

EFFECTS OF NEPOTISM AND FAMILY CONFLICTS ON THE PERFORMANCE OF FAMILY-OWNED FIRMS IN TANZANIA: CONTRASTING VIEWS

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ABSTRACT

Drawing on the agency theory and the stewardship perspective, this article examines the extent to which nepotism and family conflicts affect the performance of family-owned firms in Tanzania. From a sample of 163 family firms and the Structural Equation Model (SEM) results, the article proffers that nepotism and family conflicts have no significant negative effect on both the financial and market-based performance of family firms. Contrary to previous studies which report that nepotism and family conflicts are detrimental to a firm's performance, it demonstrates that the small family-owned firms operating in a developing economy with an inadequate institutional environment are better off by engaging committed and productive staff from those with a common family background and culture. Although the article supports the stewardship perspective on family enterprises, it indicates the need for further investigation into the impact of family characteristics on firm performance given the differing views that exist in academic literature.

Key words: *Family Firms, Nepotism, Family Conflicts and Firm Performance*

INTRODUCTION

Research on the dynamics of family businesses has recently received a lot of attention in both developed and developing countries (Charles, 2014; Chrisman *et al.*, 2005; De Massis *et al.*, 2008), partly because of their numerical dominance in most economies (Morck & Yeung, 2004; Charles, 2011) and evidence that these firms have unique characteristics derived from family involvement in them (Dyer, 2006; Habbershon *et al.*, 2003; Gupta *et al.*, 2010). Essentially, the uniqueness of family firms results from the idiosyncratic resources and capabilities that are generated when the family and business systems interact and co-exist in unison (Nordqvist & Melin, 2010). Under the Resource Based View (RBV), family uniqueness contributes to the superior performance of family firms (Habbershon and Williams, 1999; Eddleston *et al.*, 2008; Sirmon & Hitt, 2003). Conversely, empirical evidence indicates that, despite the positive effects of family members' involvement in a business (Tokarczyk *et al.*, 2007; Zellweger & Nason, 2008), it leads to family-related constraints which become a burden to the business (Stewart, 2003; Spring & McDade, 1998). These

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contradictory views have stimulated further research on what drive and constrain the performance of family firms, gradually extending to developing country contexts (Charles, 2014; Gupta *et al.*, 2010).

One of the fundamental issues regarding family involvement in businesses centres on nepotism and the behaviour and practices introduced by family members (Kidwell *et al.*, 2012; Carvalho *et al.*, 2013) that lead to conflicts (Charles, 2011). Theoretical debate drawing on the agency theory and stewardship perspective has been divided over the effects of family conflicts and nepotism on the firm's performance because of the differences in business contexts, with the stewardship perspective being more relevant in certain situations (Pieper *et al.*, 2008) and the agency theory more relevant in others (Jensen and Meckling, 1976; Fama and Jensen, 1983b). It is argued that when financial goals prevail in a family, family members' motivation to work in the family firm will be based on meeting lower-order needs and extrinsic factors, thus favouring the emergence of agency conflicts (Corbetta & Salvato, 2004). On the other hand, when non-financial goals prevail, motivation based on meeting higher-order needs and intrinsic factors is fostered, thus favouring the steward-principal relationship (Corbetta & Salvato, 2004; Charles 2011). Consistent with this view, family members' commitment to their firm leads to stewardship behaviour that supports the firm's mission and goals (Miller & Le Breton-Miller, 2007), but if left unchecked, family ownership can be detrimental to the wellbeing of the firm by protecting family members for non-economic goals (Gersick *et al.*, 1997).

Much of the research on family firms assumes that conflict and nepotism are interrelated and tend to be unhealthy and disruptive, but their effect on family firms' performance, especially in developing economies, is not well understood (Spring & Mcdade, 1998; Charles, 2011). Indeed, there is scanty empirical evidence to affirm a correlation between conflicts and nepotism, on the one hand, and firm performance on the other. Previous research on family businesses has mostly dealt with improving family relationships, and issues of governance and succession. This represents a gap in our understanding, since scholars, practitioners and policy-makers would like to know how conflicts and nepotism affect family firms' performance. In addition, much of the existing empirical evidence on conflicts and nepotism in family-owned firms originates from developed countries (e.g. Anderson & Reeb, 2003; Bertrand & Schoar, 2006; Le Breton-Miller *et al.*, 2011). In the meantime, so little is known about the actual effect of family conflicts and nepotism on business performance in the developing economy context. This paper, therefore, seeks to gain a deeper understanding of the connection between these elements and family-owned firms' performance, working on the assumption that this could lead to an improvement in how these firms are managed and organised.

In developing countries and Tanzania in particular, where there is great diversity in ethnicity, customs and family culture (Charles, 2014; Ranja, 2003; Gupta *et*

al., 2010), knowing what effect the family has on business performance is of great importance. Family enterprises are becoming more prevalent, following recent economic reforms and promotion of the private sector. As such, studies focusing on the dynamics of family businesses deserve greater attention. In addition, because most family businesses are home-based and family values easily encroach upon the business and influence management practices (Mbebeb, 2008), scrutinising the impact of family involvement on business performance in a setting where family organisations are complex can add value to management literature. Family business practices and their influence on businesses in sub-Saharan Africa and Tanzania have a collective culture that influences business decisions. For instance, some family members get positions in family ventures because they are trusted by the founders, have a close relationship with the owners and are likely to take over when the owner(s) retires, which is likely to trigger conflicts between family and non-family members working in the business as well as between family members who remain outside the business and those in key positions.

Therefore, the main purpose of this paper is to establish the effect of family conflicts and nepotism on the performance of family firms in Tanzania. The paper is organised as follows. It starts with the literature review focusing on the effect of family involvement on business performance, family conflicts and nepotism. Then it describes the methodology used to generate the findings presented and discussed in this study. Finally, it presents the conclusion and implications of the study as well as areas for further studies.

Family Involvement and Firm's Performance

The distinction between family and non-family firms is largely based on the degree of family involvement in a business undertaking and its influence on the firm. Accordingly, most definitions of family business contain elements relating to ownership, influence, involvement and succession (Astrachan & Shanker, 2003; Jennifer *et al.*, 2012). Consistent with the three-circle model, Chrisman *et al.* (2005) argue that family involvement in ownership, governance and management is what makes a firm a family firm. In this respect, family involvement is an important characteristic that distinguishes family from non-family firms because the behaviour of family members makes family firms distinctive (Chrisman *et al.*, 2005). The literature available claims that most family businesses are those in which family members have complete control over the direction of the business and who ensure that the business remains in the family (Jennifer *et al.*, 2012). In addition, there is a generational involvement that translates into significant management responsibility and direct family involvement in daily operations (Shanker & Astrachan, 1996; Charles, 2011). However, the debate on the relationship between family dynamics and firm's performance is still ongoing, perhaps because the relationship between family involvement and firm performance is complex and is affected by many factors that cannot be included in a single piece of research (Chrisman *et al.*, 2012).

Some empirical studies have been carried out on the topic and have generated contradictory findings. For instance, based on RBV, empirical evidence reveals that family involvement generally has a positive effect on the performance of family firms (Anderson *et al.*, 2003; Vilalonga and Amitt, 2006; Maury, 2006). In the same vein, Charles (2011) compared the performance of family and non-family firms in Tanzania using a sample of 378 small and medium enterprises, and found that family firms out-performed non-family firms when business performance indicators were considered. The findings are similar to van Essen *et al.*'s (2001) meta-analytical study on financial performance that show a small positive effect of family involvement on firm performance. Likewise, Guan and Songini (2003) analysed a sample of 151 firms in Italy and found that the involvement of family members in managing the company contributed to its success. Anderson *et al.* (2004) examined the agency implications of family embeddedness and suggested that family-controlled firms performed better than non-family firms.

Although several studies have argued that family involvement has a positive impact on a firm's performance, others (e.g. Chrisman *et al.*, 2004) have found that family involvement has an insignificant effect on sales growth. It is argued that family firms often experience slower growth and are slower at making decisions (Meyer *et al.*, 1989). They have to deal with additional family issues which might be resource-consuming (Lester *et al.*, 2006). The motives of family members can create agency problems as the interests of family members and the family unit take precedence over those of outside stakeholders (Lubatkin *et al.*, 2005). In addition, when family ties exist between owners and agents, this leads to nepotism, self-serving entrenched management and utility maximisation of the family, which is likely to have a detrimental effect on company profits (Vinton, 1998). In view of the nature of family firms, empirical studies (e.g. Morck *et al.*, 2006; Schulze *et al.*, 2003a) conclude that their performance is worse than that of non-family firms due to the complexity of meeting both business and family objectives. Similar results have been reported by Sciascia and Mazzola (2008), which show that the relationship between family involvement in management and performance is negative and non-linear, and that family involvement in ownership does not significantly affect a firm's performance.

The studies that have tried to assess the influence of specific characteristics of family firms on firm performance notwithstanding, the questionable link between family involvement and firms' performance remains relatively unexplored. One of the main challenges is the existence of both economic and non-economic goals in family firms, which make it difficult to determine whether their characteristics and overall performance are related. In an attempt to contribute to the debate, the study sought to establish that agency conflicts are related to nepotism, on the one hand, and family firm performance, on the other. Based on the assumption of a unified system of family and business (Chrisman *et al.*, 2003), family firm performance is measured on the basis of business objectives. As proposed by Barney (1991), both market and financial measures are used to assess the

performance of a firm. The assumption here is that when a firm is creating superior value it can attract customers who will pay a profitable price, which in turn will lead to above-average returns. Therefore, a firm's performance is measured using self-reported financial measures (sales and profitability) and non-financial measures (market share and customer acquisition rate). Using the firm performance model developed by Kaplan and Norton (2000) and Maltz *et al.* (2003), both financial and non-financial measures are used to complement each other.

Nepotism

In the family business literature, nepotism is defined as “the advancement of relatives on the basis of family rather than merit” (Donnelly, 1964) and “using family influence [...] to employ relatives” (Jones, 2011). Accordingly, Bertrand and Schoar (2006) provide evidence that a culture based on strong family ties, as in Sub-Saharan Africa, can give rise to nepotism. More generally, because business founders may derive utility from seeing relatives involved in the business, they may decide to hire key staff from within their kinship network rather than turn to more talented professional managers (Barnett, 1960). In this regard, it is argued that the distinction between family and non-family members in a family business can result into individuals receiving preferential treatment based less on their behaviour or exchanges and more on family ties (Chapais, 2001; Moore, 1992), which may lead to the perception of nepotism by those who are not part of the owning family (Muchinsky, 2011). In the same vein, it is argued that nepotism is often characterised by the selection of managers by family owners, with the subsequent negative impact on company management and results (Lansberg, 1983), which makes it difficult for owning families to effectively evaluate family members (Dyer, 2006) and dismiss them in the case of unsatisfactory performance (Gomez-Meja *et al.*, 2001). According to Morck *et al.* (1988), the majority of controllers tend to expropriate wealth from minority shareholders through excessive compensation, party-related transactions and the special distribution of dividends. Some studies indicate that shirking in family businesses happens when managers are chosen on the basis of family ties rather than on their competence, resulting into poor performance and the creation of barriers to prevent dismissal (Herrero, 2011). Family members in family businesses are also likely to hold higher-level positions and to include and encourage other family members to have a voice in the decision-making process, while excluding those who are not a part of the family (Kets de Vries, 1993). The allocation of organisational rewards (e.g. career opportunities, pay and promotion) is likely to be influenced by family membership, with family members given preference over non-family members (Brewer & Brown, 1998; Kets de Vries, 1993). Thus, when non-family members see rewards being distributed based on family membership rather than on performance or effort they will perceive this as nepotism and unjust, because the possibility of their receiving these additional benefits is almost non-existent (Jennifer *et al.*, 2012).

Nepotism is particularly found in family businesses where a family member remains in an executive position despite being insufficiently competent or

qualified (Sciascia & Mazzola, 2008; Herrero, 2011). Hendry (2002) dubbed this phenomenon as ‘honest incompetence’ when the family agent’s actions are not motivated by opportunism; nevertheless, conflicts arise due to his/her inability to deliver the results the company needs for a successful trajectory. In relation to this, Nafziger (1969) assessed the impact of family involvement and family-based management on the outcomes of family-oriented enterprises in Nigeria. His study revealed that African entrepreneurs may have little to gain by employing their relatives, but they are often very important when establishing a firm. Family members are probably an asset as employees up to a certain point in the growth process, as they are more loyal and willing to work for nothing if necessary, but at a later stage when the enterprise has grown and appears to be successful, they may become a liability because they make demands on the entrepreneur and enterprise that are incompatible with sound business practices. Ukaegbu in Spring and McDade (1998) examined the diversity of management styles in Nigerian enterprises. Based on in-depth interviews of 20 firms, he found that vestiges of the traditional system of placing relatives in top positions in one’s business complicated the relationship between owners and managers. Relatives who were given management positions in the firms took liberty of the company funds, voted as a block and generally undermined modern managers. Gomez-Mejia *et al.* (2001) found that in private, family-owned Spanish newspaper firms, performance improved when unproductive family relatives are replaced by outside employees.

Although nepotism is commonly perceived as a negative aspect of family businesses (Kets de Vries, 1993), there are cases where this has not been observed (Gilding, 2005). In Tanzania, where trust is essential, some enterprises deliberately employ family members to protect the interests of the firm (Sutton & Olomi, 2012) but such nepotism may have an impact on their performance. Because nepotism may negatively affect performance, the study was motivated to test empirically its effect on family business performance. In this study, nepotism is defined as the employment of relatives without adequate qualifications (Jones, 2004), promoting relatives to senior positions without merit (Jennifer *et al.*, 2012) and over-rewarding family members more than non-family members (Charles, 2011), as well as the way in which family members advance to higher positions.

Hypothesis 1: Nepotism has a negative effect on the performance of family firms.

Conflicts in Family Firms

The concept of conflict in family firms has many interpretations. Although it has been studied extensively, there is a lack of consensus among scholars which has given rise to differing definitions of what characterises conflict in such ventures. For instance, Korsgaard *et al.* (2008) define conflict as “the experience between or among parties that their goals or interests are incompatible”. This definition agrees with Rahim (2001), who sees it as “an interactive process manifested in

incompatibility, disagreement or dissonance within or between social entities”, whereas Dyer (1994) and Schulze *et al.* (2001) demonstrate that conflicts in family businesses emerge from several psycho-dynamic factors such as sibling rivalry, lack of harmony between a couple or parents and children, role ambiguity and differences between family and non-family employees. However, in analysing agency conflicts, this paper is not only influenced by the practicality of measuring family business conflicts, but also by the predominance of the literature that shows that the co-existence of personal and professional relationships results into family business conflicts (Kellermanns & Eddleston, 2004; Herrero, 2011). Indeed, Herrero (2011) does not doubt the existence of agency conflicts in family businesses, although there is still no consensus on whether such conflicts are more frequent in family than in non-family businesses. The intense interaction between family and business, driven by different objectives, leads to the emergence of conflicts (Mustakallio, 2002). Family businesses face significant agency costs due to conflicts occasioned by the involvement of family members seeking to defend their own interests (Dyer, 2006).

The literature shows that the effects of agency conflicts on business performance have been interpreted in two ways. Whereas one view portrays them as harmful to the firm (Wall, Jr. & Callister, 1995; Wall, Jr. *et al.*, 1987), the other portrays them as beneficial to a firm’s performance by increasing its options, preventing premature consensus and increasing the involvement and motivation of family members (Tjosvold, 1991). Contributing to this debate, Kellermanns and Eddleston (2004) argued that while most of the research on family firms tends to assume that conflict is unhealthy and disruptive, it may have a positive effect on a family firm’s performance. Likewise, the empirical literature contains mixed findings on the impact of family conflict on business performance. Using the agency theory, studies show that the cost of principal-principal conflict is found to be higher in family firms than in non-family firms, hurting firm performance (Fama & Jensen, 1983; Young *et al.*, 2008). On the other hand, Rogoff and Lee (1996) presented results which show that, despite the greater number of business-family conflicts experienced by the owners of family businesses, they are generally well-managed and do not interfere with the achievement of business objectives. A study by Sorenson (1999) demonstrates that not all family firms are plagued with the negative form of conflict because most family members can work harmoniously with each other. Some family firms involve members who contribute significantly to the business, collaborate on strategic issues and have good relationships.

Despite the mixed findings and disagreement on the relationship between family conflicts and business performance, the literature largely shows that family conflicts contribute to the negative performance of the firm. Thus, it was worth testing this assertion in the context of a developing economy where the institutional environment is unstable and businesses are more prone to conflicts because the extent to which family conflicts affect business performance

remained largely unknown. According to Dyer (2006), conflicts in family firms emerge from rivalry between family members and disagreement on the distribution of benefits to them. The emphasis here is on the disagreement on business decisions and distribution of earnings as well as the incompatible interests of family members. In this paper, conflict is perceived as disagreement on business decisions and incompatibility of interests measured in terms of rivalry between family members and disagreement on profit sharing.

Hypothesis 2: Family conflicts have a negative effect on the performance of family firms.

Methodology of the Study

Using the database of SMEs in the manufacturing and service industries prepared by the National Bureau of Statistics (NBS), 600 SMEs owned and controlled by the family were selected according to the number of workers and ownership structure, the criteria suggested by the National SME Policy². Simple random sampling using random numbers was then deployed to produce an initial sample of 186 firms to be involved in the study. Although the firms were selected from an already existing database, the simple random sampling approach was considered adequate to ensure that the firms had an equal chance of being in the sampling frame. However, before including a firm in the sample, the study ensured that other conditions that define family businesses were met, after which a usable sample of 163 firms was obtained having made sure that the data were clean. The research variables aimed at determining business performance, family conflicts and nepotism were measured using 5-point Likert-scale questions. Data analysis began with the confirmatory factor analysis of the measurement model to validate the measures of the latent constructs. Goodness-of-Fit measures and Incremental Modification Indices were applied to achieve the best fit of the measurement model.

Assessment of the fit indices indicated that the model fits the data after allowing free estimation of correlated error terms of perceived sales and profits. The fit indices generated after re-specifying the model confirm that they fit the data well. As Table 1 illustrates, the probability value of chi-square is not significant ($p > 0.05$) with the $CMIN=DF > 1$, suggesting a good fit of the model. Other indices (RMR= 0.051, GFI= 0.948, AGFI= 0.908 and PGFI= 0.534) show that the model fits the data well based on the recommended threshold values of $RMR < 0.10$, $GFI > 0.9$, and $AGFI > 0.9$ (Byrne, 2001). The baseline comparison indices also portray the same picture with $NFI = 0.964$, $RFI = 0.987$, $IFI = 0.987$, $TLI = 0.981$ and $CFI = 0.987$. Additionally, the $PRATIO = 0.689$ and $RMSE = 0.058$ satisfy the conditions for a well-fitting model. The $PCLOSE = 0.325$ supports the null hypothesis that $RMSE$ is not greater than 0.05. Finally, both

² Whereas micro enterprises employ up to 4 workers, small enterprises employ between 5 and 49 workers, and medium enterprises employ between 50 and 99 people (URT, 2003).

AIC and ECVI are lower than the values of the independence and saturated models. In this case, the assumption of a well-fitting model is justified.

Table 1: Model Fit Summary- Family Constraints

CMIN					
Model	NPAR	CMIN	DF	P	CMIN/DF
Default model	24	47.670	31	0.280	1.538
Saturated model	55	0.000	0		
Independence model	10	1320.253	45	0.000	29.339
RMR, GFI					
Model		RMR	GFI	AGFI	PGFI
Default model		0.051	0.948	0.908	0.534
Saturated model		0.000	1.000		
Independence model		1.017	0.321	0.170	0.263
Baseline Comparisons					
Model	NFI Delta1	RFI rho1	IFI Delta2	TLI rho2	CFI
Default model	0.964	0.948	0.987	0.981	0.987
Saturated model	1.000		1.000		1.000
Independence model	0.000	0.000	0.000	0.000	0.000
Parsimony-Adjusted Measures					
Model		PRATIO	PNFI	PCFI	
Default model		0.689	0.664	0.680	
Saturated model		0.000	0.000	0.000	
Independence model		1.000	0.000	0.000	
RMSEA					
Model		RMSEA	LO 90	HI 90	PCLOSE
Default model		0.058	0.019	0.089	0.325
Independence model		0.418	0.399	0.438	0.000
AIC					
Model		AIC	BCC	BIC	CAIC
Default model		95.670	99.167	169.920	193.920
Saturated model		110.000	118.013	280.156	335.156
Independence model		1340.253	1341.710	1371.190	1381.190
ECVI					
Model		ECVI	LO 90	HI 90	MECVI
Default model		0.591	0.499	0.731	0.612
Saturated model		0.679	0.679	0.679	0.728
Independence model		8.273	7.564	9.028	8.282

Key: CMIN- minimum Discrepancy, NPAR- number of Parameters, DF- degree of freedom, AGFI- adjusted Goodness of Fit Index, PNFI- parsimony normed fit index, PCFI- parsimony comparative fit index, RMSEA- root mean square of approximation, PCLOSE-the probability for testing the null hypothesis that the population RMSEA is no greater than 0.05., BCC- browne-cudeck criterion, BIC- bayesian information criteria, CAIC- Consistent Akaike Information

Criteria, MECVI- a variant on BCC, except for a scale factor, RMR-root mean square residuals, GFI-goodness-of-fit index, PGFI-parsimony goodness-of-fit index, NFI-normed fit index, RFI-relative fit index, IFI-incremental fit index, TLI-Tucker Lewis index, CFI-comparative fit index, PRATIO-parsimony ratio, ECVI-expected cross-validation index.

The statistic used to test the hypotheses is the critical ratio (CR) based on a level of 0.05, where the test statistic needs to be greater than ± 1.96 before the null hypothesis is rejected. Standardised structural estimates were used to test the hypotheses as they are commonly used when comparing the direct effect on a given endogenous variable in a single group study. Standardised weights were applied because they could compare two or more variables measuring different units. They measure how well each independent variable predicts the dependent variable when the other independent variables remain constant. The rule-of-thumb when testing hypotheses is that a standardised regression weight exceeding 0.5 shows a strong relationship among variables, whereas 0.8 to 0.9 indicate a very strong relationship. A regression weight equal to one indicates that there is a perfect relationship between variables. The findings were analysed and interpreted in relation to the relevant literature and the experience the researcher had gained during data collection.

Findings

Analysis of the findings focuses on relevant characteristics of the firms studied, such as the number of employees, conditions that define family enterprises, ownership of the business, family influence on strategic decisions and generations owning and managing the business. To test the study hypotheses the effect of nepotism and agency conflicts in family businesses was examined.

Number of Employees in the Firms Studied

The number of employees was classified in a way that would be consistent with the indicators of business size in Tanzania. Most of the enterprises (86.8%) employed 5-49 workers, and so were classified as small enterprises according to the national SME policy (URT, 2003). The proportion of micro-enterprises (with 1-5 workers) was 7%, whereas that of medium-scale enterprises (with 50-100 workers) was 6.2%. This indicates that SMEs are mostly small enterprises rather than micro and medium-scale ones. Indeed, the predominance of small firms in the sample mirrors the general pattern of firm distribution in the country, where medium and large firms form a considerably small minority. These findings are consistent with other studies in Tanzania, which reveal the 'missing middle' (Olomi, 2009; ESRF, 1997). Only a few micro-enterprises were included because it was easier to get performance information from small and medium-scale enterprises, since most micro-enterprises are informal and do not keep adequate business records. It should be noted that the predominance of SMEs in this study reflects the general trend in that most family enterprises fall within that category of enterprises.

Defining Characteristics of Family Firms

In an attempt to define family businesses, we asked the respondents to define what they understand by a family firm to determine whether and why they regarded their firms as family enterprises at the time of the investigation. This approach was borrowed from the Family Power Experience and Culture (F-PEC) scale, which defines family firms in terms of the extent and manner of family involvement in the business (Klein *et al.*, 2005). Table 4 shows that most of the respondents regarded their firms as family businesses because they were owned by a family member (57.7%); the decisions were controlled by family members (60.7%); the successor of the business would be a family member (69.9%); and the top management was dominated by family members (65%). Some of them perceived their businesses as family firms because family members were involved in the day-to-day running of the business (54.6%) and the business was jointly owned by several family members (47.7%). The implication is that most of the family firms under review were fully owned by family members and were to a large extent controlled by them.

Table 2: Defining Characteristics of Family Firms

Defining characteristics of the Family Businesses	Frequency	Sample	Percentage
The business is owned by a single family member	94	163	57.7
The business is owned by several family members	78	163	47.7
Business decisions are controlled by family members	99	163	60.7
The successor of the business will be a family member	114	163	69.9
The top management is dominated by family members	106	163	65.0
Family members are actively involved in the day-to-day running of the business	89	163	54.6

On the basis of these findings, it can be concluded that the criteria used in this study to define family firms were relevant. As explained previously, the major factor distinguishing family from non-family firms is family involvement in the business in terms of ownership, management and control. Nevertheless, the study attempted to establish the extent to which the families owned and controlled their businesses. The results indicate that 90.2% of the family firms were fully owned by family members with a mere 0.6% owned by less than 30% of family members. Taken together, 96.3% of the family firms were owned by over 50% of family members. This supports previous findings that family firms are generally owned by family members.

Table 3: Capital Ownership by Family Members

Ownership	<i>Frequency</i>	<i>Percent</i>
100%	147	90.2
>50%	10	6.1
>30%	5	3.1
<30%	1	0.6
Total	163	100.0

Family Influence on Strategic Decisions

The extent to which families influenced strategic decisions in family enterprises was determined using five-point Likert-Scale questions whose scales of measurement ranged from negligible to very high. As depicted in Table 4, 22.1% of the family firms perceived that the influence of the family on strategic decisions was very high. About 41% perceived it as high, 5% thought it was nominal and 7.4% felt it was negligible. It can be concluded, therefore, that families were involved in making strategic decisions in family firms. This supports this study's definition of family enterprises and shows that family members influence family firms' strategic management. According to Davis (1983), even when the family is not part of the management of the company, if its members have a decisive influence on its politics and direction, this is enough to characterise it as a family-owned company.

Table 4: Family Influence on Strategic Decision-making

Family influence	<i>Frequency</i>	<i>Percent</i>
Negligible	12	7.4
Nominal	8	4.9
Medium	40	24.5
High	67	41.1
Very high	36	22.1
Total	163	100

Generation Owning and Managing the Business

Most family firms were in the first generation in terms of ownership and management, at 80.4% and 76.7%, respectively. Whereas 6.7% of the firms had transferred ownership to the third generation, 4.3% had transferred management to the same generation. The firms that had transferred ownership or management to the second generation comprised 10.4% and 8.6%, respectively. About 2.5% did not know which generation owned their firms and 10.4% did not know which generation was managing their enterprises. The predominance of first-generation businesses reflects the fact that most businesses in Tanzania have been established recently as a result of economic transformation. This has some implications as Dyer's (1988) research shows that most of the first-generation family businesses have a "paternalistic" management culture characterised by

hierarchical relationships, top management control of power and authority, close supervision and distrust of outsiders.

Table 5: Ownership and Management Generations

Generation owning the business	<i>Frequency</i>	<i>Percent</i>
Third generation	11	6.7
Second generation	17	10.4
First generation	131	80.4
Do not know	4	2.5
Total	163	100.0
Generation managing the business		
Third generation	7	4.3
Second generation	14	8.6
First generation	125	76.7
Do not know	17	10.4
Total	163	100.0

Results of Hypothesis Testing

One objective of the study was to establish the effect of nepotism on the performance of family firms and so we tested the hypothesis: *Nepotism has a negative effect on the performance of family firms*. The results presented in Table 6 demonstrate that this hypothesis is rejected ($C.R=0.004$ and $p=0.997$). This means that there is insufficient evidence to support the premise that nepotism in family firms in Tanzania negatively affects their performance. As demonstrated in Appendix 1, the factor loadings for this variable are: employing family members with inadequate competence ($NOCOMP=0.84$), promoting family members without adequate competence ($PNOCOMP=0.96$) and overpaying family members ($OVERPAY= 0.88$). They show that all the selected indicators of nepotism in family enterprises were relevant measures. The fact that the survey results do not provide evidence that nepotism has a negative effect on the performance of family firms raises an issue that needs to be debated further given that several studies have shown that nepotism is detrimental to family firms' performance. Several contextual and definitional issues relating to nepotism can be raised as a subject for discussion before we draw conclusions on the effect of nepotism on business performance.

Table 6: Family Constraints Regression Weights: (Group number 1-Default model)

			Estimate	S.E.	C.R.	Standardised Reg. Weights	P
COMP	<--	NEPOTISM	0.000	0.064	0.004	0.001	0.997
COMP	<--	CONFLICT	-0.026	0.068	-0.377	-0.067	0.706
OVERPAY	<--	NEPOTISM	1.000			0.876	
PNOCIMP	<--	NEPOTISM	1.107	0.059	18.799	0.963	***
NOCOMP	<--	NEPOTISM	0.974	0.068	14.392	0.836	***
RIVALRY	<--	CONFLICT	1.000			0.881	
DISAGREDEC	<--	CONFLICT	1.071	0.055	19.382	0.957	***
DISAGREMP	<--	CONFLICT	1.056	0.061	17.443	0.911	***
SALES	<--	COMP	1.000			0.668	
PROFIT	<--	COMP	0.908	0.101	8.974	0.697	***
MARKET	<--	COMP	1.359	0.163	8.321	0.790	***
CUSTACQ	<--	COMP	1.502	0.181	8.295	0.885	***

This study found additional reasons for employing family members by asking respondents to rank the advantages of engaging family members on a Likert-scale measurements ranging from strongly agree (5) to strongly disagree (1). As depicted in Table 7, family members were employed because they could be entrusted with important roles, they were reliable and firm owners had great confidence in them. All the three factors are significant with $p < 0.05$ at 95% confidence interval. Therefore, the findings stress that trusting and having confidence in employees are crucial when selecting suitable employment candidates.

Table 7: Additional Reasons for Employing Family members

	<i>t</i>		<i>df</i>	<i>Sig.</i> (2- tailed)	<i>Mean</i> <i>Difference</i>		<i>95% Confidence</i> <i>Interval of the</i> <i>Difference</i>	
	<i>Mean</i>	<i>Lower</i>			<i>Upper</i>	<i>Lower</i>	<i>Upper</i>	<i>Lower</i>
Entrust family members with important roles	3.91	37.315	162	0.000	3.908	3.70	4.11	
Reliance on family members	3.66	36.379	162	0.000	3.656	3.46	3.85	
Confidence in family members	3.72	35.499	162	0.000	3.724	3.52	3.93	

The study hypothesised that *family conflicts have a negative effect on the performance of family firms*. Based on the survey data and the structural equation results, this hypothesis is also rejected with C.R=-0.377 and p=0.706. Although the correlation between family conflicts and firm performance is negative (-0.07), the effect does not seem to be statistically significant. Then again, the factor loadings on this variable were disagreement on profit sharing among family members (DISAGREP=0.91), disagreement on business decisions (DISAGREDEC=0.96) and rivalry between family members (RIVARLY=0.88). This indicates that the selected indicators of family conflicts were relevant measures of the existence of conflicts in family enterprises. However, the rejection of the hypothesis raises another issue that needs to be debated given that most of the literature indicates that family conflicts affect firm performance negatively.

Discussion of Findings

The literature shows that most of the studies on the dynamics of family firms emphasise the agency problems that emerge from family members' involvement in the business. In terms of the effect of nepotism and family conflicts on business performance, several studies have demonstrated a negative correlation. At the beginning of this paper, our hypotheses were influenced by the inclination of previous studies and the logic that nepotism and family conflicts must be detrimental to family-owned business performance. Although nepotism and conflicts exist in family firms, the study does not provide evidence of their negative impact on the performance of family-owned firms. In other words, there is a need for further investigation, especially in the context of a developing economy.

In terms of nepotism, our findings appear to be consistent with those of Ford and McLaughlin (1985), which show that the effect of nepotism on small family-owned firms is not significant since it provides an efficient way of obtaining dedicated personnel to staff them. The results also differ from Ukaegebu's (1998) and Dyer's (2006) findings to the effect that nepotism negatively affects family

firms. The impression from our findings is that when family members take up management positions in family-owned businesses, agency concerns are to some degree avoided, as there is much less potential for incentive misalignment between owners and agents than when non-family member managers are appointed (Eisenhardt, 1989). In a similar vein, hiring family members can potentially help firms avoid the uncertainty and transaction costs associated with locating qualified employees and monitoring their behaviour (Jones, 2011; Jones *et al.*, 2008; Nicholson, 2008a). These benefits can, to some extent, offer an additional explanation for the presence of nepotism in family businesses, which does not necessarily affect their performance. As firms grow, however, the benefits of nepotism might start to be overtaken by its negative aspects, necessitating a change in the nature of family involvement to maintain growth.

The findings demonstrate that involving family members in a business, especially when the institutional environment for employing professionals is not well developed, is not necessarily detrimental, provided the person is qualified and dedicated to the job. Consistent with Hayajenh *et al.*'s (1994) study, a developing country's environment may favour the employment of relatives in small businesses for several reasons. First, ethnic and extended family ties shape people's social values, norms and behaviour, which encourage them to fulfil their responsibilities to their families. As a result, family members are likely to be more committed to their businesses. Second, due to the cost of recruiting workers through formal methods, family connections play an important role in obtaining good employees for enterprises. Third, family firms have the advantage of attracting professional family-related workers into their businesses because of family members' inherent interest in them. In many cases, family members are often well trained in a practical sense, having been brought up in a business atmosphere and working their way through all the activities undertaken by the firm. The thorough grounding family members receive may make them sceptical of the capabilities of those who have not had that experience. These findings suggest that family firms value the experience and skills of family members through their involvement in the business, as well as their other qualities such as commitment to work, trust, etc. In fact, in a country such as Tanzania where most small firms cannot afford to attract highly qualified and professional staff, factors like hands-on experience and the business skills developed in family businesses should not be undervalued. Likewise, Ranja (2003) found that some workers in family firms in East Africa were better trained than those in non-family firms.

In terms of conflicts, the study found that the conflicts experienced in family firms did not have a significant negative effect on their performance. Although McConaughty (1998) and Schulze *et al.* (2001) perceived that the performance of family firms was affected by family conflicts, our findings are not surprising as other studies in the family firm literature present similar results. For instance, Habbershon (2006) demonstrated that family members tend to work efficiently as a team since the family is a *de facto* team. In addition, family members are

expected to be altruistic because of kinship obligations that are part of the binding moral order in most cultures (Stewart, 2003). In line with the stewardship perspective, when individuals are involved in the decision-making process of an organisation, they are more likely to behave in ways that benefit the business (Davis *et al.*, 1997), but when they are not, they are more likely to engage in anti-organisational behaviour and to act antagonistically. Similarly, the agency theory presumes that, while conflicts of interest may arise when ownership is shared, they do not generally engender agency costs in family firms because they are resolved efficiently.

Logically, the closer the relationship of the family member to the owner-manager and the higher the member's position, the greater the influence that member is likely to have on the decision-making process of the family business and the easier the resolution of conflicts among family members. One factor that helps to reduce family conflicts in family enterprises could be the direct and efficient communication between family members. For example, because most family members live together in Tanzania, they are likely to develop a common interest leading to a consensus on the issues facing their business. In this regard, it seems reasonable to expect that the more homogeneous the family work group is the fewer the conflicts. Another factor is the tradition of clan cohesion. Contrary to Western societies, family conflicts can be resolved through the clan system. In some cases, family members not involved in day-to-day management may play the role of peacemakers. The advantage of this sort of conflict resolution mechanism for small businesses is that conflicts can be resolved speedily without going to court, which is not only bureaucratic but also costly. Furthermore, the fact that most family firms in the sample were in the first generation might have contributed to the minimal effect of family conflicts on their performance. Experience also shows that most of the conflicts emerge when the business is transferred to the next generation, largely because ownership and management succession causes misunderstandings among the heirs, leading to destructive conflicts.

Conclusion and Implications

This paper contributes to the ongoing debate on the application of the agency theory and stewardship perspective to explain the difference in the performance of family firms. Contrary to the argument of the agency theory, our findings support the stewardship perspective's argument that engaging family members, especially in an underdeveloped institutional environment, is not necessarily detrimental to the business. The effects of nepotism and family conflicts are neutralised, probably because it is easier for family members to align their interests in managing their firm. Nevertheless, the effect of nepotism and family conflicts on firm performance remains unclear, as previous studies conducted in different contexts show that family members are involved in a business for a wide variety of reasons. For instance, in underdeveloped economies with an unstable institutional environment, involving family members in a business can increase their incentive to contribute to better business operations and improved

performance. Although there has been a misconception that employing family members will bring conflict to the business and affect its future, our paper shows that because of their common family background and the clan and kinship tradition, resulting in good communication, family members are able to get along as a team in running their businesses and resolving conflicts. As a matter of fact, most of the family businesses are run by the first generation and dominated by the same family, which might have contributed to the effective resolution of conflicts.

Our study makes three major contributions to the literature. First, it demonstrates the applicability of the stewardship perspective in an environment where institutions are underdeveloped and personnel are engaged on the basis of trust and commitment to common goals. This suggests that the challenges of involving family members in the ownership and management of a business can be neutralised by the benefits gained from their trust and commitment. Second, the study challenges the view that agency conflicts and agency costs increase when family members are involved in the business. Although agency costs may emerge from the misconduct of family members, the kinship culture found in developing countries plays an important role in reducing its impact. Third, our study suggests that it cannot be concluded that nepotism and conflicts affect small family enterprises which are unable to recruit and retain professional staff, especially in developing countries where most professionals are keen to work in large organisations, most of which are not family firms. Therefore, we challenge previous research findings that suggest that engaging family members has a negative impact on firm performance. Further analysis that takes into account the peculiarities of small family firms in developing countries should be done to broaden the debate that largely originated from developed countries.

Notwithstanding the contribution made by our paper, there are some limitations that necessitate further research. Since the paper is based on cross-sectional data, a longitudinal study would generate more interesting findings. The impact of family involvement should be measured over a long period given the long-term orientation of most family firms, since the main determinants of stewardship behaviour (trust, altruism, relational contracts and non-financial goals) take a longer time to have an effect on a firm's performance (Corbetta & Salvato, 2004). In addition, whereas some family firms have already grown into large companies (Sutton & Olomi, 2012), this paper focused on SMEs. It would be interesting to conduct a similar study on large family enterprises for comparison purposes. Because this study was conducted in a single country, comparative studies should be carried out in other Sub-Saharan African countries that would add value to the academic literature by revealing some contextual issues of family businesses that are likely to influence empirical results. This study provides a basis for studies focusing on the uniqueness of family businesses in the context of a developing economy where there is predominance of SMEs and informal enterprises. Therefore, it is important that future research on this subject

be conducted to refine the concepts addressed in this paper and to examine their effects on organisational performance.

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Appendix 1- Family Conflicts and Nepotism vs. Firm Performance



