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Private Firms and Corporate Governance: An Integrated Economic and Management Perspective

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ABSTRACT. This article provides a definition of corporate governance and highlights the challenges in adapting understanding of governance to the privately-held firm. We emphasize the need to develop the scope of governance in privately-held firms beyond the traditional agency theory focus in the financial economics literature relating to large publicly-listed corporations. There is a need to draw on and integrate an array of theoretical perspectives from both economics and other social science disciplines as well. We present a schematic model of corporate governance which places the contributions presented in the special issue in context and which serves as a guide to highlighting gaps in the research base. We review the principal issues relating to corporate governance in privately-held firms which relate to: governance in different organizational contexts (institutional context; the industrial sector within which the firm finds itself, the ownership context of the firm, and the stage within the firm's life-cycle); the scope of corporate governance; and other internal governance mechanisms to be considered We identify areas for further research on corporate governance in privately-held firms with respect to processes of governance, organizational contexts, assumptions about the owners, executive remuneration, financial reporting, the nature of the dependent variable relating to the expected outcome of different approaches to governance and various methodological issues. We suggest a need to develop governance codes for privately-held firms that are flexible enough to take account of the different types of governance needs of firms at different stages in their life-cycle.

KEY WORDS: Corporate governance, boards, ownership, privately held firms, research agenda, firm life cycle, excutive renumeration, financial reporting.

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1. Introduction

1.1. *Purpose and motivation*

The last decade has witnessed an international explosion of policy and research attention devoted to corporate governance (Demirag et al., 2000; Keasey et al., 2005). Much of this attention has been focused on large listed corporations (Hart, 1995; Gabrielsson and Huse, 2004). However, most firms are privately held, including some of the world's largest (La Porta et al., 1999).

The motivation for this article is to direct attention to governance in privately-held firms. First we show that governance questions also exist in privately-held firms. Second, it is important to recognize that privately-held firms are heterogeneous, ranging from high-technology start-ups to large established, family owned firms, and also include companies recently making a transition from one private

ownership form to another. Third, much of the previous research interest in corporate governance in privately-held firms has tended to focus specifically on the role of boards (Huse, 2000; Huse and Landström, 2001; Huse et al., 2002; Gabrielsson, 2003; Van den Heuvel, 2006). Yet, boards are only one, albeit important, aspect of governance. We adopt a broader perspective to encompass the full scope of governance dimensions, which include, in addition to boards and outside directors, the role of owners (both formally and informally), and other governance mechanisms such as executive remuneration, and financial reporting and auditing (Keasey et al., 2005). Fourth, the corporate governance debate has also tended to be dominated by an agency theory perspective which focuses on the problems arising from separation of ownership and control (Shleifer and Vishny, 1997). While agency issues may arise in privately-held firms, for example between family owners and managers (Schulze et al., 2003), other theoretical perspectives may shed light on the governance of privately-held firms (Lubatkin et al., 2007; Uhlaner et al., 2007). Fifth, the data available for research on corporate governance in privately-held firms is typically considerably more limited than for large listed corporations.

Thus, a special issue on corporate governance in privately-held firms that addresses these issues is timely. We seek to incorporate the broad range of privately-held firms at different life-cycle stages as well as a range of governance structures and mechanisms. Our purpose is not to review the literature on governance in privately-held firms; the articles presented here each provide summaries of the relevant research on their topic area. However, a central objective is to highlight the contribution of different theoretical perspectives, drawing not only from economics, but also from other social science and management perspectives. We seek to challenge research in corporate governance to be venturesome in samples, topics, theories and designs. Identification of the limitations in reliable data relevant for exploring governance in privately-held firms can stimulate new and creative approaches to research on governance.

1.2. *Definition and meaning of governance*

Definitions of corporate governance are numerous. Some definitions highlight that corporations and corporate governance mechanisms are instruments for shareholders (Keasey and Wright, 1993) or other external stakeholders (Freeman and Reed, 1983). Such definitions are supported by, for example, agency theory (Fama and Jensen, 1983) and stakeholder-agency theory (Hill and Jones, 1992). Other definitions may see the firm as an independent entity and not only as an instrument for external actors. In that case, the role of corporate governance mechanisms is to support what is best for the firm per se. Property rights theory (Alchian and Demsetz, 1972), team production theory (Blair and Stout, 1999) and the strategy literature (Pfeffer and Salancik, 1978; Barney, 1991; Filatotchev and Wright, 2005) lean on such definitions.

Some interpretations of corporate governance focus on the accountability or monitoring functions of governance (Cadbury, 1992; Keasey and Wright, 1993; Monks and Minow, 1995). Accountability is viewed as a subset of governance that involves the 'monitoring, evaluation and control of organizational agents to ensure they behave in the interests of shareholders and other stakeholders' (Keasey and Wright, 1993, p. 291). However, there is increasing recognition that corporate governance is not only about holding management accountable – and thus minimizing downside risks to shareholders – but also about enabling management to exercise enterprise in order to assure that shareholders benefit from the upside potential of firms (Filatotchev and Wright, 2005). This dual aspect of governance is especially important for many privately-held firms.

One of the great challenges in adapting definitions of corporate governance to the privately-held firm is that much of the research and academic debate pertains to large listed firms. A further challenge is that authors sometimes use the topic of corporate governance and boards of directors interchangeably (e.g. Forbes and Milliken, 1999), yet as noted above not all corporate governance relates to board activity nor, necessarily, in our view, is all board activity

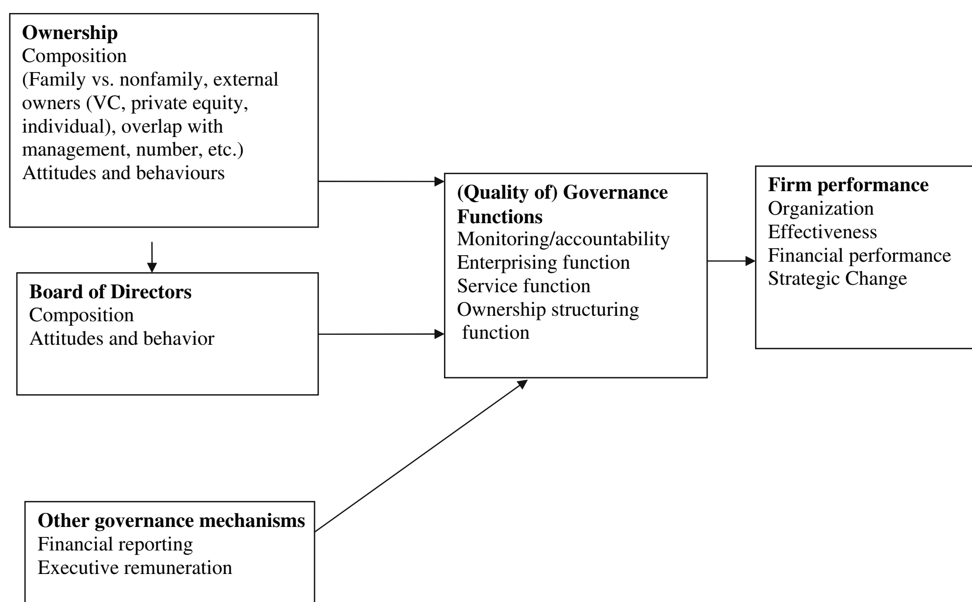

Figure 1. Framework for the special issue on governance in the privately-held firm.

an aspect of corporate governance. Moreover, in the large, listed corporation literature, discussion often focuses narrowly on the board's monitoring function for external stakeholders. In contrast, (where they exist) boards in privately-held firms are typically expected to perform less formal advisory tasks and other enterprising tasks, such as service tasks including building organizational reputation, formulating and/or ratifying organizational strategy and networking for the firm (Van den Heuvel, 2006). Moreover, the nature of this role may change as privately-held firms develop over their life-cycle (Filatotchev and Wright, 2005). It thus is an important function of governance to ensure that the appropriate forms of governance structures and mechanisms are in place and that changes in these structures and mechanisms take place in a timely manner as privately-held firms evolve.

There seems to be some confusion in the literature between the functions or processes of corporate governance (e.g. monitoring and enterprising) and the structural entities inside or outside the organization which may contribute to such governance, (e.g. boards of directors, but also owners and external auditors). This confusion becomes even more problematic when examining very small firms where ownership and management overlap, since governance should not be viewed as synonymous with either leadership or management of the firm.

1.3. *Model-framework for the Special Issue*

Figure 1 presents a schematic framework of corporate governance summarizing the contributions in this special issue. As noted above, we take a broad perspective to encompass boards of directors, the role of owners, executive remuneration, and financial reporting and auditing.

The majority of articles in this issue address either characteristics of ownership, the board of directors and/or financial reporting. The articles consider how these aspects relate either to each other, to aspects of governance and/or to organization effectiveness. According to the framework, ownership characteristics influence the quality of the two functions of governance – i.e., the monitoring and enterprise functions – both directly and indirectly as an influence on board characteristics, for instance. In firms where a board of directors is present, different aspects of the board of directors are also assumed to have a direct effect on the quality of governance. In turn, the quality of each of the monitoring

and enterprising tasks is assumed to influence different elements of organization effectiveness, in this case, strategic change and financial performance. Internal governance mechanisms such as executive remuneration mechanisms and financial reporting and the availability of information also impact the quality of the tasks of corporate governance.

External governance mechanisms (including the market for corporate control, the product market and governance codes for instance), although also recognized as potentially influential, are beyond the scope of the research in this issue and thus omitted from Figure 1.

Also not shown in the figure are a number of contextual variables assumed to moderate the relationships shown, including for instance, the country and legal system in which a firm operates, firm size, industry or life-cycle of the firm. Life-cycle aspects include not only particular stages of firm development, per se, such as start-up, expansion or maturity, but also transition stages between legal forms, such as going public (initial public offerings or IPOs), family succession or transitions from family-owned to management-owned firms, through a management buy-in (MBI) or management buy-out (MBO).

1.4. *Overview of the articles in the special issue*

One of the goals of this special issue is to blend different theoretical approaches from the fields of economics, management and other areas of social sciences, including psychology and sociology. As shown in Table I, a wide range of theories are represented in the different articles in this special issue. Although a number of articles incorporate agency theory as a starting point, other economics theories such as game theory (Scholes et al., 2007) as well as behavioral theories, including stewardship theory (Uhlaner et al., 2007), social exchange theory and social identity theory are also used to improve our understanding of corporate governance. Note that this is not an exhaustive list of theories that can be applied to governance problems in privately-held firms. For example, Lubatkin et al. (2007) synthesize agency theory and organizational justice theory to examine the differential effects of controlling owners' self-control (i.e., the governance mechanisms they adopt and how they administer these mechanisms) on the justice perceptions of the family and non-family employees.

Table I also provides a summary of other key elements of the six articles in the issue, including the target population of firms, independent and dependent variables, central findings, and the primary perspective used for corporate governance in the article. Different articles focus on different aspects of the model. Thus, for instance, Clarysse and colleagues (2007) examine the relationship between certain ownership characteristics and the complementarity of skills between the board of directors and management team. Beuselinck and Manigart (2007) on the other hand, predict the quality of the monitoring function, more specifically financial reporting quality. Zahra et al. (2007) examine the relationship between certain characteristics of ownership and boards of directors and the development of knowledge-based resources needed for internationalization. In the present framework, this might be viewed as an element of the enterprising function. Scholes and colleagues examine a rather unique set of variables related to the negotiation process during the sale of a firm (Scholes et al., 2007). And finally, Brunninge et al. (2007) and Uhlaner et al. (2007) predict aspects of organization effectiveness, including strategic change and financial performance. Most of the contributions in the special issue involve research relying on various survey instruments, in most cases mail questionnaires. Responses from one key respondent have been used in several articles (Clarysse et al., 2007; Uhlaner et al., 2007; Brunninge et al., 2007; Zahra, et al., 2007; Scholes et al., 2007). In what follows, we provide a more detailed summary of each article's contribution.

Clarysse et al. (2007) examine the determinants of board composition in high technology (high-tech) start-ups drawing on agency theory, resource dependence theory and social network theory. Specifically, they examine the tensions that exist between the founding team and other stakeholders in determining board composition. They obtain data on the board of directors from 140 companies founded in Flanders (Belgium) after 1991 using a structured questionnaire, administered during personal interviews with

TABLE I
Summary of articles in this issue on corporate governance

Author	Sample	Theory(ies)	Independent variables	Dependent variable(s)	Main finding(s)	Scope of corporate governance
Clarysse et al.	225 High-tech start ups in Flanders, Belgium	Agency; Resource Dependence; Social Network	Presence of powerful external stakeholders; (VC, public research organization)	Board composition: Complementarity of human capital (vis a vis founding team)	Complementarity depends on the type of external stakeholder – VC (–) public research organization (+)	Monitoring and enterprising function
Beuselinck and Manigart	270 Private equity backed (unquoted) firms, Belgium	Agency	Proportion of ownership by the private equity investor	Financial reporting quality	Negative relationship	Monitoring function
Uhlaner et al	233 Privately-held Dutch firms with more than 10 employees random, stratified by size	Agency, organizational social capital, social exchange, social identity; stewardship	Owner attitudes: Perceived organization rewards; Commitment; Shared norms	Financial performance	Positive relationship	Not specified
Brunninge et al.	800 SMEs, Sweden(< 250) longitudinal sample	Agency	Spread of ownership; Outside directors Size of TMT	Strategic change	Positive relationships	Enterprising function
Zahra et al.	384 SMEs, (< 500), manufacturing, US	Agency Knowledge-based view	TMT ownership; Outside director ratio; VC ownership	Knowledge based resources dedicated to internationalization	Positive relationships	Enterprising function
Scholes et al.	114 MBOs or MBIs that were formally private (family) owned, UK	Agency, Game, Negotiation	No suitable family successor; high focus on strategic importance of market value; generation; involvement of VC in succession planning	Characteristics of negotiation process: Whether information was shared equally; whether price negotiated or fixed in advance	Depends on dependent variable	Monitoring and advisory function

the founder. Their results provide evidence that teams that have powerful external stakeholders (e.g. venture capital or ''VC'' firms and public research organizations) are more likely to develop boards that have complementary skills in contrast to those of the founding team. Conversely, in start-ups where the founding team has had autonomy in composing their own board the team tends to look for outside board members with similar human capital.

Beuselinck and Manigart (2007) take an agency perspective to examine the influence of ownership concentration on financial reporting quality in private equity backed companies. Using financial statement data relating to a sample of 270 unquoted private equity backed firms in Belgium they show that their shareholder structure is associated with the quality of their publicly available accounting information. Specifically, companies in which private equity investors have a high equity stake produce lower quality accounting information than companies in which private equity investors have a low equity stake. Their findings support agency theory predictions that private equity investors with low equity stakes have a high need for high quality accounting information whereas private equity investors with high equity stakes have other means to closely monitor their portfolio companies.

Uhlaner et al. (2007) examine owner commitment to the firm and other ownership attitudes concerning relational governance of the privately-held firm. They propose a model that goes beyond agency theory to include research on organization commitment and organization citizenship behaviors, as well as stewardship theory, organizational social capital theory, social identity theory and social exchange theory. Using a survey of 233 directors of a random sample of privately-held Dutch firms with at least ten employees, they find support for the predictions of stewardship theory and organizational social capital theory that owner commitment and firm performance are positively related. The positive relationship between family (majority) ownership and owner commitment lends support to predictions of social identity theory that family plays a special role in creating a highly committed ''in-group'' of owners. But their results also suggest that the extent to which owners share collective (non-financial) norms and goals more directly predicts owner commitment. Furthermore, however, their results do not rule out the possibility that perceived organizational rewards also affect owner commitment as predicted by social exchange theory and agency theory. In sum, their findings suggest that a combination of aspects from both the ''agent'' and ''steward'' models may help to explain relational governance and performance in the privately-held firm.

Brunninge et al. (2007) investigate how governance mechanisms affect the ability of SMEs to introduce strategic change. Building on agency theory and insights from the literature on small firm governance they suggest that governance variables related to ownership, the board of directors and the top management team all affect strategic change. They emphasize that it is important to examine the interaction of these governance mechanisms. Using a longitudinal sample of over 800 SMEs surveyed by mail questionnaire in 1997 and again by telephone interview in 2000 they find general support for these arguments. Specifically, they find that closely-held firms exhibit less strategic change than do SMEs relying on more widespread ownership structures. They suggest that closely-held firms can achieve strategic change by utilizing outside directors on the board and/or by extending the size of their TMTs.

Zahra et al. (2007) argue that SME ownership and governance systems significantly influence the development of knowledge-based resources necessary for internationalization. Using a mail survey administered to a sample of 384 US SMEs they find a positive relationship between both equity held by TMT members and VC firms and the development of these knowledge-based resources. They also find that this positive association is further accentuated by the presence of independent outside directors on SME boards, implying both monitoring and enterprising roles of such directors.

Finally, Scholes et al. (2007) examine the role of governance mechanisms in the negotiation process associated with the management buy-out (MBO) or management buy-in (MBI)

of former privately-held firms (Howorth et al., 2004). Adopting perspectives relating to agency theory, game theory and negotiation theory they explore two outcomes: whether information was shared equally between vendors (i.e., family firm owners) and purchasers (i.e., MBO/I management teams) and whether a mutually agreed price had been achieved during the MBO/I sales process (versus having been fixed in advance by the vendor). Using survey evidence from the managers of 114 former privately-held family firms located across Europe that recently reported an MBO/I they detect that respondents in founded (first generation) family firms and those reporting a high focus on the strategic importance of the market value increment were more likely to report that 'information was shared equally between vendors and purchasers'. Respondents reporting no suitable successor had been identified, a high focus on the strategic importance of the market value increment, and the involvement of venture capitalists in succession planning were more likely to report that a mutually agreed sale price had been negotiated prior to the sale.

2. Governance issues in privately-held firms

This section addresses several aspects that might be considered in researching governance in the privately-held firm, including governance in different organizational contexts, the scope of corporate governance and other internal governance mechanisms to be considered.

2.1. *Governance in different organizational contexts*

Contingency theory argues that the appropriate corporate governance design for a particular firm likely depends on the context (Huse, 2005b). Contexts to be discussed further in this section include the institutional context, the industrial sector within which the firm finds itself, the ownership context of the firm, and the stage within the firm's life-cycle. In the remainder of this section, we discuss some of the extant research, including articles in this special issue that address these aspects.

2.1.1. *Institutional context*

The majority of corporate governance research has been carried out in the US context (Shleifer and Vishny, 1997), although this work is now being extended to firms in the UK as well as other institutional contexts (Keasey et al., 2005). The limited cross-cultural governance research to date recognizes the importance of cross-cultural differences (Aguilera and Jackson, 2003) but have focused primarily on differences in governance among large listed firms (La Porta et al., 1999). The articles in the present issue represent single-country samples from five different countries: Belgium, the Netherlands, the United Kingdom, the United States, and Sweden. These countries cover a range of different corporate governance systems with, for instance, different approaches to board structures and processes, information reporting requirements, and protection for minority shareholders (La Porta et al., 1999). Country differences that reflect institutional differences have not been identified in any of the studies presented here. Most of the findings have been presented as though they are general and valid across countries. Yet, this may not be the case.

2.1.2. *Sector characteristics*

Another organization context issue is that of industrial sector. There are variations across industrial sectors with respect to technologies, ownership structure, resources and resource configurations, and competitive environments (Huse, 2007; Zahra and Pearce, 1989). The set of articles included in this issue pay limited attention to sector differences but where included, there appears to be limited effect of sector. For instance, although Zahra et al. (2007) control for sector, sector itself does not appear to influence strategic change. Uhlaner et al. (2007) do not measure sector per se, but find no differences in ownership commitment for firms that are high or low in capital intensity.

2.1.3. *Ownership structure*

Ownership structure is an important element in governance of privately-owned firms. Ownership is important as a contextual variable as well as a governance mechanism. Both ownership types as well as ownership dispersion need to be under-

stood. Some aspects include for instance, the proportion of shares owned by one individual, the proportion owned by insiders (especially the top management team), the proportion of shares owned by family (or not), and whether certain external stakeholders, such as VC or private equity firms, own a portion of the firm.

As pointed out by Mustakallio et al. (2002), family firms possess many features that make their governance particularly challenging. In classic treatments of corporate governance, the owner and manager are thought to represent non-overlapping stakeholder groups. This is less frequently the case in the family-owned firm. Indeed, family members often play multiple roles in owning, governing, and/or managing the firm, overlap of which is depicted in the three-circle model of business, ownership and family (Tagiuri and Davis, 1996).

In spite of their complexity, only limited research to date focuses on the differences between governance in the family-held firm and non-family privately-held firm and the consequences this may have for firm performance. Even less is known about the consequences for the family, except in anecdotal terms. A fast-growing literature, mostly in the finance area, examines the claim that publicly owned firms with a large family blockholder may perform better (e.g., Anderson and Reeb, 2003; Thomsen and Pedersen, 2000). However, as pointed out by Uhlaner et al. (2007), the way in which the actual behaviors and attitudes of owners influence the organization is left as a black box, similarly to the way boards of directors have been studied. The actual relationship between family ownership and various organization effectiveness variables remains controversial, with more detailed analysis required than has been provided in many previous studies. It is too simplistic to presume that all family firms are necessarily less vulnerable to the agency principle for instance (Schulze et al., 2002). Owners and management vary in degree of overlap even within family-owned firms, which can range from the small owner-managed (with perhaps two co-owners) to large extended family-owned firms where many family owners have no link with the internal operations of the firm. Future research needs to treat these nuances between different types of family-owned firms more carefully rather than treating the "family" effect necessarily as uniform.

2.1.4. *The life-cycle of corporate governance*

In the introduction to their book, *The Life-cycle of Corporate Governance*, Filatotchev and Wright (2005) propose that different functions of governance may vary in importance depending upon the phase of a firm's life-cycle. Thus, for instance, they suggest that at start-up, especially where ownership and management overlap extensively, the firm may not need a monitoring system (and probably doesn't have one). Given its narrow resource base, a governance system which provides a boost in resources and knowledge (such as outside directors on the board) could be quite useful to the start-up firm. For a company on the threshold of going public, on the other hand, greater accountability to external shareholders (and with it, a more professionalized governance system) may be essential to attract new investors.

High-tech ventures such as those being spun-off from universities provide interesting examples of very early stage thresholds faced by new ventures. Vohora et al. (2004) identify four critical junctures in the development of spin-outs: opportunity recognition, entrepreneurial commitment, credibility to customers and financiers, and sustainability. The nature of governance may need to change quite significantly over these stages to enable the venture to overcome the critical junctures, including entry and exit of team members, university representatives and financiers (Ucbasaran et al., 2003). These changes raise important governance issues in terms of how changes in equity holdings are negotiated, the selection and role of new equity holders and the replacement of existing equity holders. These changes may be influenced by the power that comes from the size of an individual's equity holding or from other governance mechanisms. At present, it is not fully clear how these processes operate. Some initial work by Vanaelst et al. (2006) identifies an important advisory role for intermediaries (privileged witnesses) in effecting the formation of governance mechanisms in spin-offs from universities.

A number of other types of transitions over time may also require changes in corporate governance structures and processes. Some of these transitions and related changes may be gradual, such as the increasing professionalization of the firm as it moves from start-up to becoming more established. Other changes may be abrupt. For example, a shift from a founder-owner-managed firm to a multiple ownership structure may result in immediate demands for more accountability and in turn, more formal governance mechanisms. The succession process in family-owned firms highlights important governance issues. Many factors impeding the transfer of family firms to the next generation are influenced by the complex intertwining of family, ownership and management systems which exists in family firms (Neubauer and Lank, 1998). There may be serious family differences between owners of family firms impeding the transfer of ownership within the existing family-ownership group. However, family governance mechanisms which address ownership structuring issues, such as family councils and formal family agreements or constitutions can be implemented to overcome these obstacles (Neubauer and Lank, 1998).

Privately-held firms preparing for an IPO are an example of another type of transition which usually requires the establishment of a corporate governance system compliant with more stringent regulatory codes. The process of corporate governance development in these threshold firms is not well understood. Taking into account the argument that the development of corporate governance mechanisms is path dependent (Lynall et al., 2003), we need to understand when the process of transition takes place. For example, if the governance system is closely linked to the founder team's characteristics and distribution of power within the organization it may prove difficult to effect changes (Filatotchev and Bishop, 2002).

The taking private of a publicly listed corporation through management and leverage buy-outs presents a further point in a firm's life-cycle where corporate governance mechanisms may change (Thompson and Wright, 1995). Wright et al. (2000) suggest that these buy-outs may require different governance mechanisms than those when the company was public, depending in part on the goals of the buy-out. For instance, in the traditional buy-out, the goal of enhancing efficiency may require a management responsive to short-term profit-based financial incentives and private equity firms with financial monitoring skills. Alternatively, where public to private transactions have taken place with an eye to enhancing innovation, entrepreneurial activity, and/or long term growth, governance mechanisms which stimulate entrepreneurship, risk-taking and a long term vision and a board of directors with skill sets which can encourage strategic change may be more important than a board focused on monitoring short-term financial targets.

Some of the articles in this issue explicitly address different phases in a firm's life-cycle—some through sampling, others by using one or more control variables. Thus, for instance, Clarysse et al. (2007) examine companies in the start-up phase. Scholes et al. (2007) examine firms which have changed from family-ownership via either a Management Buy In (MBI) or Management Buy Out (MBO). In the article by Uhlaner et al. (2007), other things being equal, owners are found to have higher commitment, (an element of relational governance), during the expansion phase of the firm than in either the start-up or mature phase of the business.

2.2. *The scope of governance in the privately-held firm*

Much attention to corporate governance in privately-held firms has focused on the role of boards, typically using measures such as insider/outsider ratio, number of board members or directors' share ownership (Finkelstein and Mooney, 2003; Daily et al. 2003). While this approach has provided useful insights it treats the board as a black box without considering board behavior (see Ezzamel, 2005 for an interesting collection of key papers). A particular exception to these studies is the work of McNulty and Pettigrew (1999) and Pettigrew and McNulty (1995) which considers the role of part-time board members in the process of developing strategy and the power relations on the board. A small but growing literature relating to SMEs (Huse, 2000; Van den Heuvel,

2006), and firms in various life-cycle phases (Lynall et al., 2003; Vanaelst et al., 2006) examines both the structure of boards and their processes. Past research on privately-held firms suggests that board characteristics and contributions vary not only between but also within various categories of these firms, such as family-owned, VC backed and/or small firms (Gabrielsson and Huse, 2005).

Boards of directors are only one aspect of corporate governance, however. There are compelling reasons to examine governance aspects within privately-held firms other than boards, not the least of which is that many small firms do not have formal boards. Even when they do, they often serve little function. The need to take the concept of corporate governance in privately-held firms beyond boards alone is underscored by recent research by Hessels and Hooge (2006). Based on a large stratified random sample of Dutch SMEs with between 1 and 99 employees (n = 1469), Hessels and Hooge (2006) find that only three percent of such companies have a board of directors. Even among the larger SMEs (those with between 50 and 99 employees), less than a third (29%) have a board of directors. Furthermore only about one percent of all SME directors reporting that they have a board also report that they are responsible to a board of directors to a formal degree for their activities. Although of course this research is limited to a Dutch sample, it does raise the question more generally regarding the role of boards.

Another aspect to consider in the context of scope is the target group to be protected and or to whom management must be held accountable. Thus, for instance, governance issues may arise not only between managers and owners but also with external stakeholders, such as bankers or other debt-providers (Huse, 1998). Conflicts of interest and asymmetric information problems may thus create the need for governance of owner-managers by these other external stakeholders (Hessels and Hooge, 2006). Family-owned firms also present a special case in that family governance structures such as family councils may be used to monitor (or assist) owners and managers on behalf of the family, especially in many larger family-owned firms (Neubauer and Lank, 1998).

More recent research on relational governance has also expanded the view of governance to include the formal and informal roles of owners in governance of the firm (Mustakallio, et al., 2002; Nordqvist, 2005; Uhlaner et al., 2007). Privately-held firms – especially those primarily owned by a single entrepreneur or family of owners – often rely on informal social controls rather than on contractual governance, the latter characterized by formal contracts, incentives and monitoring systems (Jensen and Meckling, 1976). These informal social controls, based on mutual trust, a shared vision, and commitment to the firm by owners and management, and embedded in social relationships among owners and management, have been referred to collectively as relational governance (Huse, 1993; Mustakallio et al., 2002). The article by Uhlaner et al. (2007), in particular, focuses on the role of ownership commitment. Although not directly tested in their article, they infer that owners with stronger commitment are likely in turn, to behave more responsibly toward the firm and that such ownership behaviors may intervene in the relationship between ownership commitment and firm performance.

2.3. *Other internal governance mechanisms*

Two further aspects of internal governance include financial reporting systems and executive remuneration (Figure 1). Differences in ownership may change the need for accountability. Young privately-held firms are often typified by the lack of formal information systems, with much information being in the head of the founder. The professionalization phase of the firm brings the opportunity to improve the auditing, accounting system and financial reporting aspects of governance. This shift is not automatic however. Beuselinck and Manigart (2007) for instance, find that firms where private equity firms hold a minority of shares are likely to have higher quality financial reporting systems than are firms where the private equity firm is a majority shareholder. In the former case, the minority shareholder may require more protection of his or her property by requiring tougher accountability standards.

Executive remuneration in listed corporations is hotly debated and widely researched (Bruce and Buck, 2005), yet in privately-held firms there is little examination of this issue. Agency theory approaches to corporate governance emphasize the need for executive remuneration to incorporate mechanisms such as stock options that align managers' interests with those of shareholders (Bruce and Buck, 2005). Stewardship theory (Davis et al., 1997) and paternalism (Huse, 2007) present alternative perspectives which may have application to privately-held firms. From a stewardship perspective, some executives may pursue the interests of the organization even though this may conflict with their own interests (Donaldson and Davis, 1991). Applying the theory to executive remuneration, such executives may thus be willing to sacrifice for the common good and accept lower cash remuneration. The presence (or absence) of the founder serves as a moderator variable with respect to executive remuneration. For instance, Wasserman (2006) suggests that in new private ventures, the presence of organizational founder- vs. non-founder-executives provides an important context to determine whether agency and stewardship approaches to executive remuneration are more applicable. Thus, founders may be expected to behave like stewards while non-founders may act more like agents, especially as boards in new ventures rarely issue new equity to executives. Wasserman (2006) argues that stewards and agents should be remunerated differently. He finds that, consistent with both stewardship and agency theories, executives who own a higher percentage of equity earn less cash compensation. The welfare of the family is the core issue in paternalism. Thus, decisions are made in such cases to protect (nonfinancial) welfare of the family or even of employees, at the expense of profit maximization or executive remuneration (Huse, 2007).

3. Directions for future research

The articles in this special issue give many inputs to further research. These possibilities relate to organization context, assumptions about the owner, process and behavior aspects, executive remuneration, department variables to be considered in governance research as well as different methods. This section suggestions some directions for research in these different areas.

3.1. *Organization context and governance*

The contributions in this special issue highlight the need for further exploration of the role of context. The articles presented clearly show that privately-held firms do not constitute one homogeneous unit. The findings identify differences between founder-managed or family firms and VC backed firms (Clarysse et al., 2007), between firms facing succession (Scholes, et al., 2007) and high-tech start-ups (Clarysse et al., 2007), and firms with different degrees of ownership dispersion (Beuselink and Manigart, 2007). Collectively, these studies reveal a considerable diversity in ownership structures and types of firms. We have also seen the importance of understanding the context in which the firms operate. Context has several dimensions First, the various articles show the impact of life-cycle on various governance questions. This opens up a large area for future research in and across different types of privately-held firms.

Second, is the country context. In contrast to privately-held firms, research relating to governance structures and board composition in large publicly traded corporations has recognized the impact of institutional differences (see e.g. La Porta et al., 1999). This observation suggests a need for future studies of corporate governance in privately–held firms to directly bring in cross-country comparative elements. Furthermore, future research also needs to determine under what conditions sector may serve as a contingency variable in governance topics.

3.2. *Assumptions made about the owners*

Another area for future research that emerges from the articles in this special issue is assumptions about the owners (e.g. Beuselinck and Manigart, 2007; Clarysse et al., 2007; Uhlaner et al., 2007). Most research on corporate governance takes an agency theory perspective that assumes that large publicly-listed corpora-

tions are characterized by a separation of diffuse, wealth-maximizing principals from opportunistic managers as agents. In contrast, the articles in this special issue indicate that privately-held firms typically have owners that are visible and who will often have a long term relationship with the firm.

However, it is becoming clear that there is a need for further research that questions simplistic stereotypes regarding the owners in privately-held firms. For example, there is a need to understand how controlling owners of family firms behave towards other family owners and employees. Parental altruism may create governance problems in family firms (Schulze et al., 2002) although these problems can be mitigated if controlling owners exercise self-control in terms of the governance mechanisms they adopt and how they administer such mechanisms (Lubatkin et al., 2007). Recent work has also identified the problem of opportunistic principals (e.g. Claessens et al., 2000; Faccio and Lang, 2002) who, as controlling blockholders may have conflicts of interest with minority shareholders. This work also raises wider issues about the governance effects of privately-held firms that are ultimate shareholders of listed corporations.

More careful distinctions also need to be made with respect to governance issues in single owner-managed privately-held firms and firms that either begin or evolve into multiple owner firms. Thus, for instance, Uhlaner et al. (2007) control for the number of shareholders in prediction of ownership commitment and financial performance, finding no differences. Nevertheless, future research may want to examine more carefully appropriate models for governance in the owner-managed condition, versus that where ownership and management do not overlap, or at least not entirely so.

Another important aspect of privately-held firm ownership is the extent of habitual entrepreneurship, especially with respect to serial entrepreneurs who may have sold or closed a previous business (Westhead and Wright, 1998). For example, to what extent do habitual entrepreneurs make greater or less use of formal governance mechanisms? Habitual entrepreneurs may develop their human capital in terms of opportunity identification and pursuit (Ucbasaran et al., 2006, 2007), and in relation to their expertise in dealing with VC firms (Wright et al., 1997). Yet it is not clear to what extent they learn to develop governance structures such as functioning boards, whether they rely on previous team members or bring in new ones with different expertise, etc. Alternatively, they may have learned how to deal with external board members or investors demands for information in either a positive or negative (hubristic) manner.

Similarly, an important condition for receiving VC backing is the willingness to see the business sold or floated on a stock market. In these cases, the commitment of the owner may be different from that of a typical founder-owned family firm.

A further issue concerns the need for care in analyzing the relationship between equity holdings and firm performance. In particular, it may be necessary to explicitly consider the presence of founders in privately-held firms. For example, where there is a high turnover of founders, such as in higher risk companies, it is likely that CEOs will have lower equity holdings. Failure to appreciate whether the owner is the founder or has been introduced following the removal of the founder may produce misleading conclusions about the ownership-performance relationship.

3.3. *Process and behavior aspects of governance*

Future research on privately-held firm governance needs to pay more attention to the way in which individuals and groups actually behave. A positive trend in this direction is the effort to apply theories from group and cognitive psychology to understand board behavior (see Forbes and Milliken, 1999; Huse, 2005a; Huse et al., 2005). The article by Uhlaner et al. (2007) is another step in this direction, with the application of psychological theories to the understanding of ownership attitudes. There is also scope to build on the pioneering work of McNulty and Pettigrew (1999) in the context of large corporations to consider the role of external part-time board members and power relations in board pro-

cesses in privately-held firms. They find that part-time board members in large corporations are not hapless and manipulated by dominant insiders, and are actively involved in corporate strategy. An interesting research question concerns the extent to which this picture is different in privately-held firms. For example, are dominant owners in privately-held firms able to emasculate outside board members? Or, do outside board members exert influence but in a more informal manner than in large, listed corporations?

The interaction between the type of private ownership and the nature of the board of directors also warrants attention. For instance, some privately-held firms have formal boards, but they may be passive. Other privately-held firms may have "informal" boards that may be active. Further research might, for example, explore empirically the extent to which the involvement of family governance mechanisms in family-owned businesses complements or is a substitute for formal boards.

A shortcoming of process and behavioral research on governance is that it does not consider the evolution of governance processes which may be especially important in developing firms (Filatotchev and Wright, 2005). An exception is research that examines the dynamics of owners as teams (Uhlaner, 2006; Vanaelst et al., 2006). Recognizing that firms pass through different life-cycle phases, there remains a need for greater understanding of how corporate governance relates to each of these phases, and how it changes with each transition. There is also the question of compatibility. Do certain governance mechanisms, such as boards of directors and family councils, act as complements or substitutes? Further research is required, for example, to explore empirically the extent to which the involvement of family governance mechanisms complements or is a substitute for formal boards.

More generally, the extent to which the accountability and enterprise dimensions of governance are substitutes or complements may vary between the early stage of a firm's existence and when it is more mature. Evidence relating to listed corporations has identified substitution and complementary effects (Short et al., 1999) but these may differ in privately-held firms at different stages in their life-cycle.

3.4. *Executive remuneration*

Although none of the articles in the special issue address this aspect of privately-held firm governance, executive remuneration is an issue of relevance. Wasserman's (2006) study, referred to above, represents an interesting development in distinguishing between the appropriate reward systems for stewards and agents in terms of the equity versus cash balance in compensation. These arguments may be extended, for example, to privately-held family firms where there may be important executive remuneration differences between family and non-family management. Given the usefulness of stewardship theory in predicting certain aspects of ownership commitment (see, for instance, the article by Uhlaner et al., 2007), it would be interesting to see whether stewardship theory could shed light on the problem of executive remuneration.

3.5. *Appropriate dependent variables for testing contingency theories of corporate governance.*

Studies of governance in privately-held firms might usefully adopt a broader perspective of value creation than what is presented in mainstream research. The overall task of corporate governance efforts has been to control for managerial opportunism and to make decisions about value distribution. Cowling (2003) finds positive effects on productivity in SMEs of the presence of a founder on the board of directors, for instance. The study by Uhlaner et al. (2007) shows a link between owner commitment and firm performance. Other studies presented in this special issue show that in privately-held firms, corporate governance can contribute to value creation in several other ways. Boards of directors have contributions in start-ups (Clarysse et al., 2007), strategic orientation (Brunninge et al., 2007) and change, developing knowledge-based resources (Zahra et al., 2007) and negotiating in relation to MBOs and MBIs (Scholes et al., 2007). Another dependent variable may be the smoothness of transition from

one owner or ownership structure to another. Research to date on this issue is found primarily in the context of family ownership (e.g. Morris et al, 1996), but can be applied to all sorts of privately-held firms and their transitions. In an empirical study of business succession based on 332 South African family businesses Venter et al. (2003) find a relationship between governance processes and planning and the profitability of the business. The articles presented here show that different value creation perspectives are influenced by different corporate governance designs. Research should thus be explicit in the kind of values – for whom and for what – that are used.

3.6. *Methods to consider in future research*

The use of surveys is important in the exploration of corporate governance issue, and in particular, the attitudes and actual behaviors of various stakeholders involved with governance (e.g. owners, boards of directors, external players). Such data is difficult to obtain or unavailable from archival sources. The articles in this special issue exemplify the usefulness of surveys to gather such data but also that getting relevant and reliable secondary data may be particularly difficult in studies of privately-held firms. This difficulty brings at least two challenges for further research. The first is to develop tools and methods to address the problems associated with survey research, e.g. common method bias and single respondents (Podsakoff et al., 2003). The second is to utilize the potential of surveys to explore relevant research questions that may be problematical with only secondary data.

Archival sources may provide useful information about ownership structure, board tenure, or financial information (Daily et al., 2003; Huse, 2000, 2007). But even where archival data may prove useful, a major general problem facing researchers of corporate governance in privately-held firms concerns is accessing such data and combining it with other data sources. Unlike listed corporations, data reporting requirements for privately-held firms are typically highly restricted in many jurisdictions. However, in some jurisdictions, longitudinal archival datasets of privately-held firms are available. Combining archival data with questionnaire data can be used if, for instance, a subtle identification system is used to track questionnaire respondents; but then the researchers must wrestle with the ethical question of whether the promised anonymity of the responses is undermined in some way (see Uhlaner et al., 2007). Nevertheless, assuming that ethical solutions can be found, interesting research opportunities may be possible in terms of combining archival sources with questionnaire sources. For example, Harris et al. (2005) combine the Centre for Management Buy-out Research database with the UK government's ARD plant level dataset to study productivity in management buy-out and non-management buy-out plants.

A further issue relates to the use of comparator groups to examine the behavior of privately-held firms. For example, to what extent do privately-held firms resemble smaller listed corporations where there may be concentrated ownership?

Appreciation of the difference between the monitoring and enterprise roles in corporate governance also has implications for the nature of measures relating to key actors. For example, rather than simply incorporating measures relating to the presence of external board members, it may be important to encapsulate the nature of their expertise and whether or not they are independent. Similarly in relation to venture capitalists, it may be important to measure the nature of their financial versus technological or international expertise.

4. Policy Implications

The articles presented in this special issue speak to the issue of the regulation of corporate governance for privately-held firms. To date, countries vary in the extent that either the government or other independent bodies (such as financial institutions) recommend that privately-held firms follow the recommendations made for publicly listed firms. An exception is Code Buysse, the first code addressed to non-listed enterprises, developed by the Corporate Governance Commission in Belgium (Buysse, 2005). The challenge of such a code is great,

given the diversity of privately-held firms, as we have already indicated (Van den Heuvel, 2006). Code Buysse attempts to provide overall recommendations for all non-listed enterprises as well as to provide specific recommendations for family enterprises. However, given the broadness of the audience, the recommendations are often worded so generally as to be of questionable application. For instance, the code recommends identifying potential sources of conflict and then taking steps to resolve such conflict. But more detailed guidelines are lacking, leaving the would-be implementer at a loss regarding specific actions to be taken to apply the rules. Nevertheless, as a first attempt, Code Buysse does try to recognize that recommendations must differ for smaller enterprises (those with less than 50 employees) and opens the way for further discussion of governance in the private firm. The empirical basis for governance codes has been questioned generally (Short et al., 1999) and our review also suggests that this is the case for governance codes dealing with privately-held firms. Our analysis suggests that the development of governance codes for privately-held firms may need to be flexible enough to take account of the different types of governance needs of firms at different stages in their life-cycle.

5. Conclusions

This introductory article has provided an overview of issues in the governance of privately-held firms and suggested areas for further research. Corporate governance in privately-held firms has been identified as involving dimensions relating to accountability, monitoring and enabling management to exercise enterprise. Our analysis has also suggested that the governance requirements of privately-held firms are not homogeneous but may be expected to vary over the different phases of a firm's life-cycle. At present, much research has focused on individual phases in this cycle rather than examining the challenges involved in moving from one phase to the next. There is a need for the scope of governance research in privately-held firms to be widened beyond the traditional focus on boards to encompass issues relating to ownership, executive remuneration and financial reporting. The different roles, structures and processes of corporate governance suggest a need to draw on an array of theoretical perspectives beyond the traditional agency theory approach. The topics selected for inclusion in this special issue represent only a start toward development of our understanding of corporate governance in the privately-held firm, and hopefully can stimulate more research on the topic.

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