Ratio of debt to equity	-
Firm Age	It was measured as the natural logarithm of the number of years since the founding of the firm	?
North/Center	Dummy variable equals 1 if the firm is located in the north /center of Italy, and 0 otherwise	?
Industry	Dummy variables for industries (manufacturing, retail, services). The dummy for manufacturing industry is used as a benchmark and not introduced in the regressions.	?

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4. Results

Table 7 shows the results of our first regression.

Table 7: The Effect of Outsiders on Italian SFFs Performance

	ROA		ROI	
	1	2	3	4
Constant	6.16*** (12.98)	5.89*** (12.41)	6.09*** (12.11)	6.15*** (12.96)
Outsiders		0.76*** (3.96)		0.79*** (4.12)
Insider Ownership	-0.91*** (-4.97)	-1.44*** (-6.29)	-0.96*** (-4.63)	-1.48*** (-6.86)
Board Size	0.03*** (7.09)	0.03*** (7.52)	0.03*** (6.78)	0.03*** (6.56)
Employee	0.02*** (7.58)	0.02*** (7.23)	0.01*** (6.78)	0.02*** (6.32)
Leverage	-0.48*** (-5.03)	-0.41*** (-4.79)	-0.51*** (-5.62)	-0.49*** (-4.91)
Firm Age	0.26*** (2.15)	0.24* (1.79)	0.21** (2.08)	0.23** (2.42)
North/Center	0.89*** (6.89)	0.92*** (6.98)	1.10*** (8.24)	1.07*** (7.81)
Manufacturing	2.34*** (9.80)	2.41*** (10.09)	2.67*** (11.64)	2.61*** (11.50)
Retail	-1.23*** (-9.02)	-1.31*** (-9.12)	-1.35*** (-8.13)	-1.38*** (-8.28)
Services	0.51*** (3.01)	0.53*** (3.06)	0.60*** (3.43)	0.62*** (3.45)
F Value	2.31	2.15	2.23	2.26
R ²	0.28	0.32	0.33	0.35

The table provides the β coefficients of the OLS regression. The t -statistics are given in parenthesis.
 * Significance at the 10% level ** Significance at the 5% level *** Significance at the 1% level.

In the first column for the ROA and third column for the ROI, we study the effect of insider ownership variable on firm performance. The coefficient is significant and negative in all two regressions. It seems that founders and/or heirs do not possess the core competencies to improve or, at least, maintain firm performance. Consequently, insider ownership is detrimental to firm performance.

If we introduce in the regression the presence of outsiders (second and fourth columns), the variable inside ownership is still significant and negative, while the outsiders variable is positive and significant. The fact that the inside directors variable has a still significant but negative impact on the ROA and on the ROI support the conclusion that insiders do not provide the needed resources that improve firm performance. On the other hand, outsiders show a positive and significant coefficient

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in all the regressions. Given the high coefficient of this variable, it seems that having professional competencies and capabilities enhances firm performance. According to stewardship and resource dependence perspectives, in fact, outsiders are essential for giving professional advice and bringing into the firm the resources and competencies that improve the firm performance.

This result is consistent with those obtained by other studies (Agrawal & Knoeber 2001; Corbetta & Salvato 2004; Dalton et al. 1998; Dowell, Shackell & Stuart 2011; Hillman & Dalziel 2003; Pfeffer & Salancik 1978) on medium and large firms, which found evidence that linked the presence of outsiders to the firm performance. Age and size (employee) have significant and positive coefficients, while leverage is significant but negative. Consequently, the larger and older the SFF, the better the performance. Geographical location positively affects firm's performance.

Finally, our results show that the positive effect of outsiders on firm performance is similar for both the firm's profitability ratios. This result might not seem surprising. In fact, in small firms the ROA and ROI are often similar. This is due to the fact that small firms tend to focus on their core business without investing in high-risk financial activities. Therefore, especially in SFFs, the skills provided by the outsiders improve the core business performance of a firm.

From our findings we can state that outsiders positively drive firm performance. Hence, hypothesis 1 is accepted.

As a second step of our analysis we examine if the impact of insiders and outsiders on firm performance varies across generations. We, therefore, run regression (1) for each generation (first, second, and third and later generations). Table 8 and table 9 show the results.

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Table 8: The Effect of Outsiders on Firm ROA Measured in Different Generations

	ROA				
	First Generation	Second Generation		Third or Later Generation	
	1	2	3	4	5
Constant	5.35*** (9.00)	4.16*** (4.31)	4.29*** (4.33)	9.09*** (6.46)	9.15*** (6.85)
Outsiders			0.96*** (4.18)		1.43*** (4.92)
Insider Ownership	0.37** (2.14)	0.24 (1.32)	0.32** (2.05)	-0.41** (-2.31)	-0.33** (-2.05)
Board Size	0.08*** (4.32)	0.07*** (5.71)	0.05*** (5.47)	0.13*** (6.56)	0.09*** (6.24)
Employee	0.01*** (5.18)	0.01*** (5.03)	0.02*** (5.71)	0.01*** (4.54)	0.01*** (4.32)
Leverage	-0.69*** (-3.61)	-0.38** (-2.37)	-0.31** (-2.19)	-0.64*** (-3.61)	-0.69*** (-3.84)
Firm Age	0.14** (2.08)	0.16*** (2.15)	0.14* (1.79)	0.24** (2.42)	0.29** (2.54)
North/Center	0.94*** (5.25)	1.39*** (6.24)	1.42*** (6.70)	0.69** (2.39)	0.57** (2.43)
Manufacturing	2.89*** (8.45)	3.12*** (9.23)	2.91*** (8.54)	2.97*** (8.80)	2.91*** (8.52)
Retail	-0.87*** (-4.83)	-0.75*** (-3.18)	-0.71*** (-3.13)	-1.71*** (-5.46)	-1.68*** (-5.03)
Services	0.48** (2.27)	0.71*** (2.94)	0.76*** (3.04)	0.33** (2.10)	0.41** (2.15)
F Value	2.29	2.21	2.31	2.13	2.36
R ²	0.29	0.27	0.25	0.39	0.41

The table provides the β coefficients of the regression. The t -statistics are given in parenthesis.

* Significance at the 10% level ** Significance at the 5% level *** Significance at the 1% level

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Table 9: The Effect of Outsiders on Firm ROI Measured in Different Generations

	ROI				
	First Generation	Second Generation		Third or Later Generation	
	1	2	3	4	5
Constant	5.05*** (9.00)	4.36*** (4.33)	4.69*** (4.60)	9.19*** (6.83)	9.40*** (6.46)
Outsiders			1.07*** (7.82)		1.46*** (8.26)
Insider Ownership	0.31** (2.10)	0.23 (1.22)	0.38*** (2.46)	-0.39*** (-2.37)	-0.29** (-2.19)
Board Size	0.07*** (7.38)	0.09*** (7.52)	0.08*** (7.02)	0.08*** (6.59)	0.09*** (6.78)
Employee	0.02 (0.79)	0.01*** (4.75)	0.01*** (4.08)	0.01*** (4.64)	0.02*** (5.27)
Leverage	-0.59*** (-5.92)	-0.48*** (-4.92)	-0.42*** (-4.68)	-0.51*** (-5.72)	-0.59*** (-5.94)
Firm Age	0.24** (2.54)	0.28*** (2.82)	0.23* (1.76)	0.29** (2.42)	0.31** (2.46)
North/Center	1.04*** (7.70)	1.19*** (7.82)	1.22*** (8.26)	0.41** (2.30)	0.54** (2.39)
Manufacturing	2.39*** (6.82)	3.02*** (9.02)	3.04*** (9.18)	2.91*** (8.68)	2.99*** (8.80)
Retail	-0.76*** (-3.72)	-0.65*** (-3.18)	-0.61*** (-3.13)	-1.90*** (-6.87)	-1.89*** (-5.95)
Services	0.48** (2.27)	0.71*** (6.89)	0.76*** (6.98)	0.33** (2.46)	0.41*** (2.82)
F Value	2.41	2.39	2.25	2.28	2.26
R ²	0.32	0.29	0.31	0.36	0.39

The table provides the β coefficients of the regression. The t -statistics are given in parenthesis.

* Significance at the 10% level ** Significance at the 5% level *** Significance at the 1% level.

In the 230 first generation SFFs, the insider ownership variable has a positive and significant effect on ROA and ROI (column 1 of tables 8 and 9), in line with H2. This result is consistent with other studies (Adams, Almeida & Ferreira 2009; Anderson & Reeb 2003; Villalonga & Amit 2006). Nevertheless, our sample differs from these studies, which are composed of medium and large firms. In small firms founders have the skills to improve firm performance and their knowledge of the firm's strategic planning is needed, given the long-term perspective of these firms. This may be the right composition for this phase of the firm's life where the company equity is in the hands of the founder. Therefore, in this phase of the firm's life, the family board plays a

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positive role in increasing firm performance, while outsiders are less involved in their work on the board.

In the 340 second generation SFFs, the insider ownership variable is still positive, although not significant (column 2 of Tables 8 and 9).

Finally, in the 380 third and later generations SFFs, the insider ownership coefficient is negative and significant (column 4 of tables 8 and 9).

The shift from the positive and significant effect of the insiders in the first generation to the still positive but non significant in the second and, finally, to the negative and significant in the third and later generations confirms the negative impact of heirs on firm performance, in line with H2. This means that the founder has a positive effect on firm performance only in the first generation, while heirs seem to lack the competencies and capabilities of the founder to face the different and more complex challenges in maintaining the business. It seems that the founder and/or heirs do not possess the core competencies and capabilities to improve or, at least, maintain firm performance.

If we introduce both the inside ownership and the outsiders into the regression, the latter shows a positive and significant coefficient in both the second (column 3 of Tables 8 and 9) and the third generation (column 5 of Tables 8 and 9), while the former has a positive and significant effect only in the second generation. Moreover, we noted that in both the second and the third and later generations, the outsiders coefficient (columns 3 and 5 of Tables 8 and 9) is high, indicating that the variables has a strong impact on firm performance. It means that outsiders have a positive and ever increasing impact on firm performance across generations, in line with H3. In particular our findings suggest that the later the generation, the greater the advantage of having outsiders. This result might not seem surprising. In fact, heirs have to face different and more complex challenges in maintaining the business (McConaughy & Phillips 1999; Neubauer & Lank 1998; Sonfield & Lussier 2004) and often drive negative performance. Thus, this complex situation may hence create demands from outsiders because they can mitigate the ineptness of heirs. Consequently, it seems that the "heir effect" can be reduced by the presence of outsiders. Mature family businesses (firms in the third generation or later), in fact, were more likely to employ outsiders to monitor firm performance, to bring resources and capabilities into the firm, and to link the firm to its external environment (Fiegener et al. 2000; Gabrielsson & Huse 2005). In addition, SFFs in the third generation or higher appear to be less focused on family objectives. These SMEs need to have a more external orientation (Cruz & Nordqvist 2010) and to do things in new ways after ownership is passed on (Kepner 1991), if they want to grow and to maintain their competitive advantage. These effects could increase the likelihood of having outsiders. Hence, hypotheses 2 and 3 are confirmed. Finally, as in the first regression, findings are similar for both the ROA and ROI. The advices, resources, capabilities, competences provided by outsiders from the first to second and later generations improve the performance of the core business activities of the firm.

The variables age and size (apart from the first generation) are still significant and positively correlated with performance. This means that age and size play a positive effect on firm performance. This is due to the fact that we are now analysing the effect of the variable inside each generation. In this case, across generations, the firm size

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and the market complexity increase and, consequently, firms need a more professionalised style of management, typically associated with external managers (outsiders), to avoid performance decline. Leverage has a negative and significant effect on performance. Finally, geographical location (north and center) positively effects firm performance.

5. Conclusion

In this paper we endeavour to analyse the effects of outsiders on firm performance in Italian small family firms, while also considering generational effect. We make three hypotheses. To test our hypotheses we focus on a sample of 950 Italian small family firms during the period 2007-2009.

Our findings confirm that outsiders have a positive effect on SFFs' performance. Moreover, examining SFFs across generations, while the effect of insiders on firm performance shifts from positive (in the first generation) to negative across generations (in the second and in the later generations), the presence of outsiders (apart from the first generation) maintains a significant and positive effect. Therefore, outsiders have a positive and significant effect on firm performance and they might mitigate the ineptness of heirs, while still maintaining the ownership in the hands of descendants, thus avoiding agency costs (Caselli & Di Giuli 2010).

Our research has some implications for family business owners. Results suggest that, across generations, outsiders have a positive effect on firm performance. They add value to the firm through advice and arbitration, bringing new resources and capabilities into the firm as well as linking the firm to its external environment. Therefore consultants should recommend in firms run by second or subsequent generations that the owners build a well-balanced equilibrium between insiders and outsiders because of the important, yet different, role they play.

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