JOURNAL OF SMALL BUSINESS STRATEGY

SMALL BUSINESS BRIEF

STRATEGIC DECISION MAKING IN SMALL FAMILY FIRMS: AN EMPIRICAL INVESTIGATION

Bakr Ibrahim
Concordia University
bibrahim@alcor.concordia.ca

Colette Dumas
Suffolk University
cdumas@acad.suffolk.edu

Jean McGuire
Concordia University
jmcguir@vax2.concordia.ca

ABSTRACT

Family businesses play a significant role in the national economy. Despite their importance, little attention has been paid to strategic decision making in these firms. This research examines strategic decision making in 74 small family firms. In addition to the firm's internal and external factors traditionally acknowledged in strategy research, strategic decisions in family firms were found to be significantly influenced by family considerations. This finding underscores the unique characteristics of family firms. Based on the research findings a conceptual framework of strategic decision making in family firms is offered.

INTRODUCTION

Family businesses are the most prevalent type of business in both Canada and the USA. It is estimated that between 90-98 percent of all the businesses in these two countries are considered family firms (Beckhard & Dyer, 1983; Stern, 1986; Ibrahim & Ellis, 1994). Despite their ubiquity in the North American economy, there is no clear consensus concerning the characteristics that distinguish the structures and processes found in family business (Chua, Christman, & Sharma, 1999). Recently, however, scholars have proposed the unique nature of decision-making in family firms as an important distinguishing characteristic (Chua et al, 1999; James, 1999; Litz, 1997; Brockhaus, 1994).

It is therefore surprising that relatively few studies have examined strategic decision making in family firms (Brockhaus, 1994). Several reasons for this lack of research have been suggested. Lansberg, Perrow & Rogolsky (1988) argues that traditional management research biases toward bureaucratic rationality have contributed to the lack of research on the impact of family business issues on managerial behavior. Similarly Dyer and Handler (1994) suggest that traditional management research has assumed that family involvement in an organization is antithetical to effective management.

Alternatively, Habbershon and Williams (1999) make use of the resource based view of the firm to argue that 'famliness' provides unique advantages (for example more flexible human resource practices and greater organizational commitment) on which the firm can build competitive advantage. The existence of these divergent perspectives suggests that 'famliness' can represent both an advantage and a limitation for family businesses. The overlap between the family and business systems implies that both economic rationality and social/emotional factors must be considered in understanding strategy making in family firms. The objective of this research is to examine empirically the critical factors that influence the strategic decision in family firms. We examine the influence of family issues and unique characteristics on the decision making process of these firms. The present research offers a conceptual framework of the strategic decision-making process in these firms. In doing so it attempts to address an important gap in our understanding of family firms and develop a theoretical framework that recognizes the unique nature of these firms as both economic and social entities.

THE UNIQUE CHARACTERISTICS OF FAMILY FIRMS

There is no generally accepted definition of a family business (Lansberg, Perrow, & Rogalsky, 1988). The criteria that delineate a family business include ownership and active involvement in management (Barnes & Hershon, 1976; Dyer, 1986; Lansberg et. al., 1988); and anticipated transfer of ownership to next generation (Churchill & Hatten, 1987; Dyer, 1987). For the purpose of this research a multiple criteria will be used. Family business is defined as one in which 51 percent of the business is owned by a single family, at least two family members are involved in the management of the business and transfer of leadership to next generation is anticipated (Ibrahim & Ellis, 1994).

Research on family business has long recognized the unique characteristics of these firms. Litz (1997) and Hollander and Elman (1988) suggest that the overlap between both the family and the business systems and the simultaneous interactions between them accounts for the unique behavior of these firms. This may imply a dynamic tension that exists between both, the family and the business systems, giving family firms its distinct character. The family system ensures that the business pays attention to the family's needs and the survival of the firm at a level adequate enough to provide for the family. From this perspective the firms serves functions beyond economic return. The business system on the other hand ensures that the firm will attempt to maximize profits and growth.

Several studies suggest that because of the overlap between the family and the business systems, the decision making process tend to be unique serving the interest of both, the family and the business (Taguiri & Davis, 1992; Habbershon & Williams 1999). Trostel and Nichols (1982) found that family firms place more emphasis on family issues such as family involvement in the business and family unity than to the market or financial aspects of the firm. Sharma, Chrisman and Chua (1997) and Aronoff and Ward (1991) suggest that family firms have a unique set of characteristics that are different from non-family firms. In essence, family firms must accommodate multiple identities in their strategic decision-making (Pratt & Foreman, 2000). Building upon this framework, Chua et al (1999) propose that a defining characteristic of family firms is family domination of strategic decision making with the implicit or explicit objective of continued family involvement in the firm.

If, indeed, family domination of decision making differentiates family firms from other firms, family concerns may represent either a potential advantage or a potential weakness. This perspective further suggests the importance of understanding and making use of any potential family advantages. To do so, however, it is necessary to more fully understand the impact of family on strategic decision making in family firms.

FACTORS SHAPING THE STRATEGIC DECISION

If, as proposed earlier, a unique feature of family business is the incorporation of the family system into the business or economic system, we would expect that family concerns influence strategic decision-making. Studies examining factors shaping the firm's strategic decision have primarily focused on non- family organizations. These studies have mostly focused on the influence of the firm's internal resources and capabilities and its external environment including social, economic, technological, as well as market and competitive forces. (Miller & Friesen, 1983; Galbraith & Schendel, 1983; Prahalad & Hamel, 1990). This traditional approach has emphasized the rational aspects of the strategic decision. However this approach adds very little to our understanding of how family issues and unique characteristics influence the strategic decision-making process in family firms.

A second school of thought that could provide a better insight to the strategic decision-making process in family firms, focuses primarily on the influence of the entrepreneur and top management values and preferences on the firm's strategy (Child, 1972; Montanari, 1978). The strategic choice approach recognizes the unique characteristics that influence strategy in each organization (Shrivastava & Grant, 1985; Barton & Matthew, 1983). Owner and manager values and preferences were found to have a significant impact on corporate decisions, strategic choices and management practices (Covin, 1991; Freeman, Gilbert & Hartman, 1988; Guth & Taguiri, 1965; Hitt & Tyler, 1991).

Despite these arguments for the unique characteristics of family firms and the influence of family issues on the business, little empirical research has been conducted to integrate the family dimension in the strategic decision making process. Chen and Smith (1987) attribute this to research sampling biases toward large publicly traded firm and the tendency to use databases such as PIMs and Compustat. Only a few studies have been reported on the influence of family issues on isolated decisions. Khan and Henderson (1992) looked at location preferences of 435 family firms compared to 555 non-family firms in order to gain insight into the family influence on the strategic decision making process. Their premise was that site location is one of the most important strategic decisions of the firm. In thinking through such a decision, family businesses must acknowledge both the family preferences (proximity to residence) as well as the business perspective. They found that family preferences have a significant influence on the strategic decision concerning location. Dumas et al.'s (1995) study found that family issues played a significant role in the successor's strategic decision to take over the business. Harris, Martinez and Ward (1994) offered anecdotal examples of how family issues influence strategy in family firms. Ibrahim et al. (1999) found that firm strategic actions (specifically diversification) were influenced by succession concerns.

In essence, little is known about the range of factors affecting strategic decisions in family firms. The co-existence of the economic and family systems suggests that both dimensions must be considered. However, the degree to which economic, family, or other considerations influence strategy is an unexplored issue. This research represents an important first step in understanding strategy making in family firms.

SAMPLE SELECTION AND DEMOGRAPHICS

A questionnaire was sent to 460 CEO's and presidents of small family firms in Montreal, Toronto and New York metropolitan areas. The multi-industry sample was randomly selected from Dun & Bradstreet, and the Chambers of Commerce directories. The response rate was 31 percent. Of the 142 usable responses, 74 were identified as family business based on the definition criteria identified earlier. The relatively high response rate indicates a significant level of interest by family firms in the study. The average age of the respondents was 54.5. The majority of the respondents (74.3%) were original founders of the business, while 21.6 percent were second generation and only 4.0 percent were third or fourth generation. The only female respondent (representing 1.4% of the responses) was the founder of the business. The average number of family members involved in the business was 3 members and succession to the next generation was considered by all respondents through a formal or informal process. The average annual revenue was $12 million and the average number of employees was 16. The sample firms consisted of various business sectors including retail (11%), wholesale (12%), manufacturing (38%) and service (49%).

Participants were asked to respond to a randomly ordered listing of items that may influence the strategic decision in family firms. These items were selected based on items cited in the strategy and family business literature as being critical in making strategic decisions, and included modified versions of strategy and personal values instruments developed by England (1975); Ibrahim, 1993; Robinson and Pearce (1988); Miller and Friesen (1983); Dess and Robinson (1984); Khan and Henderson (1992).

Each respondent was asked to indicate the extent to which the statement influenced the strategic decision in the family business on a five-point Likert scale ranging from "a very little extent" to "a very great extent". The questionnaire items were pilot tested for accuracy and relevance on a group of 7 family firms in Montreal and New York. Their responses were statistically analyzed and questionnaire items were finalized with an item reliability of .95 as measured by Cronbach's alpha coefficient.

RESULTS

Factor analysis was used to identify sub-sets of items indicating underlying patterns of decision-making criteria. Three factors accounting for 64.3 percent of the variance were extracted using principal component factor analysis with orthogonal rotation. Rotated factor loadings, communality (actual variance explained by each variable) and content of the factors are shown in Table 1 along with eigenvalues and variance explained. Following the criterion suggested by Kim and Mueller (1978), only variables that exhibited factor loading greater than 0.50 were included in the interpretation of the factors.

Factor 1 included seven items related to the internal capabilities of the small family firm, with item loadings ranging from .51 to .82. These items included management skills and competencies; product/service quality and innovation; financial and human resources; market positioning; and product and service cost. Factor 2 identified items related to family issues and considerations with factor loading ranging from .62 to .84. Items included, family values and preferences, accommodation of offspring skills and competencies, family members involvement in the business, succession and the desire to establish zones of comfort for family members. Factor 3 identified items related to the external/competitive environment of the family firm, with factor loadings ranging from .84 to .58. These items included customer needs and wants, market and economic conditions, and competition.

The first factor taps many of the capabilities and resources commonly identified in the strategic management literature as influencing the firm's strategy. These results suggest that a 'resource based' view is particularly relevant to understanding the strategy decisions of family firms (e.g. Barney 1991, 1997). In view of the sometimes limited resources (e.g. Personnel, managerial expertise, facilities, etc) available to small family firms, it is perhaps not surprising that resources and capabilities are a major influence on strategic decisions. Family concerns were the next significant factor found in the questionnaire responses. These results confirm the qualitative studies cited earlier (e.g., Ibrahim, McGuire & Dumas, 1999; Dumas, Dupuis, Richer & St.-Cyr, 1995; Kahn & Henderson, 1992) that family considerations are critical to understanding family business.

The external/competitive environment was the third factor identified. It is striking that these factors, traditionally considered to be among the most critical in understanding firm strategy from the 'industrial economics' model (Barney, 1997) were less significant than resources and family concerns in the factor analysis results. One possible explanation for this may be that the strategic environment of small family firms is perceived as being more constrained by family concerns and firm resources than may be the case for other types of firms. Reliance on the skills and expertise of family members may place resources and resource constraints as a primary consideration in the firm's decision-making.

Table 1 Rotated Orthogonal Factor Analysis

Items	*Factor 1* *Resources & Capabilities*	*Factor 2* *Family Considerations*	*Factor 3* *External/ Competitive Environment*
Management skills and competencies	.82		
Product/service quality	.80		
Product/service innovation	.77		
Financial resources	.77		
Market positioning	.76		
Human Resources skills	.56		
Product/service cost	.51		
Family values and preferences		.84	
Accommodating the off-spring skills & competencies		.80	
Family members' involvement in the business		.76	
Succession		.71	
The desire to establish zones of conform for family members		.62	
Customer needs and wants			.84
Market condition			.72
Competition			.69
Economic situation			.58
Eigenvalue	3.88	2.25	1.45
Variance explained	38.4%	15.8%	10.1%

DISCUSSION

Results suggest that strategic decisions in family firms are significantly influenced by three critical factors. These include the firm's resources and capabilities, its external-competitive environment and family values and considerations. Earlier research in strategy found that the internal and external capabilities of non-family firms significantly influence the strategic decision in these firms (Miller & Friesen, 1983; Astley & Van de Van, 1983; Galbraith & Schendel, 1983; Prahalad & Hamel, 1990). However unlike non-family business, the present study suggests that strategic decision in family firms is significantly influenced by critical family issues including family values and preference, getting family members involved in the business, developing the business around the immediate family members' expertise, structuring the firm in such a way as to provide boundaries or zones of comfort to family members in order to avoid potential conflict, and succession from generation to generation. These research results underscore the unique characteristics of family firms and the influence of these characteristics on the strategic decisions of these firms.

The unique characteristics of family firms have been recognized in family business research (Litz, 1997; Ibrahim & Ellis, 1994; Hollander & Ellman, 1988). Our findings are congruent with Chua et al (1999), who argue that family control of decision-making represents an important distinguishing characteristic of family firms. The interaction between both the family and the business systems were found to account for the unique behavior of these firms (Tagiuri & Davis, 1992; Trostel & Nichols, 1982). Evidence on the influence of family considerations on a single strategic decision was reported by a number of studies. Khan and Henderson (1992) found that family preferences influenced the location decision of family firms. Brockhaus (1994) and Dumas et al, 1995), suggest that succession is central to family firm's strategy. Further Brockhaus (1994) suggests that differences in family members personality characteristics may influence the decision making process in family firms. This literature, however, has been limited and has provided no systematic framework for incorporating these influences into the decision making process. Family considerations, however, are only one influence on decision making in family firms.

These results suggest the need to consider family concerns as an important influence on decision-making processes in family firms. Building upon the strategic choice approach to strategy formulation (Child, 1972; Montanari, 1978) family considerations may have a significant influence on the way in which family firms balance internal and external influences on firm strategy. This approach recognizes that social and behavioral factors affect strategic choices regarding performance objectives, selection of environmental niches, and the means used to achieve selected goals (Shrivastava & Grant, 1985; Barton & Matthews, 1983).

Further this finding suggests that the strategic decision making process in family firms is different from non-family firms as a result of the alignment of both ownership and management. This conclusion is congruent with research on corporate governance that suggests that entrepreneurs and owners influence the firm's strategic direction through their power of ownership (Miller & Friesen, 1983). It is also congruent with Habbershon and William's argument for 'famliness' as a source of competitive advantage.

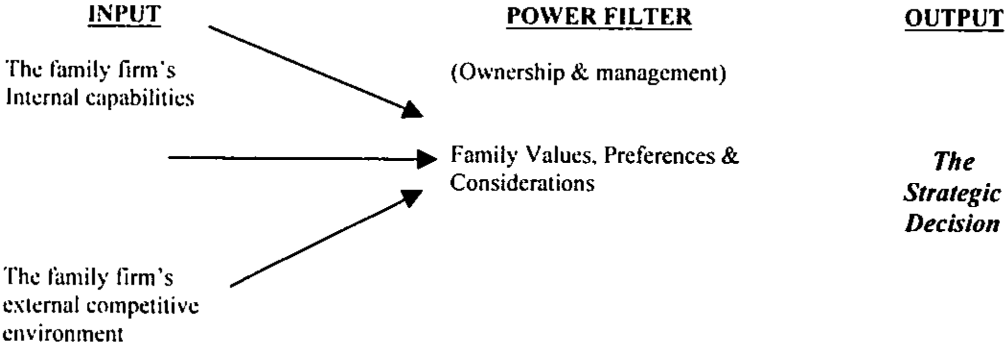
The difference in the strategic decision-making process in family firms may be beneficial to the business. A major premise of agency theory is that alignment of owner/manager interests results in more 'economically rational' decisions which contribute to shareholder wealth. Although it might seem that inclusion of such 'non rational' criteria as family considerations may be detrimental to the firm, James (1999) proposes that family considerations are advantageous helping overcome potential agency problems. Specifically, concern for continued family involvement in the firm provides an incentive for long-term decision horizons unavailable to non-family firms. Congruent with this argument Daily and Dollinger (1992) found that family firms pursued better strategic directions than professionally managed firms. Specifically, family firms pursued more active, growth-oriented strategies. Theoretically, Pratt and Foreman (2000) suggest that accommodation of multiple identities may benefit the firm by highlighting relationships among various identities (in this case family and business), and encouraging the firm to set priorities. Further, this perspective suggests that interaction of both the firm and the family systems may also encourage strategic flexibility (Pratt & Foreman, 2000).

To reconcile the impact of family and economic factors on the firm's strategic decision-making the present research suggests that the business internal and external factors are assessed in light of the family values, preferences and considerations. In fact, this perspective is congruent with Porter (1991), who notes that managers have a significant influence on corporate strategy and exercise considerable judgment in relation to the firm's internal and external factors. It is also congruent with research indicating that owner and management values and preferences were found to have enormous influence on the firm's strategic choice and action (Covin, 1991; Freeman et al, 1988; Guth & Taguiri, 1965).

A CONCEPTUAL FRAMEWORK

Our results suggest that the family dimension plays a crucial role in the strategic decision making process of family firms. Although family business research has begun to recognize the importance of family concerns in strategic decision-making (Chua et al, 1999; James, 1999), it has yet, to develop a conceptual framework that integrates family concerns with the external and internal factors traditionally seen as influencing firm strategy. Clearly, family considerations do not mitigate the need to weigh both internal and external conditions in strategic decision-making. To incorporate the reality that strategic decision making in family firms is both similar to, and distinct from decision making in non-family firms we propose that the firm's internal and external factors, the basic ingredients in the strategic decision making process, are filtered by family issues, considerations and values. This model is shown in Figure 1. The filter is the result of the alignment of both ownership and management, and the unique strategic concerns of family business. This model integrates the family dimension in the strategy dimension while maintaining the traditional balance of external and internal factors customarily seen as elements of strategic decision making.

Figure I: A Conceptual Framework of Strategic Decision Making in Family Firms



In proposing the 'family filter' in strategic decision-making, the model avoids the assumption of conflict between family considerations and economic rationality. The family system provides the filter by which strategic objectives are prioritized and the need for (or value of) resources is assessed. Rather than emphasizing the 'conflicts' between the family and economic systems, this perspective highlights the role of family considerations in the strategic decision making process as a means of balancing and weighing strategic alternatives. Congruent with Habbershon and Williams (1999) the ability to balance the firm's dual identity as a family and economic systems may represent an important source of strategic advantage to family firms. In essence, it provides a link between the family characteristics identified by Habbershon and Williams (1999) as potential sources of competitive advantage, and the development of unique family-based competitive advantage. For example, James (1999) notes that family interests may promote a longer-term decision framework than might be the case for non-family businesses. Not only may it provide an important means of differentiating the firm from its competitors, but also it may allow the firm to exploit resources and opportunities in unique ways to create competitive advantage (Pratt and Foreman, 2000). Specifically, the unique human capital provided by family ties may allow the firm a source of competitive advantage unavailable to non-family businesses (Ibrahim et al, 1999).

RESEARCH IMPLICATIONS AND FUTURE DIRECTIONS

The present research offers researchers and family business practitioners a realistic explanation of strategic decision making in family firms. The results and proposed conceptual framework integrates the family dimension in the strategy dimension and thus accounts for the discrepancy between the traditional normative approach in strategic decision-making and family business practices. Indeed Litz (1997) citing Campbell and Stanley (1963) advise concerning generalization, caution against applying research finding of non-family firms to strategy research in family firms. He suggests developing an appropriate research methodology that integrates the family dimension in the strategy dimension. Several authors have called for the need for a new epistemological approach in family business research (Litz, 1997; Victor & Cullen, 1988; Meek et al, 1988). Understanding the factors contributing to strategic decisions in family firms and in particular the family dimension can help enhance the quality of these decisions and thus improve the low survival rate of these firms. Indeed the average life span of family firms is twenty-four years and only 30 percent survive into the second generation (see for example, Ibrahim & Ellis, 1994). On the theoretical and methodological level it is hoped that this exploratory research in a largely unexplored area will provide some insight toward further research in strategic decision making in family firms.

However, several limitations of the present study must be noted. First, in light of the small size of the sample, and the focus on small family firms, care must be exercised in the interpretation of the findings discussed above especially as one attempts to generalize these to broader populations. Second, the study did not distinguish between family firms' stage of development (founder, first generation and second generation). Future research should account for the family firm's size and stage of development and test for their impact on strategic decisions.

Finally a refinement of the conceptual model will be needed to move it from a purely descriptive model to be a more prescriptive one. For example, the concept of family considerations as a 'filter' implicitly acknowledges the importance of family considerations in decision-making. Although Habbershon and Williams (1999) emphasize that 'filminess' can represent a unique source of competitive advantage for family firms, it is important to realize that the 'family filter' can also serve as a constraint. For example, the unity of command cited by Habbershon and Williams as a source of competitive advantage may also make it possible that family considerations may override other considerations. A comparison can be drawn from corporate governance theory that acknowledges the existence of various checks and balances on the discretion of major owners such as competing ownership blocks, proxy contests, and the market for corporate control. The extent to which family considerations play such a balancing role is an important question. Although the 'family filter' might provide a source of unique competitive advantage, it may allow dominant family members to direct the firm toward individualistic ends.

Understanding of the mechanisms by which family considerations influence decision making may provide insight into how family firms can benefit from the advantages of their family identity while avoiding certain of its drawbacks. To do so, one must first identify the nature of the 'family filter' operating in a given context and its sources. Congruent with the procedure suggested by Habbershon and Williams (1999) this understanding would provide the basis for identifying aspects of the family filter that can serve as potential sources of competitive advantage, and those that may represent sources of strategic disadvantage. This knowledge will provide a means by which the potential advantages and benefits of the family filter can be assessed. Further by bringing the various dimensions of the family filter (for example, the desire to maintain family control, the need for family unity, etc.) 'into the open' their relevance to strategic decision making can be more explicitly acknowledged and assessed.

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A. Bakr Ibrahim *is Distinguished Professor of Family Business, and Director, Centre for Small Business and Entrepreneurial Studies, and Associate Dean at Concordia University, Montreal. He is the author of Entrepreneurship and Small Business Management, published by Kendall/Hunt, 4th edition 2000, Family Business, Concepts and Practice, Kendall/Hunt, 2nd edition 2000, and Strategic Management published by McGraw-Hill, 1992. He has published numerous research papers in the field. Dr. Ibrahim is a member of the editorial board of the Canadian Journal of Administrative Science.*

Colette Dumas *is Associate Professor at the Business School of Suffolk University. Dr. Dumas specializes in teaching, conducting research, and consulting in the areas of Family Business Management, Organization Development and Organizational Communication. She has published numerous research papers in the area of family business. She is the author of Counseling the Entrepreneur, published by the Institute of Canadian Bankers, 1996.*

Jean McGuire *is Associate Professor at Concordia University, Montreal, Canada. She has published extensively in the areas of Strategic Management and Corporate Governance.*