

## DIMENSION OF MANAGERIAL CONTROL IN FAMILY BUSINESS

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### ABSTRACT

*One of the important elements which make the family business to be unique is the family influence over the business. To exert such an influence means to be aware of the business needs and to control them. The Article is focused on the private family business influence and analyzes the five dimensions control and their characteristics with consequences on the particularity of the business sector and firm financial performance: the degree of control is realized by the founder and/or the family members or the coalition of the family offices. The amount of control is done by the complexity number and relationship between owner and/or coalition family offices and CEO. The particularity of the business sector implies the need for a better inside or outside experience and expertise in controlling the business. The culture of the family business brings philosophy control, the unique pattern and economic goals. The succession plan is one of the earlier controlling procedures in mediating possible negative effects over the business. Thus, the Authors will draw for each theoretical dimension a hypothesis which will be demonstrated afterward with a questionnaire. By having better control, the tendency of the private family business is to have centralized decision-making.*

**KEYWORDS:** *control, dimension, family, niche, succession*

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### 1. INTRODUCTION

In the Latin language, "family" means household. From the etymology point of view, it is translated through the persons connected by blood". Today, the family business dominates the world "corporate landscape", according to La Porta et al. (1999, Villalonga and Amit (2010). The economic impact of the family businesses in the world is tremendous high, generate around 40% of GDP in the US and 48% in Europe (Lindow, 2013). In defining family businesses, the researchers approached over time different concepts, under different names, but the concept of "family business" was officially developed by the European Commission in 2007, together with Family Institute Experts, according to Kirchdörfer (2011). Researchers described over time in different ways a "family business", by taking into consideration the age of the company on the market, in minimum 25 years, others referred to the percentage of the voting rights or according to Achleitner et al., 2008) and Arosa et al. (2010) the involvement of the family in the company's control. On the other hand, a family business is unique by its originality and its synergies, according Lindow (2013). Irrespective of the fact that family business can be private privately owned or publicly owned, the degree of family control and influence represents the demarcation line between a family business and non-family business (Klein 2000; Lindow, 2013; Zelweger, 2017). Notwithstanding, the family business is defined through the family ownership percentage, which is not important in the quantity, but more important is the ownership percentage over the voting rights seen as the quality essence tool over the strategic management decisions. Therefore, the involvement of the

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founder or family members on the board of the company brings a strong family influence over the business. Examples of successful family business from Europe are Jacobs, Roche Holding AG, Bauhaus AG, Sika AG, Hilti, Tiriac Holding, Bogart, Dedeman and others.

## 2. DISCUSSIONS

### 2.1 The family business concept

Private family businesses have a specific structure compared to public family businesses or non-family businesses. (see the Table no 1, “Shareholders structure in Private family business”). The ownership percentage over the shares is always 100% either by one single family (100% ownership over the shares) or a coalition of family offices (2-3 shareholders can have 100% ownership together). However, the family unique influence over the business implies a large amount of control over the ownership, the voting rights, the culture, the business and the transfer to the next generation.

**Table no. 1 “Shareholders structure in Private Family Business”**

<b>Shareholders structure in Private Family companies</b>	
Family business with more than one shareholder (all together 100%)	Family business with one shareholder (100%)
The shareholders can be any members of the family or several family offices or a foundation Not listed and no free float traded.  <u>Real Estate:</u> Reppisch Werke AG (CH, all shareholders are family members) Swiss Property AG (CH) <u>Others:</u> Lego A7S (75% family, 25% foundation)	The shareholder is a family, a Family office or one person (owner). Not listed and no free float traded <u>Real Estate:</u> Artemis Immobilien AG (CH) Hilti, Bauhaus, Bertelsmann. <u>Special Case:</u> Jungheinrich-Family owns 100% of ordinary shares and preferred shares are listed but without voting rights

*Source:* The Authors

According to F-PEC model realized by Astrahan et al., (2002); Klein et al., (2005), it implies three large dimensions on which the family exercises control over the business: the family (F) power dimension, the experience (E) dimension and the cultural (C) one. Later, Zellweger, (2017), extended the research to five characteristics: the amount of control, the complexity of family process control, the business activities, family philosophy and family history within the company. Based on the literature review and new research, the authors have adapted the processes of dimensions, which can be seen in Table no. 2: “Control in private family business”

**Table no 2. Control in private family business**

Dimensions	Characteristics	Challenges
Degree of control	<ul style="list-style-type: none"> <li>- Ownership control</li> <li>- Management control</li> <li>- Governance control</li> </ul>	<ul style="list-style-type: none"> <li>- 20-25% -50% all together 100%; voting rights very important</li> <li>- Involvement of the family</li> <li>- The traditional set of rules</li> </ul>
Amount of control	<ul style="list-style-type: none"> <li>- Number of family members control</li> <li>- Relationship identification</li> </ul>	<ul style="list-style-type: none"> <li>- Number of family members in the daily activities</li> <li>- Owner-manager; owner-other owner associates</li> </ul>
Business niche / Industry	<ul style="list-style-type: none"> <li>- Niche Particularity</li> <li>- Paternalistic culture control</li> <li>- Family members business experience control</li> <li>- Centralization</li> <li>- Decentralization</li> </ul>	<ul style="list-style-type: none"> <li>- Know-how</li> <li>- Authority</li> <li>- Competence of family members in business</li> <li>- Specific for the traditional small private family business</li> <li>- Specific for the private large family business</li> </ul>
Culture	<ul style="list-style-type: none"> <li>- Unique Pattern</li> <li>- Noneconomic &amp; Economic goals</li> <li>- Philosophy control; identity</li> <li>- History</li> </ul>	<ul style="list-style-type: none"> <li>- Unicity of each family business</li> <li>- Traditions &amp; Profit Maximization</li> <li>- Emotional attachment against profit maximization according to time horizon; communication styles and compliance</li> <li>- better influence and experience of family within the business due to the family longevity with the history</li> </ul>
Succession	<ul style="list-style-type: none"> <li>- Insurance of the business in heritage earlier plans</li> <li>- Avoidance of in heritage Risks</li> <li>- Plans for the business future</li> </ul>	<ul style="list-style-type: none"> <li>- Preservation of principles, traditions, leadership</li> <li>- Earlier rules and in heritage plans in place</li> <li>- Continuation of the main core business but focus on the second business pillar</li> </ul>

*Source:* the Authors, based on Astrachan et al., 2002; Klein at al., (2005); Zellweger, (2017), adapted according to the new author's research

## 2.2 Dimensions of family control

### 2.2.1. Degree of control

The degree of family control dictates the power of influence over strategic decisions. First, according to Astrachan et al. (2002) the power dimension is a direct tool seen a degree of family control over the business. There have been identified three characteristics of this dimension: the ownership, the management style and the governance over the business, (Zellweger, 2017). The ownership characteristic can be defined as the concentration of the business shares rather in one family, than in a considerable number of family's coalitions. In any case, there are multiple

examples when a family owns between 20%-50% or more and the other family members and/or associates, stay with the rest. Usually, when a private family business is led by only one sole shareholder, the control is better kept in one hand. On the other hand, it could be shown some conflicts regarding the minority stake regarding the ownership percentage, such as less degree of family influence or less access to business opportunities. However, the ownership high percentage is good, but better are the family voting rights over the strategic business decisions. (Zellweger, 2017) Business family management control represents the level of family involvement in daily business. The key to the success of the family management control is that family members should have the right management education, capabilities, and expertise for their roles in leading positions. On the other hand, also, external managers are chosen to be in management leading position (non-family managers), which represent an important factor and a challenge of the family in the same time, in understanding the goals, targets and culture of the family business, acting according to their philosophy and working and deciding together with the family members. More than that, the involvement of the family members will contribute later on to the smooth transfer in the heritage process. Specific for private family businesses is lean governance, which is characterized by the traditional management style and a clear set of policy rules within the company, which are often stricter than in non-family businesses.

*Hypothesis no 1: The higher family involvement, the higher degree of control*

### **2.2.2. The Amount of family control**

The "experience dimension," (Astrahan et al., 2002), or the "complexity control", (Zellweger, 2017), refers to the number of family members involved in the business control. The power of family influence over the businesses is for the paramount importance according to Bammens et.al., (2008). The degree of complexity comes out from the family structure shareholders, or from the Board and the Supervisory Board. The complexity stays in the relationship founder – CEO or founder – other founders associates in the same family business. In the case of one shareholder, the control is perceived as a traditional one in the relation between the CEO and the owner, especially for the small private family companies. (Example, there are cases when the founder of the business is also the CEO (such as Dedeman S.R.L.) Regarding the large private family companies, the degree of complexity can be measured through the reporting in front of the management boards and through complex number of owners (Example, 1-3 family offices, different ownership percentage, but altogether 100% ownership, having three different opinions and interacting at the same time with the CEO).

*Hypothesis no. 2: The more complex the shareholder's structure, the more complex relations Owner- CEO*

### **2.2.3. The business niche**

Every business niche has specific elements for each type of activity. There are a couple of elements that define the private family business according to the business niche. The private family business can be an investor with one single business, where the competence and know-how are focused on a single direction, having a centralized business set up (Zahara, 2004). According to Dyer (1988), the paternalistic culture reflects such a business set up, focused on power and control. Short et al., (2009), reached the conclusion that family business represents an organization oriented on authority, centralization and poor in power delegation.

In this case, the family business deals with reputation advantages, know-how and expertise through family members. By the opinion of Lindow, (2013), there are also large private family businesses perceived as entrepreneurs with different businesses (business portfolio). On the other hand, it is good in bad times to have a diversification of the businesses and another functional business pillar from where the cash flow is generating. But on the other hand, this involves a lot of financial risks, by managing an entire business portfolio.

Together with this comes the family expertise over the different businesses as well as the ability to realize the business dimensions and to involve external managers, experts in running the businesses in the specific sector. Their extensive experience collected from different organizations they worked for, in the business sector is highly appreciated. They are to be considered not affected connected to the business and more economical goal oriented. The business set up brings a decentralization structure, with different opportunities, compared to the core business, financial goals and risk-taking, missing of synergies, as well as the need for corporate strategy implementation and different operational board of directors.

*Hypothesis no. 3: The simple business unit, the centralized structure; the more business diversification, the decentralized structure.*

#### **2.2.4. Family business culture**

With the **strong involvement** of the family, the business receives overtime the unique pattern of the family, consisting of **values**, attitudes (Zahra, 2004) and a **set of non-economical and economic goals** (Zellweger, 2017). The uniqueness of each family supplies to their business the foundation consisting of strong believes, principles, trust (Vallejo, 2008), commitments (Koiranen, 2002), visions, missions, and **traditions**. From the time horizon, the **family pattern** embraces the business which comes with a set of economic goals, against the non-economic goals, whereas the synergies can be struggled at the beginning and rearranged and understood over time. However, the family cannot keep a business if the business doesn't fit with the family pattern; this is possible on the short to medium term and the business is planned for selling out. The time horizon of the business existence limits the family history within the business. The history of the family within the business means the longevity of the business over generations. (Such an example is Hilti company from Liechtenstein, a family business, founded in 1941, by Martin Hilti, which today is a global leader in its business niche).

The family philosophy control enhances the business decision-making process, which has influence with respect to the emotional attachment for the company against challenges for profit maximization. More, the communication style and compliance are strictly connected to the philosophy control. According to Zahra et al., (2008), the family business has much more structural, flexible and higher trust organizational levels. According to Zellweger (2017), the culture reveals another emotional aspect, the identity gap between family and business which concerns the family members, regarding the company's reputation and public image. There are cases when the family identifies themselves with the company, by having the same name, for example, and are interested more in the positive company's image on the market, directing some social actions for the community than targeting the profit of the business.

*Hypothesis no. 4: The more family involvement is possible; the higher the pattern of the family is transferred over the business.*

#### **2.2.5 Succession control**

Specific for the private family business is the long-term focus on businesses. The continuity of businesses represents the family orientation regarding all implications which may impact the decision-making process, according to Lumpkin et al., (2010). The Authors have identified three main characteristics of the succession dimension: **the insurance of the business** continuity, where the founder of the business must ensure that all the in-heritage plans are earlier enough in place, and the whole in heritage procedure will be followed accordingly, avoiding the **risk of blocking** the business activity. It is a large risk if the succession plans are not prepared early enough, as the family business activity can be blocked when no backup plan for a leadership position is existing or wrong management people are to be hired fast pressed by the time condition.

If the first generation developed the business in a positive way, then the heirs should be prepared to take over and keep the culture from earlier times. One of the longevity secrets of the family

businesses is characterized by the early education of the family members and their progressive implications in key positions to understand the business.

Another business succession aspect is related to the diversification of the business by the heirs. Besides the main core inherited activity and the good continuation and development of it, the successors should foresee the possible bad times in the future, when, for various reasons the main core activity can suffer a deduction in EBIT results or even a negative one. In this case, a secondary business pillar can support the family business survival, at least, for a while.

*Hypothesis no. 5: The sooner the succession plans are in place, the less risk of blocking the family business.*

### 2.3 Empirical Study on the family business control

A detailed questionnaire (Table no. 3, Questionnaire: Family control in business) was developed regarding the family business control analysis of the 5 key dimensions and their characteristics. The Questionnaire was sent to 50 private family businesses, out of which, 42 companies have answered back. The Authors present the Questionnaire

**Table no 3. Questionnaire: Family control in business**

<b>Degree of control</b>		<b>Yes</b>	<b>No</b>
1. Does the company use the instruments to control the family business?	x		
2. What is the management meeting frequency per week?	High	Medium	Low
3. Does the company has policies in place like investment policies, competencies policies?	x		
4. Does the company has external management in place?	x		
5. Does the company use management control?	x		
6. Is the family involved in the decision-making process?	x		
7. Has the company a consultant for controlling the business?	x		
8. In the case of a private family business coalition, the degree of control is better performed?	High	Medium	Low
<b>Amount of control</b>			
9. How many family members are involved in the business?	High	Medium	Low
10. How strong connection to the business the family members are?	High	Medium	Low
11. Do you have a compliance policy?	x		
12. How the company takes decisions about high investments? Do you have a steering committee in such cases in place?	x		
13. Taking a period of 3 months, what is the level the company to solve different opinions regarding investments >10Mio Eur	High	Medium	Low
<b>Business Niche</b>			
14. Is the business niche relevant to your success?	x		
15. Has the family business other business except for the main business core?	x		
16. Has the company a strategy to diversify the business today and to have more than the main core business?	x		
17. Are the family members qualified for the business niche?	x		
18. If applicable, what is the level of a new external CEO, in one year, to accommodate the family business?	High	Medium	Low
18. What is the level of the Family Authority?	High	Medium	Low

<b>Culture</b>			
20. What is the level of importance regarding family business culture and tradition?	High	Medium	Low
21. If possible, is the company prepared for new large acquisitions, >50 Mio EUR?	x		
22. Does the culture of the company be affected by large new company acquisitions?	x		
23. How strong your family pattern has been transferred in a business	High	Medium	Low
24. Does the company accept the external managers with new ideas that could be against the family values?	x		
<b>Succession</b>			
25. Does the company prepare earlier the succession planning of the family business?	x		
26. Do the children practice in the family business before occupying key positions?	x		
27. Is succession planning a big issue in the company?	x		
28. Does the Founder choose an outside expert for succession plan preparation?	x		
29. Do you prefer external managers to family members in higher positions?	x		

Source: The Authors

## 2.4. Results of the Questionnaire

From the sent-out Questionnaire, 84% of private family business answered. By analyzing the Questionnaire answers, the Hypothesis can be demonstrated with the following arguments:

*H1: The higher family involvement, the higher degree of control.*

The average percentage consisting of 50% was expressed by all 42 private families regarding the Management characteristics. The most important management degree control tool for them represents the involvement of the founder and family members in the daily business activities. The families like to control the business by participating and influencing the strategic decision-making process. Regarding the ownership percentage, an average of 30% uses as management tool control, but voting rights are much more important for them. Only 15% of the private family business uses Governance as the main management tool control and 5% referred to other control tools, such as management by external experts or by better experts in case of a family business coalition.

*H2: The more complex the shareholder structure, the more complex relations Owner- CEO.*

The average of the private family business expressed their experience with 40% number of the family members involved in the business, with a strong connection to the daily activities and decisions. Also, the shareholder structure is quite important, in the proportion of 30%, which results in the complexity of control coming from the coalition of the family business. The same level of the answers, 30% have been expressed regarding the complex control in the relationship between owner and CEO. By the presented percentages, the private family business is running with a high degree of complexity, especially when it's about a significant amount of investment. There is no doubt that the high number of shareholders has implications in the relationship between owner/owners (coming from a family business coalition – CEO)

*H3: The simple business unit, the centralized structure; the more business diversification, the decentralized structure.*

According to the percentage expressed by 17% regarding the particularity of the business niche, the family business admits that the business niche has relevance to be taken into account, but much more important is the family qualification, for the private niche where the business is running. In respect to the answers of their simple main core activity, 31% from the 42 answered companies have a centralized business system, where the control can be performed at higher standards, compared to 15% family owned business who owns, except their main business, also other different business. For such a business portfolio, the private family business uses a decentralization structure control.

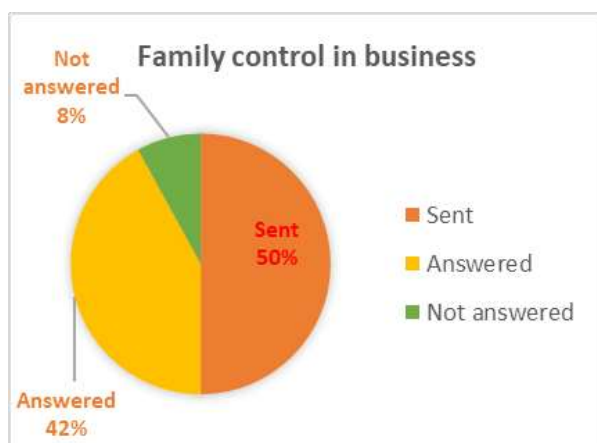
*H4: The more family involvement is possible, the higher pattern of the family is transferred over the business.*

50% of all company's answers have expressed their own importance regarding the family business culture. The family pattern has a huge impact on the business, with all the values traditions, beliefs, especially those which were formed back in history times (traditions, values, and others). For the private family business, an important characteristic represents also the economic goals, which were stated with an average of 30%. Although the economic goals are important, the companies expressed a low addiction to the new large company's acquisitions, which could be interpreted from the point of view of non-alteration of their own culture. Regarding the gap between family and business, it was expressed in only 10% from the economic point of view, being positioned much more important than the emotional attachment. The great involvement of the family members alter the business with their family formed a pattern over the years.

*H5: The sooner the succession plans are in place, the less risk of blocking the family business*

For the selected sample of 50 family business companies, 56% of the received answers expressed the positive result of earlier preparation of the succession plans and avoidance of the risk business blockage. Notwithstanding of the expressed percentage, 33% of the family business prefers external managers leading managers, which can be interpreted either as a business help during the education of the family members in the company, hereto, expressed with 11% or by the need of external experts for the business sector, with extensive experience.

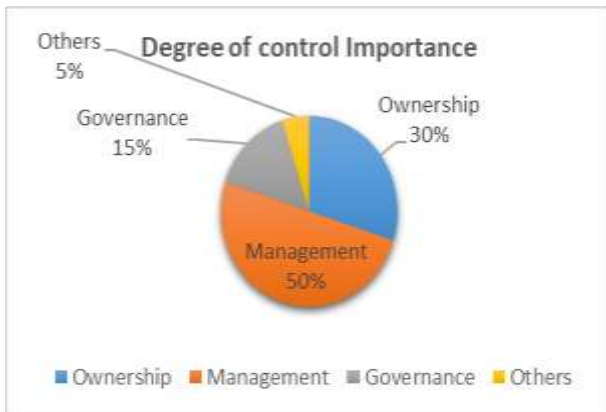
In Figure no. 1-5, "Results out of the questionnaire in family control", a short summary of the 5 main characteristics is shown to demonstrate the theory and the formulated hypothesis. 84% of the families stated clearly their addiction.



42 family business out of an eschaton of 50 families like to control the business.

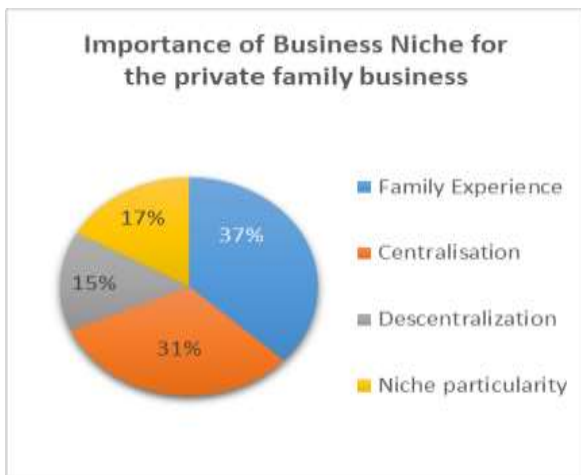
**Figure no. 1 Results of the Questionnaire regarding Family control in business**  
 Source: the Authors





Out of the Results of the Questionnaire, 50% of the family business answers are focused on the Management importance degree

**Figure no. 2 Results of the Questionnaire regarding degree of control exercised by the Family**  
 Source: The Authors



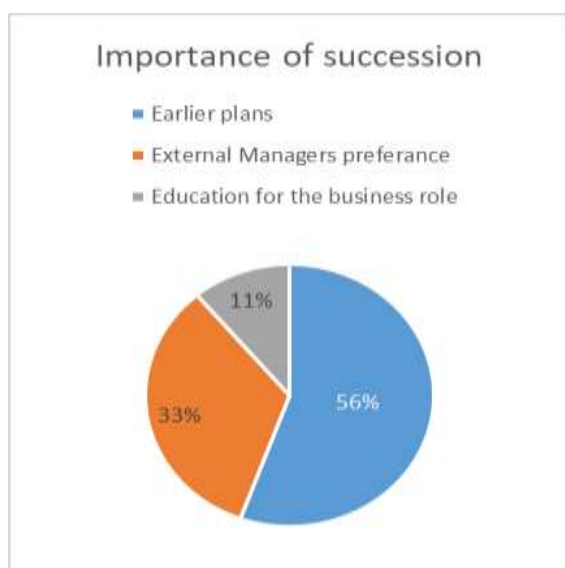
37% of the family business answers express the experience in the business niche, which leads to 31% addition to a centralized business system.

**Figure no. 3 Results of the Questionnaire in Family business regarding the importance of Business Niche**  
 Source: The Authors



Regarding the business Culture, 50% of the family businesses stated their pattern uniqueness oriented in the same time to economic goals expressed by 30% of the answered companies.

**Figure no. 4 Results of the Questionnaire in Family business regarding the importance of Business Niche**  
 Source: The Authors



56% of the answers reflected the importance of the earlier succession plans in place and 33% of the family business answers preferred the external management in case of force majeure.

**Figure no. 5 Results of the Questionnaire in Family business regarding the importance of succession**

Source: The Authors



40% of the answers expressed a percentage of 30% of shareholder structure, which indicates a high amount of business control from the family business.

**Figure no. 5 Results of the Questionnaire in Family business control**

Source: The Authors

### 3. CONCLUSIONS

By the natural set up of the private family business, the control is continuously performed. The business health and the organic increase are also one of the reasons for which the family business is much more risk averse oriented. The complexity in using the presented control business tools is dictated by the family pattern in protecting the reputation and identity of the family business, including the insurance of business legacy. The following dimension conclusions are

#### **Degree of control**

The degree of control that a private family exerts over the business is possible due to the usage of the following characteristics controlling tools: ownership, management, and governance. It is the nature of the family business to manifest a higher degree of control over the business, due to the family members involved in the organizational structure and the traditional hierarchical levels, centralized focused, in case of the companies with one main core activity or decentralized structure

for the companies with portfolio business. Based on the theory and results of the questionnaire, the business education of the family members is very important in the management involvement and supervision.

As the only shareholder (100%) or the shareholder coalition of more than two family offices, the ownership turns to be one of the first controlling characteristics of the business. The results showed a higher focus on the management controlling tool, whereas the influence of the family can be found in the strategic business roles. In many private family businesses, the external managers (non-family managers) are hired as CEO's or in other leading positions for their extensive capabilities. It will always be existing the challenge if those external managers will be fast accommodated with the family business culture and act according to the family's targets and goals. The family governance is mostly traditional, and lean performed, coming out of the family-specific behavior.

#### **Amount of control**

In a private family business, the amount equals the quantity control, referring to the family members involved in the business. In the centralized organizational structures, the business is easier to be supervised but complicated regarding the strategic management decisions dictated by the family members regarding the financial prosperity, but not so easy in the decentralized structures, where each type of business has its own organizational management board and specific departments. No doubt that the degree of control increases at the same time with the number of family members involved. The complexity control comes also in the case of the structure shareholder coalitions between more than one family business. In general, but especially in this case, the relationship between founder – CEO, either the CEO is family or non-family member it will always be stressed out by different reporting heads and their different opinions that the CEO must take them into account and face them.

#### **Business Niche**

Each Business is part of a specific niche, either it's about constructions or medical facilities business, private family bank or any other family business activity. Each business type has its own particularities as the results showed, but much more focus related to this aspect represents the qualification of the family or family members in understanding the niche, the actual and future needs of the business they are running in and to be able to control the business. Family expertise in the business sector is fundamental for business success. In this respect, the extensive expertise and the experience gained in different organizational cultures, in the business sector, highly recommend the external managers to be hired in key leading positions. More, the external managers are not emotional connection to the business, as the family and can be more economical goals oriented, but at the same time, more risk-taking. In the private family business, the paternalistic culture is much more represented by the family authority. According to the business set up, centralized or decentralized, the private family business deals with a poor delegation in terms of responsibilities.

#### **Culture**

The culture influence the family business because it comes with two elements: the pattern (traditions, believes, principles) and economic goals (maximization of the business). From the non-economic goal point of view, the family pattern should fit with the businesses they own and run, otherwise, the economic goal will be strongly affected by the weak development of the business until the closing of it. In addition, there is the risk of struggling with transferring the business over generations. The set of economic goals shows two aspects: the business continuity with a long-term historical development or short to medium term business development ending with an exit, e.g. to another investor. In this second case, family traditions and principles are weaker and not important for the family.

#### **Succession**

The long-term business orientation is one of the main characteristics which define the private family business. The private families like the organic development in the time of the business. If the business is healthy and mature, most likely the next natural business step is the succession plan

preparation. The succession is to be prepared from earlier times, starting with the education of the family members and finishing with the set of rules and roles for the heirs. The negative consequence of not having succession plans in place is defined by two major risks, consisting in the (1) blockage of the business, by not having at a moment in time a decisional leader unit and (2) the need under the force majeure to choose fast an external manager, which can come with another risk in fitting or not to the family culture. The succession represents the continuation of the business legacy, with a strong impact over the identity and reputation of the business. For the companies with one main core activity, the theory showed that financial legacy doesn't resist over 2<sup>nd</sup> generation, therefore the heirs should be prepared for the new times and new business dynamism of the market, influenced by various factors such as political and social changes, competitor innovations, or new trends in the business sector. It is always better to have developed the 2<sup>nd</sup> business pillar and to support the business by a parallel cash flow generation in case of negative EBIT produced by the main core activity.

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