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How is corporate governance influencing the innovation orientation  
of a Family Business?

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## Abstract

Family businesses are source of important innovation. The existing literature has made important findings on what are the drivers of innovation and on the idiosyncratic functioning of governance in family firms. However, little is known about the dynamics of the board of directors and top management with respect to innovation. This thesis will shed light on this relationship through a multi case-study of four different European companies. The thesis suggests following findings, namely that boards are active on innovation, that management is involved in shaping a board and innovation departments improve the innovation efforts of a family business.

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**Key Words:** Innovation, board of directors, CEO, innovation department, agency theory.

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## 1. Introduction

Family businesses can be found in every corner of every street, from the most densely populated cities to the most remote areas of the world, they are quite literally ubiquitous. There is widely available literature on family businesses on how they become more risk averse as they get older (Patel and Chrisman 2014; Gómez-Mejía et al. 2007). Multiple scholars also have researched what the role of the board of directors is on a family business (J. Davis, 2007; Pindado & Requejo, 2015). However, little has been researched on how governance can influence innovation inside a family business. As Calabrò et al. (2019) mention in their systematic review on innovation in family firms, the relationship between top management and board of directors on innovation is being overlooked. Furthermore, the author has a personal interest to better understand the underlying dynamics between the board of directors and the top management with respect to innovation in family firms.

To understand these dynamics, the author interviewed a CEO and, or a board member from four different family businesses coming from Belgium, Germany, Luxembourg, and the Netherlands. This multi-case study will allow, to not only fill the mentioned research gap, but also set up clear examples on what is and what is not, an effective board that helps to drive innovation inside a family business with the ultimate goal to continuously be an attractive actor in the market in the future.

The thesis concludes three important findings for management practitioners. First a board of directors should be granted access to the decision-making process of innovation projects. Second, top management plays an important role in selecting the directors that will constitute the board. Third finding concerns that innovation is more effective when a business has an innovation department or innovation team. These findings allow a first discussion and should incentivise for further research on the subject of how top management and board of directors interact on the subject of innovation.

## 2. Literature review

### *Family business*

There have been a multitude of articles, books, and journals on the topic of family businesses. Their predominance inside the economic tissue cannot be understated. In the German economy, where the “Mittelstand” represents about 58% percent of the businesses that generate more than 1 million € in revenue per year, are family businesses (Klein, 2000). In Belgium 83% of all businesses with five or more employees are considered to be family businesses (Jorissen et al. 2005). In Luxembourg it is considered that about 70% are family businesses and for the Netherlands it is about 74% (Alderson 2011). In general, the topics discussed in the literature vary from: generational transition and how that generational involvement impacts the family ownership (Pittino et al. 2020), over to the role a family has on innovation (de Massis et al., 2015; Muñoz-Bullón & Sanchez-Bueno, 2011; Nieto et al., 2015) and as well about the family governance (J. Davis, 2007) to mention a few. Despite an already important amount of research, scholars have had difficulties to agree on a single definition on what constitutes a family business. As Siebels and Zu Knyphausen-Aufseß (2012) comment in their literature review, definitions do vary so widely that it impacts the academic understanding of how important the role family businesses play on the wider economy. According to de Massis et al., (2015) the character of every single-family business on how it functions and operates is very unique. This makes it difficult to generalize what a family business really is about, hence, scholars tend to disagree on definitions.

Although scholars have not reached a common definition on family business, the following concepts do seem to be recurrent such as size of ownership and control, transition of ownership to a next generation, and family control over multiple generation. As these various dimensions are cited by different authors in their definitions of family business, it seems natural to follow the definition of Chua et al., (1999) because of its holistic character that seems to embody the

idiosyncratic nature of family firms. “*The essence of a family business consists of a vision developed by a dominant coalition controlled by one or a few families and the intention of that dominant condition to continue shaping and pursuing the vision in such a way that it is potentially sustainable across generations of the family*” (Chua et al., 1999, p. 25).

#### *Innovation and how it takes form in a family business.*

The word innovation is ubiquitous. It can be found in business, in politics, and in arts to mention a few (Stoneman 2016). To narrow down its field of application we are going to discuss innovation in the context of business, which according to the Organisation of Economic Cooperation and Development (OECD) has been defined as follows: “*Innovation is the implementation of a new significantly improved product (good or service), or process, a new marketing method, or a new organizational method in business practices, workplace organization or external relations*” (OECD, 2005, p. 46). This broad definition leaves however some open questions, such as “How to measure innovation?” And “Why is innovation relevant for family businesses?”

Starting to answer the first question, we find various scholars who discuss that the measurement of innovation can follow two different methods. The first one is the input that a firm provides for innovation. According to Crossan & Apaydin, (2010), input on innovation is measured on various aspects such as the amount of money that is provided for R&D or the number of ideas that have flown into the innovation process. The second method is based on innovation output. It counts the number of patents registered, or even the sales size of the new products launched with respect to sales of the existing product lines (R. Adams, Bessant, and Phelps 2006). The two methods englobe about 259 performance indicators that were identified by Nappi & Kelly, (2022). This level of detail shows that measuring innovation is a complex topic. However, that level of detail is out of the scope of this thesis. Thus, and to simplify for the research, we will

content us ourselves with the fact that a family business has or not an innovation department and how that impacts innovation.

The second question is why innovation matters for family businesses. In general, scholars agree that innovation gives companies a competitive advantage (Tu and Wu 2021). Thus, one could assume, because family firms being so ubiquitous in the economic tissue, that they are very innovative. The literature, however, does not support a consensus, to what extent family businesses are more, or less innovative than non-family businesses. Muñoz-Bullón and Sanchez-Bueno, (2011) expose both sides of the discussion. The elements that speak for more innovation from family firms are their capability to invest with a long-term perspective and their direct involvement into management will help them to invest more into R&D. The aspects speaking against, are often the limited access to capital, due to the preference of family firms to finance themselves with equity rather than taking-on debt. The agency costs, mainly altruism & nepotism, that they incur. And finally, their risk-taking behavior where family firms are concerned about their wealth and thus reluctant to take on higher risk investments.

De Massis et al., (2015) takes this discussion between scholars a step further and lays out two distinct sets of paradoxes that family businesses face on innovation. The first paradox discusses the development of internal innovation being costlier than leveraging on existing external knowledge (Chesbrough, Vanhaverbecke, and West 2011) which in turn tends to be more reliable than the internal development. However, family firms are afraid to enter an open innovation process because of their strong concerns about potential loss of control (Gómez-Mejía et al. 2007) and therefore the tendency to purchase external knowledge is low. The paradox here is the fact that family firms “*have a superior ability to identify opportunities and acquire knowledge from outside their boundaries because of their non-economic goals, long term orientation and discretion to engage external stakeholders*” (de Massis et al., 2015, p. 8). The second paradox is about the ability of the business to adopt innovation. According to the

sociological models of innovation diffusion, they suggest that the decision to adopt innovation is characterized through high uncertainty (Burt 1987). In other words, companies fear how their specific innovation will play out, even when elements such as cost of purchase, utility or even customer reports are known. This translates into family firms being less open to adopt innovation because of the risk of loss of control. The paradox to adopt innovation is that because of a family's discretion i.e., "*personalized control*" that lowers the barriers of adoption, in other words their actual involvement into the business, allows them to implement more easily an innovation (König, Kammerlander, and Enders 2013).

To fend off these paradoxes, de Massis et al., (2015) propose a framework, that establishes a triangular relation of the family willingness, family ability as discretion and family ability as resource. This triangular relation has to fit into the triangular relation between the locus of innovation, approach to innovation management and type of innovation. De Massis et al. (2015) call this fit between family and innovation process, family driven innovation (FDI). The framework works as follows, the family first decides where it is heading with the business (Chrisman et al. 2012; Kotlar and de Massis 2013), then how can the family achieve that goal (de Massis et al. 2016), and does it have the resources it needs to achieve this goal (Hambrick and Finkelstein 1987; Finkelstein and Hambrick 1990). If these points match with the concept of what to innovate, how to innovate and with which resources, then the family can overcome the paradoxes identified previously.

### *Governance in Family Business*

Governance of a business has a clearly defined mission, which is to align the interests of shareholders and managers. Scholars have agreed on the definition of corporate governance by the European Central Bank (ECB) which defines it as "*Procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the*

*organisation – such as the board, managers, shareholders, and other stakeholders – and lays down the rules and procedures for decision-making” (European Central Bank, 2004, p. 219).*

### *Agency Theory*

Corporate governance as a topic has emerged out of agency theory. This theory is built around the idea that humans act first in their self-interest to maximize their utility (Smith 1776). In other words, managers (agent), who act on behalf of shareholders (principal), face conflicts of interest, when they are not aligned to the interests of shareholders (Smith 1776). If no mechanism is put in place, then the interests of managers inside a firm may not necessarily converge with the ones of its owners (Shleifer and Vishny 1997; M. Jensen and Meckling 1976). Therefore, the goal of the agency theory is to provide a successful contract that manages this “negative” relationship in the most efficient way possible (Eisenhardt, 1989) and converges the different interests between managers and shareholders (M. Jensen and Meckling 1976). In the case of corporate governance, that would translate into a mechanism that monitors the work which has been delegated from the shareholders to the managers (Shleifer and Vishny 1997; M. Jensen and Meckling 1976).

In the case of family businesses, it is considered that the conflict between managers and shareholders is less of a problem. However, agency theory is more related to majority and minority shareholders, also called principal-principal theory (M. C. Jensen and Meckling 1976). Agency problems can arise in cases of shareholder entrenchment (Bae, Kang, and Kim 2002; Bertrand, Mehta, and Mullainathan 2002; Bertrand et al. 2008; Douma, George, and Kabir 2006), parental altruism or intra-family conflicts (Lubatkin et al. 2005; Schulze, Lubatkin, and Dino 2003; Lester and Cannella 2006). Thus, we could ask ourselves if the board’s role of monitoring is effective at all, and if it should rather take on a role of advisor? In general, with active family shareholders inside the firm, the role of supervision of a board of directors decreases (Mustakallio, Autio, and Zahara 2002). (We will see in the next section

what a board of directors is). And according to Mustakallio et al., (2002) and (Gomez-Mejia et al. 2011), the goal of a board of directors inside a family business is to harmonize and enhance the direction that the different family shareholders want to set. In other words, the board acts as a mediating and advising body between top management, family shareholders and potential minority shareholders, to set the direction that the business will be taking and putting in place common long-term (and short-term) goals. Agency in family businesses is important to take this point into consideration because, governance should harmonize the interests of each party.

### *Board of directors*

As indicated in the definition of the ECB, there is a governance mechanism that acts as nexus between shareholders and management. This thesis will base itself on the board of directors. According to the book “The Board of Directors” by Croci (2018), this body is an independently selected group of directors, by the shareholders. First and foremost, the board appoints the CEO of a company, who will build the link between the board and the top management. The literature then diverts to what the extended role of the board will be. In essence, there are two streams in the literature which help us define the role of the board of directors. The first stream considers that the directors’ sole role, is monitoring the work from the management of the firm. This role has clearly derived from the agency theory as discussed above and is defended by more conservative and purist scholars (Cornelli, Kominek, and Ljungqvist 2013; Monks and Minnow 2011). There is a certain downside to this oversight as it tends to pit the overseeing party against the overviewed party. The second view broadens the role of the board to monitor and advise the management of the firm (Monks and Minnow 2011; Renée B. Adams and Ferreira 2007). This latter view tends to “unite” the opposing parties, as they set common goals to achieve for the company. And where the board can then monitor if the management is achieving these set goals. With respect to our research question, it is crucial to find out if the board plays a role in the innovation process, which would be a pure advising role. As the second

view weighs more for this thesis, we will dive deeper into understanding how it originated and why there are two different views on the role of the board of directors.

Since the first articles on the role of boards appeared, which mostly focused on monitoring, directors repeated that they also actively advise the top management on company strategy (Demb A. and Neubauer 1992; R. B. Adams 2009; Renée B. Adams and Ferreira 2007). In more recent years, (R. B. Adams 2009) the research went a step further and identified that directors place more effort and time on advising the company in their strategy than actually monitoring the top management. However, to be able to provide the right advice, the directors require good and trustworthy sources of information. Thus, the apparent question is, how is it possible if agency exists, that directors are receiving the right information? Adams and Ferreira, (2007) concluded that the CEOs are willing to withhold information if it will harm their position (conflict of interest), if the CEOs know that the board is actively and solely monitoring their work. This point illustrates quite well the agency theory. However, in the case that the board is less stringent on their monitoring role, Adams, and Ferreira (2007) identified that CEOs will be more willing to share crucial information (regardless, if that will harm them or not), and thus the quality of the advice will increase. In other words, the less that the CEO and his team feel that they are being monitored in their work, the more open they will be with sharing information with the board, and the better the quality of the advice will be.

### *Board systems and board composition*

The next question we should ask ourselves, when does a company need a board and how should it be composed? There are a few points to cover here. The first one is that a board becomes a legal requirement as soon as a company is publicly traded. Then there are two different types of boards, one-tier (Anglo-American system) and two-tier (German system) (Croci 2018). One-tier typically covers the supervisory and the strategic responsibilities that the board of directors take, and it is composed of independent directors and members of the top management of the

company (Belot et al. 2014). Two-tier on the other hand, and as the name indicates, separates the role of strategy and supervision into two distinct boards. The strategic role is taken on by the top management and the supervisory rather by independent directors (Crocì 2018). However, as the top management reports to the independent directors, the difference in practice is not significant and both models are represented in all major advanced economies (Belot et al. 2014). For this reason, we will not make a difference between both types in this thesis.

In terms of board composition, there are two types of directors: dependent directors and independent directors. In the case of a family business dependent directors are considered to be top management and family members. The dependent director tends to have a greater conflict of interest, especially in terms of supervising the role of the CEO and his team. It can engage higher agency costs, which in the family business translate in altruism or entrenchment. This can be when the business takes over private expenses of the family, employs family members that are neither fit the right profile for the role or provide salaries for members who do not effectively work. On the other hand, independent directors are defined as persons that are neither active in the business (other than the board) nor family members. Their profile tends to have an expertise in a topic, related or important to the company. The effect of being independent allows the members not only to use their expertise and better advise the business but as well to fulfil its mission in supervising the business. Furthermore, in a study conducted by Schwartz and Barnes (1991), where 1100 family firms were asked about the effectiveness of board meetings, 91% agreed that meetings tended to be more effective with outsider members i.e., independent directors. Finally, according to Crocì (2018), there is no exact number on the most effective size of a board. Yet, there is a consensus, that a small number of members in a group tend to find it easier to take decision and effectively fulfil their role. This view of small boards is supported by the negative correlation between board size and firm value (Yermack 1996; Jenter, Schmid, and Urban 2018; Hermalin B. E. and Weisbach 2003).

### 3. Methodology

#### *Multi case approach*

Having explored the different theoretical models of family businesses with respect to innovation and governance, we will try to understand practically how the board of directors intervenes at the level of innovation inside family firms. To understand this intervention, we need to look at the relationship between the board and the top management. Relationships are difficult to quantify, especially in the case of agency theory, as it relates to how information is shared, how decisions are taken and how those result in an outcome. Furthermore, and to be able to assess the way that a board of directors impacts the innovation process of a family business, it becomes apparent that a discussion needs to be held with active members of boards and top management. For this reason, the research was conducted based on qualitative data.

The research format chosen, is a multi-case study analysis. As established in the introduction of this thesis, the identified research gap evolves around the nexus of the board and its impact on the innovation point of a family business. The literature has intensively researched the role of boards (Siebels & Zu Knyphausen-Aufseß, 2012) and how family businesses tend to become more risk averse (Cassia, de Massis, and Pizzurno 2012). However, it has not been evidenced that governance can or cannot help a family business keep their competitive advantage. And as Calabrò et al., (2019) suggest for of further research, to understand the nexus between governance and innovation inside family businesses. The different theoretical elements such as agency theory, family driven innovation are deeply researched models. It makes sense to explore them from a practical side, how they entwine through a multi case study, where we will be using the Eisenhardt Methodology (1989).

The multi case methodology puts concrete real-world cases at the centre of theory building, where the idea is to extrapolate data from “extreme” scenarios. The inductive approach from building theory out of case studies follows a systematic path, that has been set and developed

in 1989 by Professor Eisenhardt K. Before diving into its construct, it is important to note that this generally accepted methodology, follows the criteria of any research methodology by accepting replicability, objectivity, and generalizability.

The steps to conduct a multi case study are quite straight forward. It starts with identifying a research question that is broad enough and open to build theory from case exploration.

### *Case Selection*

The case selection is a crucial step because it will define the basis where the data is collected to build the theory. As Eisenhardt (1989) develops in her methodology, all the cases should have a set of common antecedents, because they should be comparable from their starting point. This becomes part of the element of replicability that every research and experiment should have. In the case of this thesis the common ground was set by the criteria metric below. The author selected two variables that are innovation and agency theory which are measured using the criteria bellow (see table 1). The first criteria are if the company has some form of innovation department or not. As mentioned in the literature review, innovation has been left as broad as possible. The second criteria are if the company CEO is either a family member from the owning family or not. The idea is to evaluate if the difference between the CEO being a family member or not impacts agency theory.

<b>Variables</b>	<b>Proxy to measure</b>
<i>Innovation</i>	Innovation Department or R&D Budget
<i>Agency theory</i>	Family member CEO/ C-level

*(Table 1: List of case selection criteria)*

Based on these criteria points we have selected four different companies (see table 2). Companies A and B have a form of formal innovation team. In essence A has, what it calls an “innovation centre” and Case 2 has what it calls “project process management team”. Case 3 and 4 do not formally employ a form of innovation centre. In terms of family vs non-family

CEO, Case 1 & 3 the CEO is a non-family member and in the case of Case 2 & 4 the CEO is a family member.

		Case nb.	Industry	Founding year	Nb. of employees (2021)	Yearly revenue (2021)*
<b>Innovation team</b>	<b>CEO non-family</b>	Case 1	Machinery manufacturing	1919	350	€ 80
	<b>CEO family</b>	Case 2	Food and Beverage wholesales	1935	3.975	€ 1.898
<b>No Innovation team</b>	<b>CEO non-family</b>	Case 3	Food and Beverage retail	1928	32.966	€ 10.049
	<b>CEO family</b>	Case 4	Food production	1704	71	€ 59

\* In million

(Table 2: Selected cases)

Case 1 is a German machine manufacturing firm. In 2021 it employed about 350 people and earned 80 million € in revenues. The business was founded in 1919, and it is a highly knowledgeable firm in the production of machines specialized for pressing pharma products. The business is owned 100% by one family, who today amount to about 10 shareholders. Case 2 is a Dutch wholesale and distribution company in the food & beverage industry. In 2021 it employed about 3.795 people and made 1.898 million € in revenues. The business was founded in 1935 by a Dutch family, today still holding about 30% of the shares, whereas the other 70% are either held by employees or free floating on the Amsterdam Stock exchange. Case 3 is a Belgian food retailer. In 2021 it employed 32.966 people and made 10.049 million € in revenues. It was founded in 1928, and it is still owned 100% by one family with about 100 shareholders. Today they have more than 700 stores in Belgium, Netherlands, Luxembourg, and France combined. Case 4 is a Luxembourgish flour producer. In 2021 it employed 71 people and made 59 million € in revenues. It was founded in 1704, and it is owned 100% by three different families with the number of shareholders undisclosed. They are specialized in end consumer flour products and started to diversify their activity into plant-based meat. They are an important stakeholder to the Luxembourgish agriculture and bakery business.

### *Data collection & participants*

For this thesis we have focused the data collection on semi structured interviews with the either CEO and or a board member. The content of the interviews has been juxtaposed to any available secondary information such as financial reports, family charters or online information. Triangulating the information gathered from different sources is important to keep objectivity and provide replicability (Yin 2009). Finally, and important to mention, the interviews have been conducted on a strictly confidential level. There are multiple reasons to set the interviews as confidential (Baez 2002). There are however two key reasons that motivated this decision. First, it is the fact that family businesses tend to be more secretive (Davis P., 1983). Thus, through a confidential discussion, the hope is to have a familiar and honest picture of the situation inside the family business. Second, respecting the privacy of any person being part of a research is at the heart of a researcher's DNA (Baez 2002). For these two reasons we have opted for the data to be collected confidentially.

<b>Interviewee</b>	<b>Case n.</b>	<b>Position</b>	<b>Family Member</b>
Interviewee 1 (I1)	Case 1	Board member	Yes
Interviewee 2 (I2)	Case 1	CEO	No
Interviewee 3 (I3)	Case 2	CEO	No
Interviewee 4 (I4)	Case 3	Board member	Yes
Interviewee 5 (I5)	Case 4	CEO	Yes

*(Table 3: list of interviewees)*

In total we interviewed five different persons coming from the four companies (see table 3). Interviewee 1 (I1) is a board member in Case 1 and one of the family shareholders. Our discussion was conducted in German. Interviewee 2 (I2) is the CEO of Case 1. I2 is married with I1 but does not own shares in the company. Our discussion was conducted in German. Interviewee 3 (I3) is the CEO of Case 2. He does not own any shares of the business and is not a member of the owning family either. Our discussion was conducted in English. Interviewee 4 (I4) is a board member of Case 3. He is a family member of the owning family and

shareholder. Our discussion was conducted in English. Interviewee 5 (I5) is the CEO of Case 4. He is also a family member of one of the three owning families. Our discussion was conducted in Luxembourgish.

#### *Data interpretation*

The interviews were recorded for the interviewer to better concentrate on the discussion and follow up on points that remained unclear. The discussion was translated into Luxembourgish and German when necessary and transcribed based on these recordings. Based on these transcriptions we picked the most relevant quotes from the interviews. The Eisenhardt methodology does not specify any method for qualitative data interpretation (Eisenhardt 2021). It specifically notes that “it is both the most difficult part and least codified part of the process” (Eisenhardt, 1989). We will therefore use a methodology from the Applied Behavioral Sciences where Gioia, (2021) built a framework which looks for similar patterns among the qualitative data. The idea is to set a second order meaning from each quote, and then extrapolate to an aggregate dimension. These data interpretations will be shown below in our section findings.

#### 4. Findings:

The interview questionnaire (Appendix 1) was divided into three topics. The first covered agency and how the board and top management interacted and exchanged information. The second topic was on innovation in general, how the company perceived innovation and what their latest exploits were. The third and last topic was how family and board influence innovation inside the business. The findings will be organized accordingly.

#### *Agency – Family trust and CEO’s market knowledge*

In the discussion with the family CEO’s and their respective board members, trust was the word that emerged very often. “I have trust into the decisions that the chairman takes” (Case

3) or “the board does hand me out important trust on the day-to-day decisions” (Case 4). This finding is strongly linked to the extensive market knowledge that the CEO tends to have. “The board does not have the market knowledge, however, I [CEO] have a good understanding of our customers’ needs and what the market tendencies are” (Case 1). The CEOs have mentioned that the trust increases when the board is part of taking decisions with respect to company strategy. “When the decisions taken result to be beneficial to the company, then the trust of the board remains intact” (Case 1). In the financial report of Case 2, they state that “As the Supervisory Board, we believe that the Executive Board has succeeded in finding a balance between, on the one hand, the issues and initiatives for the years up to 2025 and, on the other, making conscious preparations for the phase thereafter” (Case 2).

Taking the idea, a step further, CEOs tend to feel this exchange of information as the board’s role to not only supervise but as well to show interest in the business. “Our Agenda is set in common between the chairman and myself [CEO]” (Case 2). This point is even more emphasised by board and CEO when a decision needs to be taken with the agreement of the board. These “information sessions” tend to take place in an informal exchange. Which leaves the agenda of the formal board meetings to be set mainly by the legal requirements that a board needs to fulfil. However, it happens on a yearly basis, in the more progressive companies they “discuss a topic that has been required by the majority of shareholders”, and where “CEOs share information based on the questions and interests of us as shareholders” (Case 3). In Case 4 the sharing method on how information is shared with the board is strongly regulated in their family charter.

In the case of non-family CEOs, independent directors are either in place or strongly wished for. Independent directors believe in the idea that the role of the board is to monitor and advise. This vision is shared from the family CEO’s point of view. The non-family CEOs mentioned two reasons for having independent directors. First reason being that as the board should not

only be supervising but also fulfil the “function of advising, [where] it needs to consist of a more heterogeneous population” (Case 1). The second reason being that independent directors tend to act more as “mediating factor between board members representing the family and the CEO being non-family” (Case 2).

#### *Agency – Board constitution and role*

Agency dynamics present themselves differently when the CEO is a family member or not. In the first case, directors are appointed as a combination between their capacity and for being a family member. Various reasons were mentioned for setting this secret environment. First due to the “lack of trust the family holds towards outside people” (Case 3 and 4). Second, the “family members feel that outside people lack commitment” (Case 3). However, it has been mentioned by Case 4 that having outside directors would allow external input, which can have a positive aspect in terms of advisory. They do hold the possibility in their family charter to include outside members to the board should it be needed.

Board constitution also requires nomination of directors. In all the observed cases, the procedure is legally established to follow a vote by the shareholder assembly on who will sit on the board. However, in real life, the four companies that we interviewed mentioned that the “directors are appointed in common agreement by the chairman and the CEO” (I4 and I5). The main reason why this happens is that the “Chairman and myself [CEO] need to have suitable working partners” (I3) (i.e., the board member should be a good sparring partner). Thus, appointing a figure allows them to control who joins the board and not, in order to preserve stability and confidentiality.

A common trait between all the CEO’s is that they feel that “any decisions taken by them they are backed by the board” (I3). The CEO’s mentioned that this feeling tends to arise after a topic has been analysed and discussed. Board members showed the same direction by adding that “having a board of proximity and small size” (I1) tended to increase intercommunication

between the CEO and the board. They felt that this support and proximity allowed for greater agility in agitated times.

#### *Innovation – Innovative company*

The general innovation questions, started with a personal company appreciation, if or not it considers itself as being innovative. This has been answered with a firm yes, regardless, if or not it operated a centre helping internal innovation to sprout. This can also be confirmed from a firms' longevity point of view because all of them are in business since four generations or longer.

#### *Innovation – Innovation driver*

An important differentiation emerged between who and what is the innovation driver of the company. There are three kinds of innovation drivers, that are not mutually exclusive one to another. The first driver being the market, which serves the customers' needs. The second driver concerns companies' need to survive, and thus has a long-term attitude on innovation. The third and final driver is the innovation department, which employs a systemic review and approach to transform ideas and projects into reality.

Starting with the first driver, it concerns mainly product innovation and looks to satisfy customers' needs by providing new or improved solutions. Various respondents talked about fulfilling the needs of their customers, either by understanding market dynamics or, as Case 4 laid it out, "we provide innovative solutions for our customers which they did not think about previously". By providing a novelty the company becomes a market trend setter, where "the competition very often follows our path" (Case 4).

A second driver of innovation is the long term view a company takes. This was mentioned by a few interviewees who either have "no R&D budget per year, we rather have an opportunistic approach" (Case 1, 3 and 4) or take a "long term attitude on innovation [...therefore...] projects

take a lot of time to get reality” (Case 2). The opportunistic approach has however allowed for these companies to survive in the past and adapt towards new business models. Such as the examples of Case 1 and 4. Both had important moments in their long history and where in the 1980’s where a new product line opened and today this has become their main source of business. And for example, as Interviewee 5 said, “we would not exist anymore if we had not changed from animal food to flour production”.

The third driver is the innovation department. For this thesis, the author interviewed two companies having an innovation department and two not having a formal innovation department. In the first situation, Case 1 and 2 have an “innovation centre” respectively a “process progress management team”. In both examples the interviewees discussed “the efficiency of the implementation” (Case 1), both shared a sense of trust towards their teams and finally both CEOs mentioned not being “the drivers of innovation” (Case 1 & 2). Concretely in Case 1, the CEO mentioned that he participates “in the commercialisation efforts, but in technological part I let the engineers do their thing”. In Case 2, “there is not one person driving innovation [alone]”. In the experience of Case 3 and 4, we will see further that the companies by not actively having an innovation department say they need to implement one, as the CEO of Case 4 says, “we have reached a size where I need to delegate more the innovation to our middle management”. And even in the example of Case 3 it is considered a risk to have a “top down only, innovation driver”.

#### *Innovation – Active role of CEO and board on innovation*

Inside the different Companies we saw that the CEO and the board take a more or less active or passive role on innovation. In the cases where there is no innovation department, “I [the CEO] am the driver of innovation” (Case 4). This imposing figure takes an exaggerated role in Case 3, where the chairman has become the main driver of innovation “our chairman is very creative and visionary, he is the main driver of our innovation”. The board member considered

this to be a risky approach, especially because “today the chairman is a visionary, but the following to come might not be”. In the examples of Cases 1 and 2, the CEOs depend more on their innovation department and thus play less of a centric role in the innovation project. As Interviewee 2 says “I do not have the technical expertise to provide any ideas or hints regarding innovation”.

### *Role of board to challenge innovation*

In Cases 1, 2 and 4, our interviewees have all agreed that the board does not take an active role in the innovation process. Two reasons have emerged from our interview process. The first reason is because the board has a mandate to actively monitor the work of the top management. The second reason is that the board lacks the market knowledge and often lacks the knowledge day-to-day activity of the company.

The first reason is the controlling function of the board. Our interviewees have identified two main streams how the board can exercise control. The first one is that the board tends to challenge the CEO. This can be seen, in discussions where the CEOs often have to clarify to the board, the projects in question. In Case 2 we have a clear example where the CEO mentioned “it is good that the board challenges us, because if the owners think we are taking too much risk [they need to challenge that]”. In the example of Case 1 and 2 the board has a clear supervising role which is acknowledged by the CEO. Interviewee 2 mentions that the function of the board is to control the management and interviewee 5 mentions that “we defined in our charter that their [the board] role is not to lead innovation but to challenge it”. Together with the role of challenging the management the board in the end formally signs off major innovation projects. Thus, a CEO and his board need to find an agreement. Case 4 solves it by “finding a consensus”. In the four companies this is done by discussing a project in depth, with the final goal to find a consensus between management and shareholders.

The second reason relates around the board's trust in the CEO in what concerns company management and the board's lack of market knowledge. Case 1 and 4 do not have an active tracking of innovation projects. These companies entrust the project to the CEO to execute it. However, the CEOs need to let the respective boards actively challenge the projects prior to signing them off if they want to continuously receive the trust from their respective boards. The CEO sees it as "important because it allows me to have a confirmation that I am doing well my job" Interviewee 5. The board sees it as equally important because we "feel included into the process of our company's evolution" Interviewee 1. In Case 2 and 3, the challenge is more institutionalised on the progression of the innovation project. Top management defines a set of KPI's which the board follows. In both cases there is either a "monthly follow up on the innovation process" (Case 3) or "the board receives a monthly report from CEO and CFO with all the KPI's and financial results and if they have any questions, we meet up to answer those" (Case 2).

## 5. Discussion

This thesis contributes to the literature on innovation and board dynamics in family firms and bridges both topics. **The findings of this thesis are in relation to observations already made by previous scholars. In some cases, the findings of this thesis extend the theory that the literature provides.**

In terms of innovation, Tu and Wu's (2021) finding that innovation helps a company to be more competitive, is found in all the observed cases. The cases used for this thesis all faced at their own moment in history, decisions on innovative products, in order to remain relevant for their customers. This point is also supported by the current efforts of these companies to innovate on new products and processes that will allow them to differentiate from their competition.

De Massis (2015) provides the family driven innovation (FDI) model. He builds his model based on the paradox of families using outside and inside knowledge, as well as the paradox on implementing innovation. The **findings list three drivers of innovation for companies, where two drivers follow the FDI model.** The first driver, which are customers and market, do require that the family and the company formulate the direction that they want to head, to fulfil their customers' needs. FDI tells us that the formulation of the direction that the company takes and subsequently the innovation needs to be aligned. For this to happen shareholders and management need to formulate a direction based on the input received from the market and their customers.

**The second driver of innovation can be explained using de Massi's (2015) model on FDI,** is the use of an innovation department and is directly linked to the argument above. We see in our findings that the department can help to structure the innovation process. As de Massis explains, the structure is important because it will help the family and the business decide how to innovate and what resources to use. The innovation department brings structure into these questions on innovation which helps the management and shareholders to be aligned in the direction they will want to take.

**The third driver of innovation,** which is the opportunistic approach, **elaborates on Muñoz-Bullón & Sanchez-Bueno, (2011) theory about the limited capacity to invest into innovation and their long-term attitude towards their investments.** As it was mentioned by various companies, they do not have a budget for innovation, rather they focus on opportunities that arise or not. This point is supported as well by the more or less, small structure around innovation that the four companies tend to have. All of them have mentioned that by preferring flexibility over rigidity, they can stay competitive and that concerns the innovation part as well. **This point is important when establishing a board because the family or management should allow the board to react on opportunistic solutions.**

The second element to discuss in the findings concerns the structure of a board of directors, and the role that the board and the CEO play on the innovation process. **The literature review of this thesis discusses agency theory and how agency impacts a family business. It discusses the structure and role of the board of directors in family businesses.** The findings of this thesis can be explained using these theories as well as extend some results.

Starting with the structure of the board of directors and based on the findings, the families' trust toward the CEO is based on his market knowledge. **This finding strongly reflects the definition of Chua et al. (1999)** that pinpoints to the control a family wants to have when managing its organization. In this case the control is either handed to the CEO when he is a family member or to the board when the CEO is a non-family member. Furthermore, **Chua et al.'s (1999) findings can be extended** when looking at the informal process of sharing information between family CEO and shareholders. The "coalition" between the family member CEO and the shareholders prefers to meet rather at informal occasions where the coalition uses these moments to discuss and take decisions. This creates a rather secret environment and enforces the power to the coalition formed. In the case of the CEO being a non-family member, the informality is within the board.

The second finding around the board of directors is its constitution which tends to be more informal and its role more reactive inside a family business. **This finding extends on Croci's (2018) work on the board's role** from the point of view of the second stream. The first stream only supervises the board, whereas the second stream supervises and guides. All the CEO's and Board members that were interviewed for this thesis shared the idea that the board should supervise and guide the management. In the four cases, the managers tend to look up to the board for advice, (with the exception for the CEO of Case 1 who stuck to a more conservative role of the board definition). Board constitution follows a strict legal procedure as explained above. In the findings however, we observed that the legal procedure is entwined with an

informal cooperation between board chairman and CEO. This has been mentioned in all the cases, and thus **can be extended in the findings of Croci (2018)**, that board constitution is based on preliminary discussions between CEO and chairman, with the goal to add value to the company through an ideal work atmosphere between board and CEO.

The theories on agency and how information is shared between the CEO and the board, will provide a better understanding on the role that the board and the CEO have on innovation, and why there is a rather active and a more passive party. Starting with the active role, it can be concluded (except for Case 3) that the CEO, who tends to possess market knowledge, will drive innovation. However, **agency theory states that there is a risk of imbalance on information between board and CEO**. Yet, Adams & Ferreira, (2007) found that this **imbalance will decrease if the CEO believes that the role of the board is not only to supervise him but as well to guide him**. As mentioned earlier in the findings, **this point is strongly supported in this thesis**, as all the interviewed CEOs discussed about the board having an active role in guiding them on their innovation efforts. The CEOs actively share information, be it in an informal setting when the CEO is a family member or a more formal setting when the CEO is a non-family member. And they do share because they know that the boards input can provide valuable guidance as it is suggested by Adams & Ferreira (2007).

The passive role is attributed to the board, as mentioned in the findings, they want to challenge the innovation ideas of their CEOs (with exception of Case 3). They are aware of the potential knowledge gap, which they see as motivation to ask questions and understand the idea behind the innovation solution. Gomez-Mejia et al. (2011) and Mustakallio et al. (2002), mention in their findings that part of the guiding role of the board is to challenge and ask questions. However, it is not the board that will provide an innovation project, as they do lack market knowledge.

In order to conclude the discussion, and as mentioned in the literature review, the role of the board is to be a guide on the innovation process and let the CEO and his team actively come up with innovation solutions.

## 6. Limitations

Despite these findings which build on existing literature, this thesis faces three important limitations. First, not all the companies operate in the same legal jurisdictions and thus the role of the board and its constitution are subject to change from one jurisdiction to another. This implies that the different legal requirements between one-tier and two-tier could impact agency theory, depth of the board involvement on the strategic decisions for the company, etc. The second limitation concerns the methodology on how the data was collected, specifically about the people interviewed for this thesis. Due to time constraints and access to the people, it has not been possible to interview systematically the CEO and a board member of each case. This would have allowed for a better triangulation of the data provided by each interview. The third limitation concerns the nature of business of the cases selected. Each company operates in a different industry, one manufactures machines, two are in retail and wholesale of food and one is a flour producer. They all have different needs in terms of innovation and have different requirements in terms of management. This implies that the findings could be difficult to generalize mainly due to their different needs on innovation.

Thus, for future research, one should target the involvement of the board on innovation in industry specific cases. This, together with the participation of CEO and a board member will allow to better understand the success of the board's involvement into the innovation efforts.

## 7. Conclusion

As an implication for practitioners, we have been able to show that a board contributes to the innovation process of a company. Regardless of the tendency that boards have rather a passive

role on the subject of innovation, the company will gain advantage of its engagement with management in the topics of innovation. Management also needs the challenge provided by the board, because it will not only help to improve the strategies of innovation but also assist the management to formulate projects and to reflect well on the process, execution, and implementation. Furthermore, and throughout the four cases, it has been observed that the CEOs play an active role in shaping the board and its members. Finally, it has been observed that innovation is less effective when it is only driven by the CEO or an individual than when it is driven by a specific structure for innovation. This in practice has been the innovation department that helps drive innovation from inside the company. As a concluding note, the board has an important role in the success of innovation inside a family business. The implication for management practitioners for this is therefore that a board should have access to the decision making on innovation projects and in cooperation with the CEO establish a plan how these projects will be set up. Finally, this thesis has been an educational journey and has helped the author to better understand the dynamics between the board and the top management when it comes to incentivising innovation.

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## Appendices

### *Appendix 1: Questionnaire.*

#### **Questionnaire for Board Member & CEO:**

##### *On the topic of Agency:*

- How would you define the role of the Board of Directors at **Name of the company**?
- How are your directors nominated to join the Board?
- How often does the Board meet?
- How would you describe the composition of the Board?
- How is the agenda of the board meetings defined?
- How does the process for sharing information by the CEO and his team organized? Is this something that you feel could be improved?
- Do you feel that Board meetings are productive? Is there anything you think could be changed to make them more productive?
- Can you recall a situation where board and CEO had different views on a subject? And can you share how did you solve those differences?

##### *General questions of firm Innovation:*

- Do you think that **Name of the company** is an innovative organization?
- How do you define innovation inside **Name of the company**?
- According to your definition of innovation, did you have any innovation projects over the past 3 years?
- Who is the main driver of innovation in the organization?
- How successful do you think these innovation efforts are?
- Does the company benchmark its innovation vs its competitors (or the industry)?
- What has been the allocated budget per year for innovation? (*Perhaps this can help find some sort of golden rule on how much from total sales is allocated into innovation per year*)

##### *Role of Governance on innovation:*

- Is innovation a topic that the board has on its agenda systematically (e.g., once every x months the board meeting, or part of it, is dedicated to innovation)?
- If yes, how does the board address the topic? What is the information that gets shared, what are the decisions that get discussed/made?
- Who came up with the initial ideas of the projects discussed above?
- What kind of role does (or did) the board play on these specific projects?
- Is the board tracking the progress of specific innovation projects?
- How differently does board and management see innovation? Who pushes who towards innovation?

##### *Role of Family on Innovation*

- What is the role of the owning family in the company's governance and management?
- Does the owning family play a role on the innovation process?