Are family firms more internationally involved than non-family firms? The case of Italy

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ABSTRACT

There is limited research on the international strategies of family firms. Some have argued that because family owners tend to be relatively more risk averse and restrict their management to family members, who may be internationally inexperienced, family firms should be relatively less internationally involved than firms with dispersed ownership. On the other hand, family firms are said to have the longer time horizon needed for the significant investments required to penetrate international markets. Empirical studies tend to find that family firms are less internationalized, but they have mostly focused on SMEs and have used a less-than-optimal measure of internationalization. We look at the foreign sales of a panel of 263 Italian firms listed on the Milan stock exchange. Using a better measure of internationalization, we find that Italian family-managed firms have higher foreign sales than non-family firms, but that this is not true when the family does not participate in management. The positive impact that family management has on foreign sales is higher for regions at greater psychic distance from Italy.

Key words: Internationalisation, family firms, corporate governance, gravity model

1. Introduction

What determines the extent to which firms sell abroad? The transaction cost theory of the multinational enterprise (MNE) sees MNEs as institutions that coordinate activities across countries through employment contracts when such activities are more efficiently organized this way than through market transactions, and when the benefits of organizing these interdependencies within a firm are higher than the costs. Whether this is the case depends on transaction characteristics. Hence firms which have to handle transactions subject to high market transaction costs may end up with a larger foreign footprint than those which can rely on efficient international markets (Hennart, 1982).

Transaction cost theory implicitly assumes that all firms follow the same strategies and internalize transactions when the benefits outweigh the costs. But decisions to internalize transactions are not made in a vacuum: they are made by managers. The incentives they face, the level of risks they are willing to take, as well as their time horizon, depends on the way firms are organized, i.e. on their corporate governance. It is quite plausible that, keeping all transaction characteristics constant, corporate governance may exert an independent influence on the extent of a firm's international expansion (Strange Filatotchev, Buck and Wright, 2009; Filatotchev and Wright, 2011).

One particular type of corporate governance is the family firm, the dominant form of corporate governance in many countries (La Porta, Lopez-de-Silanes and Shleifer, 1999). For example, family firms account for 71% of all Italian firms and for 55%f of the workforce of Italian manufacturing companies with more than 50 employees (Bianco, Golinelli, and Parigi, 2008). Yet there is only limited research on whether this form of corporate governance encourages or discourages internationalization.

Agency and international business (IB) theorists are divided on this matter, and the limited empirical evidence to date is also inconclusive. Agency theorists have argued that concentration of ownership in a few hands increases the incentives that owners have to monitor managers (Jensen and Meckling, 1976; Denis, Denis and Sarin, 1997). If owners manage the firm, as is often the case in family firms, they will have incentives to maximize firm value. Does this mean that family firms will be more internationalized? The IB and the finance literature make opposing predictions on this point because they have opposing views as to the optimality of foreign expansion strategies. Finance researchers see international expansion as international diversification. They argue that unconstrained managers are likely to opt for an excessive level of both domestic product and international diversification because it results in a larger firm, and a larger firm means higher compensation and lower risk for them. Concentrated ownership in family firms will thus result in less internationalization (Denis, Denis and Yost, 2002). In contrast, most IB scholars see

international expansion as leading to higher profitability (see Kirca et al, 2011 for a review of this literature). Hence family firms should be more internationalized.

Family owners have typically sunk most of their wealth in the firm. This may make them more risk averse than managers of non-family firms who typically own a much more diversified portfolio (Miller et al, 2008). Since expanding abroad tends to be seen as more risky than expanding at home, this suggests that family firms should be less internationalized. It has also been pointed out that owners of family firms typically take a long-term perspective since they have their reputation and much of their wealth invested in the firm and are often interested in safeguarding it for future generations (Davis, Schoorman, and Donaldson, 1997, Anderson and Reeb, 2003a). Because of this, family owners may be willing to make the long-term investments required by international expansion.

On the other hand, family firms often reserve managerial positions for family members, who may not have the skills needed to manage international activities, while qualified outsiders may decline to join the firm given the lack of long-term career opportunities (Gallo and Sveen, 1991). This lack of qualified managers may hamper their international expansion (Graves and Thomas, 2006).

To sum up, theory does not give us clear predictions as to whether family firms should have more or fewer foreign sales than non-family firms. This lack of clear theoretical predictions is matched by ambiguous empirical findings. The few studies that have investigated whether family firms are more or less internationalized than non-family firms have come up with contradictory results. Potential limitations of these studies are that most of them focus on small firms at very early stages of their life and that they use a less than satisfactory measure of internationalization.

There is therefore a need for additional research on this issue. Our paper makes two main contributions. First, we study a sample of larger firms (Italian firms listed on the Milan stock exchange). Because our sample has a good mix of mature mid-sized family firms and firms with other types of governance, we are able to test how family ownership and management affects internationalization in mid-sized and larger firms. Our second contribution is that we use a gravity model to measure a firm's degree of internalization. This is a finer-grained measure of internationalization than the ratio of foreign to total sales, the measure that has been used in most studies. Using this sample of more mature firms and our new measure of internationalization, we find that family firms which are actively managed by the owning family sell more abroad than non-family firms. Furthermore, the positive impact of family management on international sales is higher the higher the psychic distance between Italy and the target region.

2. Empirical studies of the impact of family ownership and control on international sales

Given plausible arguments in both directions, whether family ownership and management favours or hinders internationalization would seem to be an empirical issue. Unfortunately the findings of empirical studies are inconclusive.

Table 1 lists some of the studies that have investigated the link between family ownership and management and internationalization. Three of these studies are based on US samples, four on firms outside the US (Spain, Italy, Taiwan and Australia), and one on a worldwide sample.

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Insert Table 1 about here

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Zahra (2003) looked at 409 US manufacturing firms. He assessed the impact of three indices of family control (the percentage of equity held by a family, the percentage of equity held by inside family directors, and the degree of family involvement in management), on two internationalization variables, the share of exports in total sales and the number of countries in which the firm sold. He found that the higher the percentage of equity held by the family, the higher exports as a percentage of sales. while a higher degree of family involvement in management increased exports as a percentage of sales but reduced the number of countries in which the firm sold. Gomez-Mejia, Makri and Kintana (2010) selected 160 US family-controlled firms and matched them with 200 non-family firms. Family control, a dummy equal to one if a family owned more than 10% of the shares and if two or more family members sat on its board, decreased the share of exports in total sales. Family firms, when they sold abroad, also tended to choose culturally closer countries than non-family firms. Sciasca, Mazzola, Astrachan and Pieper (2012) looked at how the percentage of family ownership impacted a firm's ratio of exports to total sales. Their sample consists of 1035 US family-owned SMEs (average employment was 84). They argue that family ownership is both an advantage and a drawback for internationalization and that the advantages work at low levels of family ownership and the drawbacks at higher ones (why this would be the case is not totally clear). They find a significantly negative impact of family ownership on exports over total sales in the linear model, and a significant inverse-U shaped relationship in the quadratic one.

Fernandez and Nieto (2006) analyzed 8,497 Spanish SMEs (average number of employees was 46). Family firms were less likely to exports, and, if they exported, exports made up a lower percentage of their sales. The focus of Thomas and Graves (2005) is on 871 Australian manufacturing SMEs. Their dummy for

family firms is equal to one if a family is the majority owner and if it manages the firm. Family firms tended to export less than non-family firms. Majocchi and Strange (2012) studied the impact of the percentage of stock owned by families on the dispersion of foreign sales of 78 Italian manufacturing firms. They find that family ownership and the presence of a family member as CEO or President both result in more uneven distribution of foreign sales (a lower entropy index). Lien, Piesse, Strange and Filatotchev (2005) focus on the decision of Taiwanese firms to invest abroad and find that family ownership and management has little impact on this decision.

The only strong support for a positive influence of family ownership and management on foreign sales is provided by Carr and Bateman (2009). They match 65 non-family firms to the world's largest 65 family firms and find that family firms are more likely to pursue global strategies.

We draw three conclusions from this literature. First, the evidence on the influence of family ownership and management on internationalization is mixed, with four studies showing that the extent of family ownership and management leads to a lower level of internationalization, three studies finding the reverse, and one finding a curvilinear relationship.

Second, with few exceptions (Lien et al., 2005; Corr and Bateman, 2009; Gomez-Mejia et al., 2010; Majocchi and Strange, 2012), past studies have focused on small or medium-sized firms, many of them at very early stages of internationalization. It is unclear whether these finding can be generalized to the older and larger firms that are typically studied by IB scholars.

A second potential limitation of this literature is its measure of internationalization. In five of the eight studies listed in Table 1, internationalization is measured either as a dummy or as the ratio of foreign sales (sometimes just exports, sometimes exports plus local production) to total sales).[1] A good measure of internationalization should reflect the extent to which firms are willing to handle the additional investments and shoulder the additional risks of international expansion (Mansi & Reeb, 2002). Yet the ratio of foreign to total sales falls short of that goal. Consider a Canadian firm located in British Columbia near the Canadian-US border that sells half of its output across the border in the US state of Washington. The degree of internationalization of such a firm is low. Yet, when measured by the ratio of foreign to total sales, this firm's degree of internationalization would be exactly the same as that of another Canadian firm that sells half of its output in twenty foreign countries including Japan, Burkina Faso, Ecuador and Finland (Hennart, 2007). The entropy measure used by Majocchi and Strange (2012) is an improvement, since it

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[1] Zhara (2003) complements an export/total sales measure with a count of the number of countries in which the firm sells.

measures the dispersion of a firm's international sales, but it has two weaknesses. First, one would not expect a firm's level of foreign sales to be evenly distributed between world areas, but instead to be proportional to market potential, as measured, for example, by an area's aggregate GDP. Second, an ideal measure of internationalization should not only measure the dispersion of foreign sales, but also their level. Entropy does not do this. Hence a firm with total foreign sales of $100 million with 20% of its sales in each of the world's five continents has exactly the same entropy index as one with the same distribution but sales of only $1million. A similar problem arises when internationalization is measured by the number of countries in which a firm sells, as in Zahra (2003), as this does not account for the absolute volume of sales in each country.

Zahra (2003: 509) has argued that we need more research on the link between family ownership and management and internationalization, and better measures of internationalization. We respond to this call by investigating this relationship on a sample of listed Italian firms. Our paper also introduces a new and more

comprehensive measure of internalization based on a gravity model. The next section sets up our hypotheses. We then describe our novel way of measuring internationalization, before presenting our sample, our methodology, and our results. We conclude with suggestions for further research.

3. Hypotheses

While there are substantial differences between family firms, they generally have the following characteristics: (1) a family owns a substantial share of the stock and is the dominant owner; (2) one or more family member hold managerial positions in the firm. These characteristics have important consequences for the extent to which such firms venture into international markets.

First, agency theory tells us that the concentration of a substantial block of shares in the hands of a single or group of owners (here the family) reduces the typical agency problems that arise between shareholders and managers (Anderson and Reeb, 2003a) and increases the chance that managers in family firms will act in the interest of the majority of the owners (Demsetz and Lehn, 1985).[2] Whether this will increase or decrease the firm's extent of internationalization depends on whether one sees internationalization as positively or negatively contributing to firm profits. As we have seen earlier, finance scholars consider

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[2] Family owners may defraud minority shareholders (Faccio, Lang and Young, 2001; Fama and Jensen, 1983; Shleifer and Vishny, 1997).

internationalization to be international diversification, and have argued that such diversification is good for managers, but bad for the firm. They have therefore predicted that family firms should have fewer foreign sales, everything else constant, than firms with more dispersed ownership.

Gomez-Mejia et al. (2010) have argued that a major goal of family firms is the preservation of what they call its socio-emotional wealth. This socio-emotional wealth consists in the ability to exercise authority, to put family members in key management positions, and to gain local prestige and recognition from the success of the firm and from its contribution to the local economy. Internationalization can pose threats to this wealth. International business is generally thought to require additional management capacity, specific expertise, and formalized processes (Fernandez and Nieto, 2006). Selling abroad requires foreign travel, which eats into management time. Because family firms typically reserve managerial positions for family members, they tend to have smaller management teams than non-family firms, even when they have to tackle foreign business, and this may prevent their successful internationalization. Graves and Thomas (2006) found this to be the case for Australian exporters. International operations also require specific skills, such as foreign language expertise and intercultural communication (Leonidou, Katsikeas and Piercy, 1998). Family members may not possess these skills, yet family firms are generally reluctant to hire external managers with such skills because the founding family fears losing control (Gallo and Sveen, 1991; Gomez-Mejia et al., 2010). Graves and Thomas's (2006) study of Australian SMEs found that family firms were less likely than non-family firms to employ outside managers and less likely to make use of management and professional training. Managers of family firms also prefer informal and personal forms of control (Daily and Dollinger, 1993; Graves and Thomas, 2006) because they typically have a personal, often intuitive, knowledge of the business. This personal knowledge may no longer be sufficient when the firm moves abroad, because foreign environments often differ significantly from domestic ones. Hence the usual control forms used in family firms are generally thought to be poorly adapted to international operations (Aaby and Slater, 1988).

International operations tend also to be inherently more risky than domestic ones. Family owners have typically more of their wealth tied to the firm than owners in non-family firms, insofar as they have had to finance it in its early stages, and that the income of a number of family members depends on the continued success of the firm (Demsetz and Lehn, 1985; Donckels and Frolich, 1991, Gomez-Mejia et al., 2010). Because their portfolio is less diversified than that of the typical owner in widely-held firms, one would expect owners of family firms to be more averse to risky investments than those of non-family firms. All these reasons lead us to hypothesize that

H1a: Family firms will be less internationalized than non-family firms.

While these arguments seem persuasive, there are counter-arguments. As we have seen, the concentration of a substantial block of shares in the hand of a single owner (the family) increases the chances that managers will act in the interest of the owners. If, as most IB scholars argue, international expansion is generally profitable, managers in family firms are more likely to maximize the value of the firm, and family firms should therefore be more internationalized than non-family firms.

A second argument is based on the 'stewardship' perspective (Arregle, Hitt, Simon and Very (2007); Gomes-Mejia et al, 2007; Miller, Le Breton-Miller, and Scholnick, 2008). Proponents of this view argue that family owners are more deeply involved in their business than professional managers in widely-held firms. First, their economic well-being and socio-emotional wealth is tightly tied with their firm, since a good part of their wealth is invested in it, and the firm provides income for them and for members of their family. Family pride and reputation in the community is also often tied to the success of their firm (Gomez-Mejia et al., 2010). In contrast to professional managers whose career is often only temporarily tied to the firm in which they work, and to owners of shares in firms with dispersed ownership who may be holding them for a limited time only, family owners often see their firm as an asset to be passed on to future generations, and are thus interested in assuring the continuity of the enterprise (Corbetta and Montemerlo, 1999). They are thus likely to adopt a long-term outlook and to maximize the value of the firm in the long run (Anderson and Reeb, 2003b). Developing foreign sales takes substantial investment over a relatively long time. Family firms may be more willing to make such investments (Miller et al., 2008). Family owners are also likely to nurture a motivated and loyal staff who is likely to have a long tenure with the firm. A cohesive and experienced staff is able to make the quick decisions needed for international expansion. This suggests that

H1b: Family firms will be more internationalized than non-family firms.

As we have seen, family firms have two characteristics: (1) concentrated ownership, which alleviates at least in part the problems inherent in the separation of ownership and control; (2) often management by the owning family. Many of the potential effects of family ownership and management we have mentioned are linked to this second characteristic. For example, family firms in which the owning family does not manage the firm should be able to recruit internationally experienced managers, thus alleviating one of the problems we have mentioned above. Likewise, the powerful reputation effects that provide incentives for family managers to maximize the long term performance of the firm, and hence presumably to optimally

invest in developing foreign sales, are stronger when family members actively manage the firm (Andersen, Mansi, and Reeb, 2003).[3] Consequently we would expect that it is family management, not necessarily family ownership, which has the strongest effect on internationalization. Hence:

H2: Differences in the extent of internationalization between family-owned and non –family-owned firms will be greater when the owning family actively manages the firm

Alongside geographic distance and the size of the foreign market, psychic distance has been recognized as an important factor affecting foreign sales (Beckerman, 1956; Dow and Karunaratna, 2006; Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977). Johanson and Wiedersheim-Paul (1975, p. 308) define psychic distance as consisting of "factors preventing or disturbing the flow of information between a firm and a market. Examples of such factors are differences in language, culture, political systems, level of education, level of industrial development, etc."

There are reasons to believe that the greater the psychic distance between the home and the foreign country, the greater will be the impact of family management on foreign sales. First, the greater the psychic distance to a foreign market, the less information a manager will have on the prospects and risks involved in selling in that market. If family-firm managers and managers of non-family firms differ in their level of risk aversion, the impact on foreign sales will be greater the greater the psychic distance to the foreign market. Second, selling to markets which are at a high psychic distance requires collecting more information and possibly making more marketing mix adaptations than would be needed for markets at lower psychic distance. If family-firm managers have a longer term outlook than those in firms with dispersed ownership, and if this translates in a willingness to make more long-term investments, then the additional amount of such investments, and hence the resulting level of foreign sales, should be greater for countries at high psychic distance. Likewise, if family firms suffer from a lack of internationally experienced managers, this deficiency should have greater consequences in markets where international experience is most crucial, that is in markets at high psychic distance, than in markets more similar to the home market. For all these reasons we hypothesize that:

H3: The impact of family management on internationalization will be greater, the greater the psychic distance between the home and the foreign market

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[3] Andersen and Reeb (2003b) looked at whether family firms were more profitable than non-family firms and found this to be the case only when family members served as CEOs. Similarly Maury (2006) find that family firms where family members hold either the CEO or the Chairmanship position perform significantly better than firms owned by families with passive form of control.

4. A gravity measure of internationalization

We have seen that the extant literature on the impact of family ownership and management on a firm's foreign sales has used rather crude measures of the extent of such sales and that the most common measure, the ratio of foreign sales to total sales, fails to adequately measure the breath and the depth of a firm's internationalization. One way to better measure whether a firm sells in a foreign market more or less than it should, given the opportunities and the costs involved, is to use a gravity model. IB scholars have used gravity models to explain international trade and investment flows (for a review see Zwinkels & Beugelsdijk, 2010). Gravity models stem from the Tinbergen's (1962) application to economics of Newton's famous law of gravity that states that the attraction between two objects is proportional to their mass and inversely proportional to their distance. By analogy, trade transactions between two countries should depend on their economic size, typically measured by their GDP, and on the distance between them. Distance generates costs that lower the profitability of doing business and hence reduce foreign sales. These costs are both objective and subjective. Geographical distance increases the costs of transporting goods and services and hence reduces the optimal level of sales. Subjective distance is whatever makes the target country more or less distant in the eyes of the manager contemplating sales in that country. Hence differences in language, political systems, religion, education, culture and level of economic development hinder the flow of information between the home and the target country, and may be perceived by managers as increasing the costs of negotiating with foreign trade partners, adapting products to local conditions, monitoring foreign employees, and understanding local business customs and regulations (Boeh & Beamish, 2012), and hence may, everything else constant, increase the subjective distance managers may feel exists between the countries. A greater subjective distance will reduce the level of business they may decide to do in that country (Cuervo-Cazurra, 2008; Dow & Karunaratna, 2006). This subjective distance has been called 'psychic distance''.

As we have argued, firm governance will affect how managers perceive the distance to a foreign country. If managers in family firms are more risk averse than those in non-family firms, they will see foreign countries as more distant than their counterparts in non-family firms, and will, everything else constant, choose to do less business in these countries. Inversely, if managers in family firms are more committed to developing long term business in foreign countries, they may see them as less distant, and may be more willing to develop business there. We therefore include family status in our gravity equation, both directly and as mediated by psychic distance. Everything else constant, we hypothesize that family status will affect

how managers react to the psychic distance stimuli between Italy and foreign countries, and hence will affect the sales they make in those countries and that this impact will be greater at greater psychic distance.

5. **Data and methodology**

Our data consist of all the Italian firms listed on the Milan stock exchange. That stock exchange (along with those of Germany, France and some other continental European countries) has a mix of relatively large family-controlled and non-family controlled firms (Faccio and Lang, 2002). In publishing, for example, our sample includes Mondadori and L'Espresso, which are family firms, and Sole 24 Ore and RCS Corriere della Sera, which are not. This makes it possible to compare the degree of internationalization of mature firms. Italy stock exchange regulations require companies to disclose any owner of more than 2% of the shares, allowing us to precisely ascertain ownership. Listed firms must also provide data on the destination of their foreign sales, although the reporting is not as standardized as we would like. To avoid potential bias associated with reliance on a single year, we collected data for two years, 2005 and 2008. After excluding foreign firms which had a secondary listing in Milan and those which were suspended that year, we were left with 272 firms that were listed in 2005 and 2008. From this population we excluded firms with less than 10 employees (3 in 2005 and 2008). Data on foreign sales was missing for 6 firms in 2005 and for 3 firms in 2008, leaving us with 263 firms in 2005 and 266 firms in 2008.

Dependent variable: Our dependent variable is the natural logarithm of the value of foreign sales by a firm in each of four different world regions in 2005 and 2008. We collected this data from the firm's annual report. These data suffer from two limitations. First, they do not distinguish between foreign sales realised through export and those realised through foreign subsidiaries. Second, the lack of homogeneity in reporting forced us to consolidate foreign sales (the sum of exports and foreign production) into four relatively homogenous world regions: Europe (the 27 countries that make up the European Union plus Norway and Switzerland); Asia; North America (US and Canada) and Latin America (all countries south of the US). Table 2 lists the countries that make up each of our four world regions. Our sample consists of the sales of 263 firms for 2005 and 266 for 2008 in four world regions, resulting in 2,116 usable observations [(263×4) + (266×4) =2,116].

Main Independent variable. Our main independent variable (*Fam*) is a dummy which takes the value of one if the firm is a family firm. Following previous studies (Anderson & Reeb, 2003b; Gomez-Mejia et al., 2010) we defined a firm as a family firm if the following two criteria were both met: (1) the largest shareholder is

a family member or a family holding company with a percentage of ownership larger than 10 percent;[4] (2) the Chairman of the board of Directors or the CEO is a member of the owning family (Faccio & Lang, 2002). These criteria yielded 107 family firms in 2005 and 102 in 2008. The small decrease in the number of listed family firms between 2005 and 2008 is consistent with the results of previous research on listed family companies in Italy (Banca d'Italia, 2008). Ownership data was hand-collected from the website of the stock exchange national supervisory authority (CONSOB). It is common in Italy for the ultimate shareholder to exercise control over a listed company through ownership of other listed or unlisted companies (Enriques & Volpin, 2007). When the ultimate owner is another unlisted firm we looked at all available data sources (economic news and specialised publications) to find out whether this firm was family-owned (Anderson & Reeb, 2003a). CONSOB, for example, indicates that the main shareholder of Gefran, an electronic devices producer, is an unlisted holding company named Fingefran Srl. Further analysis of news items and of the corporate governance reports of the firm shows that the Franceschetti family is the majority owner of Fingefran, and hence is the main company shareholder. We are confident that through this two-step process we were able to identify the ultimate owners of all Italian listed firms in our sample. In order to separate the impact of family management from that of ownership, we introduce the variable *Fam own* that includes only those firms for which the largest shareholder is a family with an ownership percentage larger than 10 per cent, but in which the Chairman of the board and the CEO are not member of the owing family. The number of such family-owned but not managed firms is 27 in 2005 and 26 in 2008 for a total of 53 firms and 212 observations. Finally, we introduce an interaction term (*Fam x Psychic dist)* between our family dummy variable (*Fam*) and the variable measuring psychic distance (*Psychic dist)* (see below).

Control variables: We enter four categories of control variables to control for region-specific, firm-specific, sector-specific, and year-specific influences on foreign sales.

Region-specific control variables include a region's market size and its geographical and psychic distance to Italy. We measure a region's market size by the natural logarithm of its GDP in dollars at purchasing power parity (PPP) (*lnGDP*) (Source: IMF, 2012). Geographic distance between Italy and the target region (*Geo dist*) was measured by the natural logarithm of the great-circle geographical distance in kilometres between

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[4] The choice of ownership threshold for family firms has been a matter of discussion, with some authors (Gomez-Mejia et al., 2003) arguing that an ownership of 5% is sufficient to give its owner substantial influence. Following La Porta et al. (1999), we used the more conservative threshold of 10 % but it is worth noting that using the lower threshold of 5% would have led to the same results.

Milan, Italy's industrial capital, and the following focal points: Washington for North America, Brasilia for Latin America, Beijing for Asia and Brussels for Europe.

We also enter an estimate of the psychic distance between Italy and our four target regions (*Psychic dist*). That estimate has six components, measuring differences between Italy and the target region: (1) in political systems; (2) in religion; (3) in language; (4) in education; (5) in per capita income (adjusted for purchasing power parity); (6) in culture.

Data for items (1), (2), (3) and (4) were taken from Douglas Dow's website (www.mbs.edu/home/dow/research). Item (1) is the single factor solution to differences in political systems. Item (2) is a three item factor score for differences in religion. Item (3) is a three item factor score for differences in language, while item (4) is a three item factor score for differences in education (for more information on these variables see Douglas Dow's website). Item (5) is a single item measuring differences in economic development using the per capita GDP at PPP for the year 2005 and 2008 (source: IMF, 2012). Inter-country cultural distance (item 6) was calculated on Hofstede's five cultural dimensions (Hofstede, 2001) using Kogut and Singh's (1988) formula.

Each item was calculated for each foreign region by weighing the item for each country by its GDP at PPP (IMF, 2012). Following Dow and Ferencikova (2010), we combined the six items into a single composite index of psychic distance (*Psychic dist*) using the Kogut and Singh formula.

We also control for firm characteristics. First, we include a dummy variable (*State*) for State-owned firms. Following Thomsen and Pedersen (2000) we define a firm as state-owned if its largest shareholder is the State or a public entity. State-owned firms make up 7% of all firms in our sample. We also control for a firm's age (*Age*) and size (*Size*) (measured by the number of employees). Since international expansion is a gradual process that takes substantial time to implement (Johanson and Vahlne, 1977), older firms should be more internationalized, everything else constant. Larger firms are also more likely to have foreign sales in each region. Data on a firm's age and number of employees were obtained from the website of the Milan stock exchange (www.borsaitaliana.it).

Because the level of transportation costs, the degree of product adaptation, and the height of tariff and non-tariff barriers, all factors that affect foreign sales, vary systematically across products, we also enter industry dummies for firms in chemicals and raw materials (*Chemicals*), consumer goods (*Consumer goods*), consumer services (*Consumer services*), pharmaceuticals and dietary products (*Health products*), energy (*Energy*), banking and finance (*Banking and Finance*), high technology products (*Tech*), telecommunications (*Telecom*)

and utilities (*Utilities*). Machinery (mechanical and electrical) and industrial construction is the omitted category. Industry dummies also control for average research intensity which has been found to be a determinant of foreign sales (e.g. Swedenborg, 1979)[5].

Finally, following Baldwin & Taglioni (2006), we include a dummy variable (*year05*) that takes the value of 1 for the year 2005 to control for possible time-specific effects and to correct for the lack of deflation of nominal foreign sales. The descriptive statistics and correlation of our variables are reported in table 3. With the exception of the correlation between geographic distance (*lnGeo dist*) and psychic distance (*lnPsychic dist*), most are low suggesting that multicollinearity is not an issue.

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Insert Table 3 about here

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Methodology: The gravity model used in the present paper is a further development of the traditional gravity model (Hejazi, 2007). As most previous scholars, we use the log-linearized version of the model but we add firm-specific variables. Our equation takes the following form:

$Log(Foreign\ Sales)_{jit} = a_0 + \beta_1\ log\ (Age)_{it} + \beta_2\ log\ (Size)_{it} + \beta_3 log\ (Geo\ dist)_{jt} + \beta_4\ log\ (GDP)_{jt} + \beta_5 log(Psychic\ dist)_{jt} + \beta_6\ (Fam)_{it} + \beta_7 log(Psychic\ dist \times Fam)_{jt} + \lambda_i + \tau_t + \varepsilon_{jit}$

where $Log(Foreign\ Sales)_{jit}$ is the natural logarithm of the volume of foreign sales of firm *i* in the year *t* to region *j* with *i* ranging from 1 to 266 (firms), *t* = 2005 or 2008 and *j* ranging from 1 to 4 (Europe, North America, Asia and Latin America). The parameters β are the coefficients to be estimated, λ_i is a set of industry dummies, τ_t is a dummy for the year and ε_{jit} is the usual error term.

The log-linear form of the equation is consistent with a long tradition of previous studies (Anderson & van Wincoop, 2003). However, this transformation requires that all the variables be positive and different from zero. In our case the first condition is always satisfied but the second condition is frequently violated since a large number of firms do not have foreign sales in some of the regions. We do not want to delete these observations since they provide important information. We partially solved this problem by adding 1 to all observations for the dependent variable. However, as Santos Silva & Tenreyro (2006) have shown, two additional issues should be addressed. First, the loglinear specification of the gravity equation often suffers

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[5] Because R&D expenditures do not receive in Italy preferential tax treatment, Italian firms often do not distinguish between R&D and operating costs, and published figures are poor measures of a firm's R&D effort.

from serious heteroskedastic problems since the log of the errors terms are statistically independent from the regressors only under very strict conditions. Second, when the dependent variable has many zeros, as in our case, the OLS procedure is likely to generate inconsistent estimators. To overcome these problems, we followed Santos Silva & Tenreyro (2010) and used a Poisson pseudo-maximum likelihood regression technique. Our weighted non-linear least squares estimator with robust standard errors (procedure ppml in Stata11) has recently been used in similar models (Egger, Larch, Staub and Winkelmann, 2011). We also used the Stata 'cluster' subcommand to correct for the fact that our dependent variable consists of the sales of a given firm in four regions and hence our observations are not strictly independent.

6. **Results**

The results of the Poisson pseudo-maximum likelihood regression are presented in Table 4. The model has a high overall fit, with a pseudo R-square of 39 percent.

In model 1 we enter the control variables. In model 2 we enter our main independent variable, *Fam*, our dummy for firms in which a family is the dominant shareholder and owns more than 10 percent of the stock, and in which members of that family occupy the posts of CEO or Chairman of the Board. The coefficient of *Fam* is positive and significant (at the 5 percent confidence level) indicating that family firms have higher foreign sales than non-family firms in all four foreign regions. H1b is thus supported. In contrast to Gomez-Mejia et al. (2010) who found that US family-owned firms sold less abroad, Italian family-owned firms sell more in all foreign regions than other firms. However, this effect disappears when we substitute *Fam* with *Fam own,* a dummy variable equal to 1 for family firms in which the Chairman of the Board and the CEO are not member of the owning family. As shown in Model 4, *Fam own* is not significant, confirming H2 that posited that family involment in management is what leads to greater foreign sales. In model 3 we enter *Fam x Psychic dist,* the interaction term between family ownership and management (*Fam*) and the psychic distance between Italy and the foreign region (*Psychic dist*). The coefficent of this term is positive and significant, suggesting that the negative impact of psychic distance on foreign sales is reduced when owning families manage the firm. Hence, as we hypothesized in H3, the beneficial influence of family management on foreign sales is particularly felt in regions at great psychic distance from Italy. This is in contrast to Gomes-Mejia et al. (2010) who found that family firms, when they sold abroad, tended to target culturally close countries.

Other variables perform as expected. As predicted by gravity models, regions with higher market potential attract higher sales (the coefficient of *lnGDP* is positive and significant at the one percent confidence level).

Consistent with gravity models, we also find that distance negatively affects foreign sales: the coefficient of *lnGeo dist* is negative and significant at the one percent confidence level, and so is the coefficient of our proxy for psychic distance *lnPsychic dist*. Turning now to firm-level controls, we find that the coefficient of the dummy variable for State-owned firms (*State*) is negative and significant, confirming previous findings (Majocchi & Strange, 2012). The variable measuring firms age (*lnAge*) is not significant, suggesting that firm age has no influence on foreign sales. The coefficient of firm size (*Size*) is positive and significant at the one percent confidence level. This is consistent with previous studies (e.g. Verwaal & Donkers, 2002). The sign and significance of our industry dummies are also as expected, with foreign sales significantly lower in consumer services, health products, banking and finance, technology products, telecommunications, and other utilities, than in chemicals and raw materials, consumer goods, oil, gas and solar energy, and the omitted category, the industrial sector, which includes mechanical and electrical machinery and industrial construction, sectors which are typically global and where Italian firms are traditionally strong and internationally competitive. The year dummy (*year05*) is not significant.

7. Discussion and conclusions

While transaction cost theory has explained the international footprint of firms by the characteristics of the transactions they handle (Hennart, 1982), a growing stream of research looks at how the incentives facing managers affect their internalization decisions (Strange et al., 2009, Filatotchev & Wright, 2011). One very common type of firms, especially in the European context, is the family firm, and an emerging literature is looking at the impact of family ownership and management on internationalization. The theoretical arguments are not clear cut. There are reasons why family firms should be less internationalized: family firms are supposed to be more risk averse and they tend to reserve managerial positions for family members who may not have the skills needed to conduct international business. But because family owners are interested in passing on the family firms to descendents, they have the longer term perspective needed to develop foreign sales, and hence one would expect them to gain market share abroad. Empirical studies have come up with contradictory findings. While most have found that family firms are less internationalized than non-family firms, a few have found the opposite.

We revisit the issue with a sample of Italian firms listed in the Milan stock exchange. Italy has a good mix of relatively large and established family and non-family firms. Most past studies have looked at samples of small or medium-sized firms at the very early stages of internationalization. By focusing on larger and more mature firms which have had the time and resources to develop their international operations, we are able

to test whether family ownership and control favours or hinders internationalization in larger and more mature firms, a topic which has up to now been relatively under-researched.

Our second contribution is a better measure of internationalization. Most past studies have measured internationalization by a firm's ratio of foreign to total sales, a measure which does not truly reflect a firm's commitment to international markets, or by an entropy index of foreign sales, a measure that does not reflect the magnitude of such sales. In this paper we use a gravity-based measure. Gravity models have been successfully used to predict the level of sales all firms from one country make in a foreign target country based on the size of that target country and on the objective and subjective distance to that target country (Hejafi, 2007). We use the model at the firm level to predict the sales of a single firm in a group of foreign countries (a foreign region). We argue that a firm's sales to a foreign region will depend on the size of that region, on the geographical distance to that region, but also on the subjective evaluation by the firm's managers of the cost and risk of doing business in that region. By entering a family firm dummy we can test whether managers of family firms systematically differ from those of non-family firms in their evaluation of that distance and hence in the level of sales they achieve in foreign countries. We therefore regress a firm's sales in four foreign world regions on a dummy variable indicating whether that firm was a family firm. In contrast to much of the extant literature, we find that family firms sell more in foreign countries than their non-family Italian counterparts, but only when family members actively manage the firm. We also interact a dummy equal to one when family members manage the firm with the level of psychic distance between Italy and the foreign region. As predicted, the positive impact of family management on foreign sales is greater when selling to psychically more distant countries. Our findings are consistent with some recent empirical studies (Anderson and Reeb, 2003a; Maury, 2006) that have found that, contrary to prior literature that argues that family ownership leads to poor performance (e.g. Morck & Yeung, 2003), family firms do in fact perform better than non-family firms, but only when members of the owning family actively participate in management.

What drives these results? We know that they are not driven by firm size or age, since we control for this. Hence the higher internationalization of family firms is not due to the fact that they are young, born global firms, since the insignificant sign for our age variable shows no difference in degree of internationalization between younger and older firms. Controlling for age also allows us to control for the possible difference in internationalization between founder-run family firms and second and third generation family businesses, which are likely to be older firms—our insignificant age variable shows that older firms (and

hence second, third and fourth generation family firms) do not have systematically lower foreign sales.[6] Furthermore, our results cannot be due to the fact that in Italy family firms tend to be concentrated in globalized industries, since we control for industry.

An analysis based on a subset of our sample shows that family CEOs are less likely to have a university degree and international experience than those of non-family firms. On the other hand, they have longer tenure. Perhaps the commitment of family managers to the business more than compensates for their lower education and international experience.

This leaves us with a number of potential questions that will need to be probed by additional studies. One of them is whether our results are dependent on our specific Italian context. It could be that both Italian culture and institutions are more compatible with the personal and informal touch of a family-owned business than with the impersonal bureaucratic control of a widely-held firm, and hence that family firms do better all around in Italy than non-family firms. A similar study on a wider pan-European sample might tell us whether this is the case, or whether our Italian results also apply in a non-Italian context.

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[6] Villalonga and Amit (2008) argue that second generation family firms are less efficient than founder-managed family firms.

Table 1: Main studies of the impact of family ownership and management on internationalization

Study	Sample	Family control/ownership (FC)	Internationalization (I)	Impact of FC on internationalization (I) (foreign sales or exports)
Sciasca et al. (2012)	1035 US family firms (> 10% family ownership +1 family member in management)	% family ownership	Exports/total sales	FC decreases I FC + FC^2= inverted U shape
Gomes-Mejia et al (2010)	360 US firms (160 family and 200 non-family)	FC Dummy = 1 if family owns >10% voting stock + 2 members of board are family members	Exports/total sales	FC decreases I % of sales of FC firms in Asia-Pacific lower than for non-FC firms
Zahra (2003)	409 US manufacturing firms	1.% equity held by family 2.% equity held by inside family directors 3. degree of family involvement in management	a. Exports/total sales b. Number of countries where firms sells product	1. increases a and marginally b 2. increases a and b 3. increases a but reduces b
Carr & Bateman (2009)	65 worldwide family firms (family owns > 50% if private, > 10% if public) + 65 public firms in matched SIC	family owns > 50% if private, > 10% if public	Classification into 9 global strategies	Family firms more likely to follow global strategies than non-family firms
Fernandez & Nieto (2006)	8497 Spanish SMEs with less than 200 employees	Firm belongs to family and one or more family member is in management	a. Dummy if firm exports b. Exports/total sales	Family firms not more likely to export, and likely to have lower export intensity
Thomas & Graves (2005)	871 Australian manufacturing SMEs	FC dummy = 1 if firm is majority family owned and is managed by family members	a. Dummy if firm exports b. Exports/total sales	Weakly negative relationship between FC dummy and exports/total sales
Majocchi & Strange (2012)	78 Italian manufacturing firms	1.% owned by families 2.President or CEO is member of controlling family	Entropy index of foreign sales in 6 regions	Both 1 and 2 decrease entropy

| Lien, Piesse, Strange & Filatotchev (2005) | 228 Taiwanese listed firms | 1.Dummy if family control 2.Family ownership | a. dummy = 1 if FDI in China and ROW
b. Total number of FDIs in China and ROW | Weak impact of 1 on a in China and ROW.
Weak impact of 2 on a in China |

Table 2: Composition of each world region

Region 1: North America	*Region 3: Asia*
United Sates Canada	Afghanistan; Armenia, Azerbaijan, Bahrain; Bangladesh; Bhutan; Brunei Darussalam; Cambodia; China; Democratic Republic of Timor-Leste; Georgia, Hong Kong S; India; Indonesia; Iran; Iraq; Israel; Japan; Jordan; Kazakhstan; Korea; Kuwait; Kyrgyz Republic; Lao People's Democratic Republic; Lebanon; Malaysia; Maldives; Mongolia; Myanmar; Nepal; Oman; Pakistan; Philippines; Qatar; Republic of Yemen; Russia; Saudi Arabia; Singapore; Syrian Arab Republic; Taiwan Province of China; Tajikistan; Thailand; Turkmenistan; United Arab Emirates; Uzbekistan; Vietnam, Yemen.
Region 2: Latin America	*Region 4: Europe*
Antigua and Barbuda; Argentina; Barbados; Belize; Bolivia; Brazil; Chile; Colombia; Costa Rica; Dominica; Dominican Republic; Ecuador; El Salvador; Grenada; Guatemala; Guyana; Haiti; Honduras; Jamaica; Mexico; Nicaragua; Panama; Paraguay; Peru; St. Kitts and Nevis; St. Lucia; St. Vincent and the Grenadines; Suriname; The Bahamas; Trinidad and Tobago; Uruguay; Venezuela.	Austria; Belgium; Bulgaria; Cyprus; Czech Republic; Denmark; Estonia; Finland; France; Germany; Greece; Hungary; Ireland; Latvia; Lithuania; Luxembourg; Malta; Netherlands; Norway, Poland; Portugal; Romania; Slovak Republic; Slovenia; Spain, Switzerland.

Table 3a: Descriptive statistics

	Average	SD	Min	Max
Age	55.4	61.45	0	537
Size	5,697	18,207	11	198,348
Geo dist	6,123	3,222	697	8,911
GDP (000)	13,798	6,785	4,772	27,102
Psychic dist	68.44	19.80	47,61	98,14
State	152 (State=1)		0	1
Fam	836 (Fam=1)		0	1
Fam own	212 (Fam own=1)		0	1

Table 3b: Correlations for continuous variables

	1	2	3	4	5
lnGeo dist (1)	1				
lnGDP (2)	-.072***	1			
lnPsychic dist (3)	.684***	.162***	1		
lnAge (4)	.000	.007	.011	1	
Size (5)	.000	-.0007	.010	.233***	1

*** $p < 0.01$

Table 4. Impact of family ownership and management on regional foreign sales

VARIABLES	Model 1	Model 2	Model 3	Model 4
lnGDP	0.472***	0.472***	0.471***	0.472***
	(0.079)	(0.078)	(0.079)	(0.079)
ln Geo dist	-0.256***	-0.256***	-0.255***	-0.256***
	(0.024)	(0.0236)	(0.024)	(0.023)
lnPsychic dist	-0.963***	-0.963***	-1.212***	-0.963***
	(0.116)	(0.116)	(0.153)	(0.116)
Fam		0.149**	- 1.887**	
		(0.069)	(0.728)	
Fam×Psychic dist			0.501***	
			(0.185)	
Fam own				-0.062
				(0.112)
Controls				
State	-.475 **	-.428 **	-.428 **	-.482 **
	(.200)	(.200)	(.200)	(.200)
lnAge	0.0280	0.038	0.038	0.030
	(0.033)	(0.034)	(0.034)	(0.033)
Size	0.243***	0.245***	0.245***	0.243***
	(0.020)	(0.020)	(0.020)	(0.020)
Chemicals	0.049	0.033	0.033	0.040
	(0.138)	(0.126)	(0.126)	(0.137)
Consumers goods	.0039	-0.007	-0.006	-0.038
	(0.066)	(0.069)	(0.069)	(0.065)
Consumers services	-1.095***	-1.099***	-1.099***	-1.109***
	(0.203)	(0.204)	(0.204)	(0.204)
Health products	-0.288*	-0.285*	-0.285*	-0.287*
	(0.149)	(0.149)	(0.149)	(0.151)
Energy	-0.026	-0.040	-0.039	-0.031
	(0.193)	(0.188)	(0.188)	(0.193)
Banking and finance	-1.204***	-1.171***	-1.171***	-1.206***
	(0.133)	(0.133)	(0.133)	(0.133)
Tech	-0.554***	-0.551***	-0.551***	-0.551***
	(0.184)	(0.187)	(0.187)	(0.184)
Telecom	-0.558*	-0.536*	-0.535*	-0.564*
	(0.312)	(0.312)	(0.312)	(0.312)
Utilities	-1.404***	-1.368***	-1.367***	-1.404***
	(0.393)	(0.395)	(0.395)	(0.394)
year05	0.078	0.074	0.074	0.078
	(0.0616)	(0.061)	(0.061)	(0.062)
Constant	1.336**	0.123*	2.243***	0.133*
	(0.701)	(0.698)	(0.833)	(0.700)
Observations	*2,116*	*2,116*	*2,116*	*2,116*
R-squared	*39.33%*	*39.40%*	*39.81%*	*39.42%*
Pseudo log-likelihood	*-6850.20*	*-6832.69*	*-6814.94*	*-6848.87*

Robust standard errors in parentheses - *** p<0.01, ** p<0.05, * p<0.1

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