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A theory of venture capital family business: a governance trajectory

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Abstract

Purpose – The purpose of this study is to understand venture capital family businesses (VCFBs) governance of portfolio companies through the deal process.

Design/methodology/approach – This study applies a theory-developing approach. A model of VCFB governance is developed whose key aspects are illuminated by four examples (cases) of VCFBs.

Findings – Recent research suggests that a venture capital firm's corporate deal processes can be divided into the pre-deal, deal and post-deal phases. Based on the age, size and succession dimensions, propositions for how a governance trajectory develops for VCFBs, affecting the deal process of target family firms (TFFs), are presented. These propositions highlight how the family owners' actions and behavior are related to VCFB governance, which in turn, influences the three phases involved in making an investment.

Originality/value – The propositions suggest how personal and administrative VCFBs' governance of the deal process of portfolio companies is significantly affected by centrifugal and centripetal forces that drive the respective types of governance where third-generation family owners appear as changers of governance approach.

Keywords Venture capital, Family business, Family generation, Governance, Deal process, Portfolio company

Paper type Research paper

1. Introduction

Differences regarding governance and ownership are likely the most decisive elements distinguishing venture capital (VC) companies' goals and strategies (Bertoni *et al.*, 2015). Since a significant proportion of VC companies are family-owned, their governance is affected by the generational changes in the owner family (Ljungkvist and Boers, 2017). However, more research on how the transgenerational aspect influence governance is needed (Suess, 2014; Suess-Reyes, 2017; Zellweger *et al.*, 2012) which also concerns how different investor types handle the deal processes (Schickinger *et al.*, 2018). We define venture capital family businesses (VCFBs) as companies whose governance of portfolio companies is influenced by the family ownership logic (Brundin *et al.*, 2014) and which aim to create value for current and future family generations through temporary equity stakes in other firms (Wright and Robbie, 1998). Thus, studying how VCFBs organize the governance of portfolio companies is paramount.

The heterogeneity of VC firms was first noted and discussed in the late 1980s (Sahlman, 1990) and further developed in more recent studies (Elango *et al.*, 1995). For example, heterogeneity in investment patterns (Bertoni *et al.*, 2015), objectives (Scarlata *et al.*, 2015) and management composition (Patzelt *et al.*, 2009) have been investigated. Another important difference is that many of these VC firms are family businesses (Ljungkvist and Boers, 2017). Ljungkvist and Boers (2017) defined these firms as hybrids, i.e. combining a normative and a utilitarian aspect, family and business (Boers and Nordqvist, 2020), with strategy formulation and the governance of portfolio companies being influenced by family ownership (Boers *et al.*, 2017; Worek, 2017). Consequently, important decisions regarding goals and governance in these VCFBs are affected by the family ownership logic (Brundin *et al.*, 2014). Furthermore, Ljungkvist and Boers (2017) emphasized that VCFB governance of portfolio companies is often personalized, i.e. affected by the family owner's personal responsibility and focus, which relates to the fact that the relationship between deal objects (firms) and external investors can both hinder the closing of deals and facilitate the governance of portfolio companies (Schickinger *et al.*, 2018). However, research has only started investigating when these two parties meet in a deal process, so further research is needed (Schickinger *et al.*, 2018). Indeed, "the role of family equity, that is, financial capital in the hands of a family and available for (entrepreneurial) investments, is not well understood" (Bierl and Kammerlander, 2019); thus, the research gap regarding investments by transgenerational family businesses and the role of governance mechanisms calls for further attention and research efforts (Suess-Reyes, 2017).

VCFBs usually have a portfolio of firms in which they are interested and invested in. Accordingly, a VCFB's governance of portfolio companies is affected by the level of involvement and the roles, which in turn, relate to the family business's age and size and to the number of family successions within the company (Jaffe and Lane, 2004; Ljungkvist and Boers, 2017; Suess, 2014; Suess-Reyes, 2017). Accordingly, "[A]s a family [firm] enters the third generation, it has become a complex structure with several family branches, diverse interests and stakeholders, and challenges to sustain collaboration and effectiveness" (Jaffe and Lane, 2004, p. 81), highlighting the necessity of developing a governance infrastructure for the family firm (Sharma and Nordqvist, 2008). Thus, the family-owned company's portfolio governance will likely change after the second or third family succession (Jaffe and Lane, 2004; Suess, 2014). For example, family succession affects governance issues such as practices, guidelines, board composition, professionalism and strategic planning (Blumentritt, 2006). As previously described, family firms are also involved in acquisition activities, although academic attention to the patterns and modes of deal processes is limited (Achtenhagen *et al.*, 2017).

The purpose of this study is to understand VCFB governance of portfolio companies through the deal process. This study formulates propositions addressing the consequences of family business succession, creating a governance trajectory for the deal process and aims to answer the following research question: How does succession in VCFBs affect the governance of the portfolio company deal process? However, to clarify the impact of the family dimension on deal process governance, only deal processes in which VCFBs ended up as majority owners (cf. Landström, 2007) were studied. This paper follows the work of Schickinger *et al.* (2018), who divided the deal process into three relationship-based phases: pre-deal, deal and post-deal.

This study highlights the importance of understanding how the governance of deal processes is affected by the succession (Jaffe and Lane, 2004) of VCFBs. The paper contributes to the family business literature by improving our understanding of how family succession affects the governance of portfolio companies, and by identifying third-generation family owners as likely changers of governance approach, influencing the deal process. The paper continues by developing the research approach and a theoretical framework. Then, a model of VCFB governance is developed, which is illustrated by empirical cases. Based on this application, propositions are developed. Finally, the paper discusses implications and limitations.

2. Research approach

This study applies a theory-developing approach (Klag and Langley, 2013). We draw on the family firm and VC literatures to explore governance (Schickinger *et al.*, 2018). By drawing on a VCFB perspective, we extend Schickinger *et al.*'s (2018) general model and suggest new ways to understand the relationship between portfolio companies and VC firms regarding governance trajectories. In this way, the forces that arise from personal experiences, interpretations and proximity (centrifugal forces) are contrasted with those generated by external conforming and normative expectations (centripetal forces) (Czarniawska, 1999), whereby we offer a new perspective (cf. Whetten, 1989) on the family governance of deal processes.

To illuminate key aspects of our theoretical model, four examples (cases) of VCFBs are used (Siggelkow, 2007). As representativeness is critical for case studies (Seawright and Gerring, 2008), the cases were chosen to illustrate how succession in VCFBs affects the governance of the portfolio company deal process. Therefore, all cases consist of second- or multi-generation owned VCFBs, which in turn represent differences in age and size. The cases illustrate how personal and administrative VCFBs govern the portfolio companies during the deal process.

The theoretical framework reviews relevant literature related to VC firm heterogeneity, the different phases of an investment process and VCFB governance. Since the overwhelming majority of all small and medium-sized companies in Europe, i.e. potential target firms of VCFBs, can be classified as family firms (Carney *et al.*, 2015), they are also affected by the family ownership logic (Brundin *et al.*, 2014), for example, the significant presence of non-financial goals (Neckebrouck *et al.*, 2017), which differentiates them from non-family businesses. Therefore, this study only covers VCFB governance of target family firms (TFFs). Moreover, because our definition of VCFBs emerged from Wright and Robbie's (1998) definition of equity firms, our study only concerns deal processes of late-stage TFFs.

As a result of the theoretical framework, Figure 1 presents a model of different types of VCFBs and their suggested behaviors. In the next step, the model is applied, and with the help of illustrative examples, propositions are developed. Being based on abductive reasoning (Klag and Langley, 2013), this paper contrasts the empirical examples with each other and with the VC and family business literature. By developing a model that addresses the identified governance shift in multi-generational VCFBs, this paper explains this discontinuity by combining empirical examples with the dualistic concepts (Klag and Langley, 2013) of centrifugal and centripetal forces (Boers and Ljungkvist, 2019; Czarniawska, 1999). We have chosen to base our examples on real company cases that illustrate a certain behavior and thereby justify the developed propositions (De Massis and Kotlar, 2014).

2.1 Data collection

To illustrate the phases of the deal process, data were collected from 17 interviews with key-persons in VCFBs and portfolio companies, 16 secondary interviews with VCFB owners covering the deal and governance processes from leading Swedish newspapers and business press, statements from three Responsible Investment Transparency Reports [1] and from 12 annual reports, and 123 press clippings, all concerning these processes.

The interviews covered VCFBs' chief executive officers (CEOs) and family board members from different generations and managers from portfolio companies, and lasted for approximately 60 min. The interview questions focused on the role of family ownership, how governance is conducted, strategy and acquisitions of portfolio companies. Furthermore, the secondary interviews were collected from the business sections in the largest Scandinavian newspapers, i.e. *Dagens Nyheter*, *Svenska Dagbladet*, *Hufvudstadsbladet*, and from the business magazines *Affärsvärlden*, *Veckans Affärer* and *Dagens Industri*. The VCFBs' Responsible Investment Transparency Reports, and other documents describing their governance, were downloaded from the companies' websites. The press clippings were primarily gathered from the news platforms MyNewsdesk and Retriever for Germany.

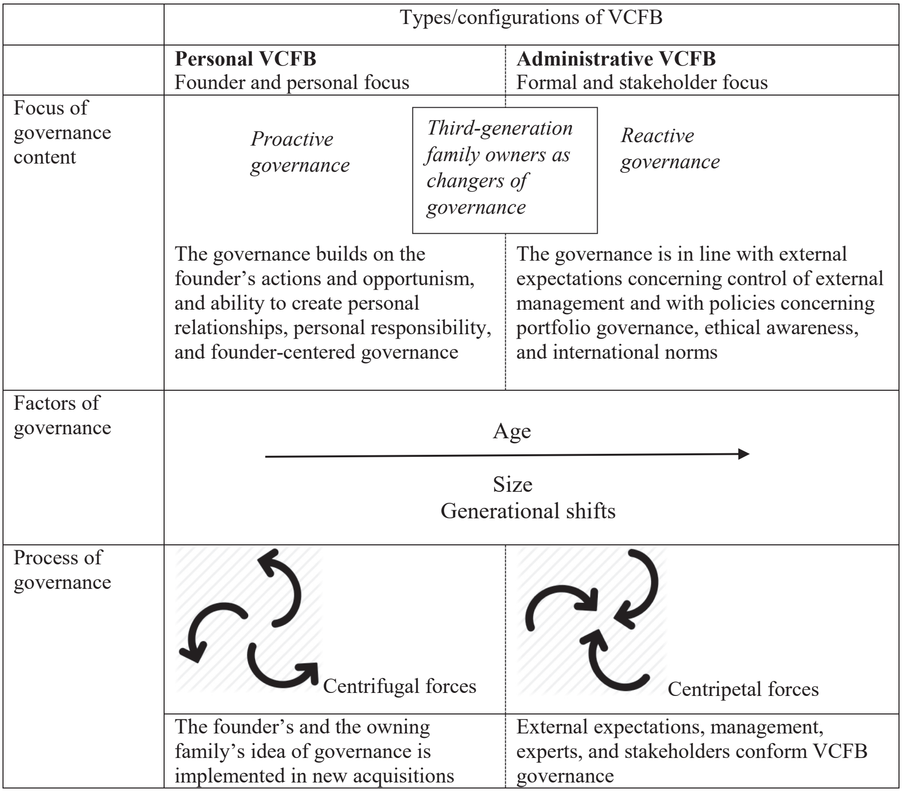

Figure 1.
Governance implications of VCFB configurations

2.2 Governance practices

Several governance practices are available to VCFBs, such as "family constitutions, family code of conduct, clear selection and accountability criteria, family council, formal family communication mechanisms and family reunions" (Berent-Braun and Uhlaner, 2012, p. 103). In this research, we chose to highlight governance practices that are directly used by the family business to govern, control and determine the direction of the portfolio companies and their management, namely, family constitutions, family codes of conduct, and clear selection and accountability criteria. These governance practices are directly observable in the case companies' descriptions and in the public news feeds. The *family constitution* and *family code of conduct* refer to documents containing the fundamental principles and rules of family firm management, clarifying internal as well as external relationships with partners and society at large and related expectations (Berent-Braun and Uhlaner, 2012; Suess, 2014). To enhance cooperation between internal and external stakeholders, *clear selection and accountability criteria* describe the reasons why people, including family members, are chosen for management positions and responsibility roles (Berent-Braun and Uhlaner, 2012). All in all, these three governance practices are central issues for the family firm board.

To maintain the studied VCFBs' anonymity, the real names of companies, people and places are not revealed. However, as earlier studies have shown, many family firms are active in the VC or private equity industry, indicating the importance of the research area (Ahlers *et al.*, 2018; Schickinger *et al.*, 2018; Schüler *et al.*, 2019).

3. Theoretical framework

3.1 VC firm heterogeneity and TFFs

VC firms [2] represent a heterogenous group and differ according to several criteria, such as origin, type of firms invested in and industry (Bertoni *et al.*, 2015; Elango *et al.*, 1995; Patzelt *et al.*, 2009; Scarlata *et al.*, 2015). Another factor contributing to the heterogeneity of VC firms relates to their ownership (Sahlman, 1990). The impact of ownership has often been disregarded (Fraser *et al.*, 2015; Wright, 2017), although it plays a decisive role in the family business context (Brundin *et al.*, 2014).

The VC literature usually treats family firms as the targets of VC firm activities (Schüler *et al.*, 2019), for example, providing financing for TFFs, which possibly leads to tension and even resistance (Neckebrouck *et al.*, 2017). Only recently have some researchers begun to argue that VC firms can also be family firms, which may affect the relationship between VC and portfolio companies (Ljungkvist and Boers, 2017).

VC firms are just as heterogenous as other firms are, having various strategies for interacting with target companies (Howorth *et al.*, 2016; Schickinger *et al.*, 2018). The literature describes several possible sources of tension between external investors and TFFs (Schickinger *et al.*, 2018). Tensions can result from conflicting goals, as the TFF may have non-financial goals, whereas VC firms primarily have financial goals (Dawson, 2011). Other examples relate to the long-term perspectives of target firms (often family businesses), whereas external investors are interested in short-term financial gains (Zata Poutziouris, 2016). Despite recent research showing that the strong identification of TFF owners with their firms (Neckebrouck *et al.*, 2017), recent reports have noted an increasing number of deals between VC firms and TFFs (Schickinger *et al.*, 2018). The motives behind this increase are not fully understood, but some research has shown TFF owners' affinity towards certain external investors, such as individual investors, family offices (Neckebrouck *et al.*, 2017) and investors that are family firms, i.e. VCFBs (Ljungkvist and Boers, 2017).

Several factors, such as culture and history (Garvi, 2007), motivate VC firms and influence their business activities. Garvi (2007) also found that VC firms are driven by their visions and by human beings with their individual priorities. However, as family firms represent a rich context in which non-financial goals may be more prevalent (Neckebrouck *et al.*, 2017), we proceed by considering the different phases through which VC companies interact with their target companies when making investments.

3.2 Three phases of investing

Recent research posits that the behavioral motives for acquisitions are underexplored for private family investors (Gomez-Mejia *et al.*, 2015). Although there is some evidence of different acquisition strategies in relation to growth (Achtenhagen *et al.*, 2017), there is no research investigating the deal processes of VCFBs. As VC companies represent a special group of firms, analyzing their investment behavior is imperative. It is worth clarifying at this point that a VC firm usually exits the target firm with a profit after a certain period (Maas *et al.*, 2020).

In principle, a VC company interacts with a potential investment object before, during and after a deal is closed. These three phases generally apply to the relationship between potential portfolio companies and VC firms (Schickinger *et al.*, 2018). In a recent review, Schickinger *et al.* (2018) summarized their key findings concerning the three phases. Each phase can be broken down further, but for the present purpose, these three phases are sufficient for exploring the impact of VCFB governance trajectories.

3.2.1 Pre-deal phase. Schickinger *et al.* (2018) found that studies pertaining to this phase have investigated four dimensions: the reasons for seeking VC financing, the reluctance to accept this financing, the drivers of family firm investments, and the challenges of these investments (Schickinger *et al.*, 2018, p. 272). Clearly, the commitment and professionalism of the TFF is critical (Dreux, 1990). Schickinger *et al.* (2018) also noted several weaknesses of pre-deal studies, particularly their neglect of the role of the private family investor. Furthermore, there is disagreement concerning the degree and importance of qualifications and governance: whereas some argue that VC companies can contribute knowledge and increase the professionalism of TFFs (Dawson, 2011; Tappeiner *et al.*, 2012), others highlight the complexity and particularity of the knowledge possessed by TFFs (Hall and Nordqvist, 2008), suggesting that further investigation of these issues is called for (Schickinger *et al.*, 2018).

3.2.2 Deal phase. In this phase, the basis for an agreement between the investor (i.e. the VC company) and the TFF is established. Schickinger *et al.* (2018, p. 273) reported that studies of the deal phase usually address the valuation and pricing of TFF or behavior during the negotiation between the TFF owners and investors. In these situations, the reduction of information asymmetries is vital. Limited information sharing with the investor may benefit the TFF owners in the short term, but will likely damage the relationship in the long term (Howorth *et al.*, 2016). Moreover, if the TFF owners are interested in obtaining non-financial resources from the investor, they are more likely to grant external owners more voting rights (Tappeiner *et al.*, 2012). The level of experience and governance can also be a factor easing the negotiation process on both sides (Tappeiner *et al.*, 2012). For example, an investor's active participation in succession planning tends to support the deal agreement (Scholes *et al.*, 2008).

3.2.3 Post-deal phase. In this phase, the TFF and the investor have reached an agreement, and the investor has become a shareholder in the TFF. Schickinger *et al.* (2018, p. 274) found that studies of this phase address firm-level outcomes, family-level outcomes and family–investor interaction. The findings regarding this phase vary, and several weaknesses have been identified, such as an overemphasis on single-country studies and the absence of research on different types of investors (Schickinger *et al.*, 2018, p. 274). In particular, TFF–investor interaction has only been researched in a single case study (Achleitner *et al.*, 2010), suggesting that further studies in this area are warranted.

3.3 VCFB governance

Family business governance can be described as a combination of different practices (Berent-Braun and Uhlaner, 2012) that are "put in place at the highest level of the business, family and ownership to make the best possible decisions regarding the direction of the business and assurance of accountability and control" (Gallo and Kenyon-Rouvinez, 2005, p. 45). Governance is an important matter for VC firms, and in this context, it refers to the VCFB's governance of its portfolio companies. However, there are several family governance solutions similar to VCFBs, i.e. family offices, family foundations, trustees and family portfolio entrepreneurship. Yet, as family offices focus on custom-made wealth management solutions and the preservation of family identity (Welsh *et al.*, 2013), family foundations on donation management (Lungeanu and Ward, 2012), trustees on the management of legal and financial agreements (Jaffe and Lane, 2004), and family portfolio entrepreneurship on the "ownership of multiple businesses" (Carter and Ram, 2003, p. 375), none of these solutions focuses explicitly on making gains through temporary ownership. Moreover, since VCFB governance centers on raising the value of portfolio companies within a given timeframe, it also differs from the established family firm notion of having long-term non-financial goals. Thus, VCFB governance diverges by being more financially oriented and temporary than the other mentioned governance forms.

It is well-known that VC investors largely form the governance of the companies in which they invest (Jolink and Niesten, 2016), which, in the VCFB case, may involve the replacement of top management and board members (Ljungkvist and Boers, 2017). However, research shows that potential TFFs are interested in taking on VC investors to overcome issues related to succession (Scholes *et al.*, 2008) or to gain knowledge regarding internationalization (Dawson, 2011; Schickinger *et al.*, 2018). In such cases, VC firms often trigger the acquired firm to develop a higher caliber of professionalization (Schickinger *et al.*, 2018). The equity stake taken by an external investor has several governance implications (Neckebrouck *et al.*, 2019), which vary based on the investor's ambitions with respect to either the VC firm (e.g. acquiring new equity) or the acquired firm (e.g. buying out portfolio owners) (Neckebrouck *et al.*, 2019). Irrespective of the origin of the goals, investors usually want something in return, such as financial cash flows (e.g. dividends) and a seat on the board of directors, in order to support their influence (Achleitner *et al.*, 2010).

In addition to providing continuity in transgenerational family businesses, family succession also affects family firm governance (Suess, 2014). Jaffe and Lane (2004) noted that the governance structure changes during the first three generations of a family business. During the first generation, the company is dominated by the founder's/entrepreneur's personal vision and control, which makes the governance implicit and characterized by ad hoc solutions (Labaki, 2011; Salvato, 2004). During the second generation, the founder continues to exert influence on the family firm's governance; however, the Chairman of the Board and the CEO positions are often held by the second-generation family members, and the governance structure is frequently characterized by implicit policies (Jaffe and Lane, 2004). By the third and later generations, the family firm often takes the form of a holding company. The growth in family members requires formalization of organizational policies and norms, and the Board and the CEO positions are often held by external persons (Kellermanns and Eddleston, 2006). Hence, due to family business succession, VCFB portfolio governance tends to be more professionalized and formalized during later generations.

Specifically, a family firm's governance is also affected by its age and size (Suess-Reyes, 2017). Several researchers have shown that older family businesses are more likely to develop formal governance practices than younger ones, which instead are based on the founder's or CEO's informal decision-making power (Fahed-Sreih and Djoundourian, 2006). This tendency can be explained by the complexity of multi-generational family businesses. Mature family businesses tend to involve family members from several generations, who tend to be less active in the business, resulting in a need for an increase in formal governance practices (Brenes *et al.*, 2011; Suáre and Santana-Martín, 2004). In addition, the social interaction within the family tends to decline as the family business expands across different generations and the number of family members increases (Mustakallio *et al.*, 2002). However, there is also a correlation between the family firm's actual size and the presence of governance practices (Suess-Reyes, 2017). The larger the family firm becomes (an expansion that often occurs across family generations), the more elaborate the governance becomes (Brigham *et al.*, 2014; Corbetta and Montemerlo, 1999), which can explain the increased need for formalization to maintain control of the company (Mintzberg, 1980). Therefore, we can expect the portfolio governance practices of older and larger VCFBs to be more elaborated, for example, concerning family constitutions, codes of conduct and accountability criteria.

It is important to note that, in this paper, governance refers not only to the formal governance of the portfolio companies, but also to the governance style, which is affected by the investor's experience and expertise (Sapienza *et al.*, 1996). VC companies follow different approaches with respect to their portfolio companies. Common approaches are direct interaction with the CEO of the portfolio company and involvement in the board of directors (Bonini and Capizzi, 2017).

Regarding the different deal phases (Schickinger *et al.*, 2018), it can be assumed that the formal governance relationship between investor and investee begins when a deal has been closed. This does not mean that there are no governance issues in the pre-deal and deal phases. Rather, the investor will likely have ideas of and benchmarks for how the relationship between the two parties should be organized. However, from a family ownership perspective, this informal (and not legally binding) governance is an important complement to the contractual governance mechanism (Calabrò and Mussolino, 2013), as it supports and fosters "the transgenerational orientation of the business" (Suess-Reyes, 2017, p. 766) in all phases.

4. Developing a model of VCFB governance

Family-owned VC firms can be categorized according to their configurations as personal or administrative VCFBs. Personal VCFB consists of the founder and the second generation, while the administrative VCFB consists of the third and subsequent generations (Ljungkvist and Boers, 2017). The *governance content* of personal VCFB builds on the founder's actions and opportunism, and ability to create personal relationships, personal responsibility and founder-centered governance (Ljungkvist and Boers, 2017). The *governance content* of administrative VCFBs' is characterized by external expectations concerning control of external management and with policies concerning portfolio governance, ethical awareness and international norms (Ljungkvist and Boers, 2017) (Figure 1).

The differences in *age and size* between these two firm configurations, which relate to the number of family successions, influence the level and modes of governance (cf. Stewart and Hitt, 2012), which in turn, affect the firm strategy and governance. However, Figure 1 identifies third-generation family owners as likely *changers of governance approach*. Since personal VCFB's governance of the portfolio deal process is closely connected to the founder's personal experiences and his or her personal solutions (Ljungkvist and Boers, 2017; Salvato, 2004), the next generation of family owners tends to be less entrepreneurial (Miller and Le Breton-Miller, 2011), their management style tends to concern conceptualizations of the founder's governance solutions. Furthermore, the larger a company becomes, the more public attention it attracts, meaning higher governance expectations from the business world and society in general (DiMaggio and Powell, 1983). In this way, the demand for higher education extends to all internal and external managers. Due to this process, the second and third generations of family owners are sent to internationalized business schools (Suess-Reyes, 2017), favoring more or less globalized approaches, theories and concepts, which in turn influence their professional behavior (Giddens, 2013; Røvik, 2011), meaning that the drive for uniqueness declines. However, the second generation of family owners' *immediate* contact with the founder in the business affects their entrepreneurship and governance even more (Hamilton, 2011). This immediate relationship with the founder does not occur for the third-generation. Instead, this and later generations will likely meet the increasing complexity related to the multi-generational family business's growing age and size by enhancing the organization's formal governance (Fahed-Sreih and Djoundourian, 2006; Jaffe and Lane, 2004; Suáre and Santana-Martín, 2004). By applying international governance concepts, the ability to formalize and centralize information increases, also providing the multi-generational family firm with legitimacy (Meyer and Rowan, 1977).

To deepen our understanding of the VCFB *governance process* and the portfolio deal process, the dichotomy between centrifugal and centripetal forces (Boers and Ljungkvist, 2019; Czarniawska, 1999; Sheremata, 2000) is a useful concept. The centrifugal forces are characterized by outward moves and by unique experiences that are emphasized and transmitted to the surrounding world (i.e. the creation of new ideas), stimulating and developing a particular understanding of the local market, including its details and specific customer relationships (Boers and Ljungkvist, 2019; Czarniawska, 1999). The centripetal forces move in the opposite direction, inwards, meaning that global ideas and methods concerning governance and strategy affect the local company (Boers and Ljungkvist, 2019). Consequently, the general prevalence of conformity, coherence and standardization increases (Czarniawska, 1999; Melewar and Saunders, 1998).

Regarding the personal VCFB *process of governance*, several features suggest that centrifugal forces primarily drive this configuration and the governance being applied. Because the strategy and governance are closely connected to the founder, his or her personal experiences and interpretations, as well as the local setting, are the prime sources of these forces. The actions of the founder and other family members build on their own unique experiences (Hambrick and Mason, 1984). This also entails the diffusion of personal ideas concerning management, strategy and governance to the organization and other stakeholders. If the personal VCFB is praised in national or international media, it is likely in some respects to influence the industry and society. Thus, personal relationships (Chrisman *et al.*, 2003) with the TFFs, portfolio companies and customers, personal responsibilities, opportunistic actions and founder-centered governance all generate personal and organization-specific governance that affects the firm's environment.

In the older and larger configuration of administrative VCFBs, the *process of governance* mainly emerges as centripetal forces. As these companies are older and larger, they have been exposed to institutional expectations, for example, from banks, public authorities and international associations, to a greater extent and for a longer time (DiMaggio and Powell, 1983), and governance in line with a Western standard is expected. Centripetal moves in line with higher conformity, coherence and standardization (Czarniawska, 1999; Melewar and Saunders, 1998) are therefore encouraged and generated. Key management functions and practices are adjusted in line with global and international norms and expectations. In the case of the administrative VCFBs, recruitment of external managers, cooperation with portfolio company management teams, and a financial policy signaling ethical awareness and trust appear to be specific criteria (Ljungkvist and Boers, 2017). These governance practices have a more or less conforming effect on older and larger VCFBs and VC companies.

Thus, the governance trajectory implies a shift from centrifugal to centripetal approaches, suggesting third-generation family owners as changers of governance orientation–from an action and proactivity-oriented approach to a reactive norm-adapted one.

5. Applying the model to the three deal phases

In this section, we develop the model further by applying it to the three deal phases suggested in the literature (Schickinger *et al.*, 2018). We also elaborate upon our model and propositions with the help of empirical illustrations from VCFBs.

5.1 Illustrative cases

To present the main implications of the model proposed above, this section presents illustrative features of four anonymous cases. VCFBs A and B illustrate the theoretical propositions concerning the personal VCFB, while VCFBs C and D illustrate those concerning the administrative VCFB. Combining these two case categories illuminates the change of governance over time, i.e. the governance trajectory.

VCFB A was founded in Sweden in 1974. The founder was Board Chair and CEO until 2001, when his son took over as CEO. However, the founder is still the Board Chair, and his son, Andreas, is a member of the board. VCFB A has no industry focus and invests in small and medium-sized listed and unlisted Swedish companies. VCFB A clearly states that its ownership builds on close cooperation with the management of the portfolio companies. In addition, the founder and his son are board members in most of the portfolio companies.

VCFB B is a Finnish company established in 2001. The founder has been the Board Chair since the beginning and is the principal owner of the company. His son is the CEO, a minority owner of VCFB B, and a member of the company's board. VCFB B has no industry restrictions, targeting portfolio investments made in Finland. The founder and his son take part in the portfolio companies' boards and have crucial roles in these companies' key decision-making.

VCFB C is a fourth-generation Swedish family company that was founded in 1866. Both the Board Chair and CEO are external, but the owning family is represented on the board. One descendant of the founding family is the Board Chair, and his cousin is also a member and the deputy chair of the board. VCFB C's individual investments are EUR 25–550 million in size, and the TFFs are preferably located in Nordic countries, although global investments can be made by VCFB C's holdings.

VCFB D is a German VCFB that was founded in 1795 as a trading company. Representing the sixth generation of the founding family, a family member is director of VCFB D and a board member. VCFB D's investment strategy focuses on growth financing and succession planning for established medium-sized enterprises, including traditional manufacturing companies as well as high-tech information technology (IT) companies. These companies are located mainly in Germany, but also in other European countries. VCFB D is usually not interested in taking any operational responsibility, but simply in investing its own money in the portfolio companies: "Thus, every financial partnership is an integral part [of VCFB D] and connected with corresponding entrepreneurial interests" (VCFB D homepage).

5.2 The governance of portfolio companies through the deal process

5.2.1 Illustrations and proposition regarding personal VCFBs. As shown, VCFBs A and B are still strongly founder centered (Figure 1), as the founders and their sons occupy the Board Chair and CEO positions. Thus, these companies have been created and shaped by the founders' personal values and experiences, which affect the decision-making and preliminary interactions during the pre-deal phase (Schickinger *et al.*, 2018). Three of VCFB A's six strategic goals clearly state the importance of close cooperation with portfolio managers, emphasizing the importance of personal attributes and of "chemistry" between the VCFB and the portfolio management teams (Achleitner *et al.*, 2010; Dreux, 1990). Therefore, VCFB A's and B's search for the right personal fit between the VCFBs' family members and the management teams of the TFFs is essential, as illustrated by the following quotation: "When targeting investments, we first of all look at the people [of the TFF] . . . it is necessary that they sympathize with our philosophy" (CEO of VCFB A). In these cases, the screening process, ultimately originating from the founders' and their sons' personal experiences and values, generated as centrifugal forces. Furthermore, the pre-deal phase is affected by these two VCFBs' opportunism, i.e. desire for "low-hanging fruit" (Schickinger *et al.*, 2018), emanating from the owning family members' unique mindset. For example, VCFB B suddenly, without announcement, invested in Russian real estate, which was reported in the Finnish business press as follows: "The preliminary [i.e. pre-deal] agreement describes how the company's Russian properties use its subsidiary in Luxembourg, providing very favorable tax conditions [i.e. no capital gains tax on sales]" and, according to VCFB B's CEO, "we will have a 'real jackpot' if the Russian properties are sold" (business journalist). The pre-deal phase can be characterized by rapid change and action in terms of investment decision-making, following personal and centrifugal interpretations of the business situation.

In the deal phase, both VCFBs A and B stress the personal responsibility of potential portfolio managers, emphasizing the personal factor. Based on the founder's experiences, VCFB A has developed an in-house method of business development, called "the methodology", which can be regarded as a family business constitution (Berent-Braun and Uhlaner, 2012). The methodology document clarifies the roles and commitments for future cooperation between VCFB A and a portfolio company. Close and decisive co-working with the portfolio company's management is highlighted, and future collaboration and related expectations are elements of the deal negotiations. Depending on the TTF's financial and non-financial goals, and on the trust and personal chemistry (Ahlers *et al.*, 2018) between the parties, these intensive interactions may repel or attract the owners of TFFs. Clearly, the emotional dimension comes to the fore in this situation (Hirigoyen and Basly, 2019). Furthermore, the element of rapid and adaptable bargain-hunting appears in VCFB A's searches for "turnarounds", i.e. companies that have potential but are experiencing severe problems: "The company [i.e. VCFB B] is basically interested in owner-managed companies that need support, and where there are clear financial incentives" (business analyst). The CEO noted: "It is very important for us that revaluation is achievable for a substantial part of our investments. Besides, the portfolio company's management must consist of committed people with whom we can closely cooperate." This statement demonstrates clear selection and accountability criteria (Berent-Braun and Uhlaner, 2012). Regarding VCFB B, the business valuation of its investment objects is aligned with a self-developed management model, i.e. a family business constitution that supports rapid and decisive action. For example, VCFB B sold a shopping center in central Helsinki shortly after it had opened because a good price had been offered.

Generally, the involvement of family members in the personal VCFB ensures that more than just financial interests guide the negotiation process (Berrone *et al.*, 2012). The owner family's involvement in the personal VCFB secures the basis of trust between the owning family and the TFF (Calabrò and Mussolino, 2013; Steier, 2001) and their proximity to the target (Brundin *et al.*, 2014). Summing up, the founders' personal experiences lead to the development of unique management solutions that stimulate rapid and decisive action, affecting negotiations in the deal phase.

Regarding the post-deal phase, personal VCFB founders' unique experiences, local interpretations, and opportunism result in a volatile and changeable management (cf. Czarniawska, 1999; Ljungkvist and Boers, 2017). Moreover, the family owners of a personal VCFB see the business as an extension of themselves, giving them the mandate and incentive to engage with the target company (Brundin *et al.*, 2014). Concerning VCFB A, there are no established committees, but VCFB A's board members in the portfolio companies have full personal responsibility for all board matters. However, VCFB A's board interactions indicate opportunism: "Even though the owning family claims to have close dialogues with the portfolio management teams, there is ongoing criticism that VCFB A roughly and abruptly replaces boards and managements [in the portfolio companies]" (business journalist). In addition, VCFB A has been publicly accused of breaking up portfolio companies and selling them in pieces: "They [i.e. the management of VCFB A] talked about synergy effects, [but] they never mentioned that they would break up the company" (former portfolio Chair). However, the CEO of VCFB A gives a somewhat different picture: "Our concentrated ownership means that we can have a long-term approach." In VCFB B, governance during the post-deal phase is characterized by sudden decisions. Occasionally, the portfolio companies' management has been unexpectedly and abruptly removed. These management changes were made for personal reasons, indicating governance based on abrupt and non-public actions (Ljungkvist and Boers, 2017). Thus, in the studied personal VCFBs, the post-deal phase is characterized by the founders' and the second-generation family owners' rapid and unforeseen decisions. As these decisions are based on personal judgments, they have a unique and centrifugal impact on the environment and stakeholders. Altogether, this deal process leads to the following proposition:

P1. The personal VCFB's governance of the deal process of portfolio companies is significantly affected by centrifugal forces that drive personal and action- and proactivity-oriented governance.

5.2.2 Illustrations and proposition regarding administrative VCFBs. For VCFBs C and D, the pre-deal phase is less focused on personal attributes and opportunism. Both use institutionalized governance systems (i.e. constitutions) including codes of conduct (Berent-Braun and Uhlaner, 2012), which may attract TFF owners with a strong focus on sustainability. VCFB C stated that a potential portfolio company's business model should be well-proven and aligned with key ratios, following objective criteria. In addition, VCFB C adheres to international environmental, social and governance (ESG) criteria when screening for investments. The firm claims to "avoid companies with main risks related to factors outside management control" (VCFB C homepage), implying more risk-averse, non-opportunistic behavior. Similarly, VCFB D takes a long-term approach, in line with its existence since 1795, acquiring long-term ownership stakes in well-developed and publicly recognized businesses. Furthermore, the company only invests in firms that complement its "strategic and human commitment", which also concerns sustainability: "We always look for sustainable business models [among potential investments]" (Director of VCFB D). VCFB D's accountability and trustworthiness are emphasized in the company presentation and are obviously related to the firm's reputation, corresponding to normative expectations (DiMaggio and Powell, 1983). Overall, the pre-deal phase of these administrative VCFBs emphasizes governance considerations regarding established business models and key ratios, following institutionalized criteria and responding to conformist centripetal forces.

Regarding the deal phase, the managements of VCFBs C and D are heavily dominated by external managers, so the search for the right personal chemistry and personal attributes in the counterparties during a deal negotiation is less important (Zellweger and Astrachan, 2008). Consequently, the actual figures of the deal can be more objectively and professionally discussed: "In the board, we conduct many different types of thorough analyses . . . we talk a lot about tactical, operational, and strategic issues" (non-family member of VCFB C board). Furthermore, both VCFBs C and D claim that their portfolio management cooperation is decentralized. VCFB D stated that "our investments are therefore partnerships," rendering centralization of the performance matrix more important (Mintzberg, 1980). However, VCFB C states the following in its Policy for Sustainability, Corporate Responsibility and Responsible Investments: "We set clear requirements and expectations for employees and partners [e.g. portfolio companies] regarding the environment, ethics, and social responsibility, which are presented in our code of conduct," which places clear demands on TFF owners. Another aspect of the deal phase is succession planning, which, if handled properly, will likely positively influence the agreement process (Scholes *et al.*, 2008). VCFB D affirmed the importance of succession planning. To highlight and plan for the succession of the selling TFF owners, attentiveness to industry expectations and ethical awareness are necessary. Common to both VCFBs C and D is their underlying transparency; notably, symmetrical information-sharing between the negotiating parties supports transactions (Howorth *et al.*, 2016). In VCFB C's Responsible Investment Transparency Report, the "RI [i.e. responsible investment] roles and responsibilities" and the "breakdown of investments by strategy" are clearly described and publicly available: "We shall work to ensure that our subsidiaries and other holdings conduct their operations in a responsible and sustainable manner . . . when assessing new investments, risks and opportunities are mapped, as well as the company's maturity in terms of sustainability." This documentation follows international "principles of responsible investments." Moreover, the board, as a formal governance mechanism (Calabrò and Mussolino, 2013), can balance the influence of family members, as the board is considerably influenced by the independent directors (Anderson and Reeb, 2004). Several depersonalizing aspects, such as professional governance, succession planning and transparency, are in line with centripetal forces and conform to industry expectations and international standards.

During the post-deal phase, both VCFB C and D are dominated by external hired managements, indicating more professionalized governance (Howorth *et al.*, 2016). Independent directors are present on the board of directors to balance the family influence

(Anderson and Reeb, 2004). Considering standardized norms, these VCFBs are more decentralized. For example, VCFB C stated: "We enable medium-sized companies to maintain their independence and develop faster by being part of something bigger" (family board member). This approach also applied at VCFB D: "As it is not our intention to take over the operational management of our investment companies ourselves . . . [VCFB D] sees itself as a partner" (VCFB D homepage), relating to a modern management approach (Giddens, 2013; Røvik, 2011) that leaves decision room for the potential remaining management from the TFF. However, despite the use of decentralization, these VCFBs apply an overall agenda: "The portfolio companies' CEOs know that we are a stable and long-term owner and that we have an agenda, but we have an ongoing conversation about it [with the portfolio CEOs]" (former non-family CEO of VCFB C). Moreover, VCFB C's and D's governance reports express the importance of ESG policy. VCFB C has expressed the following high priorities: "Doing business with good business ethics, including anti-corruption" and "ensur[ing] sound corporate governance and transparency" (VCFB C homepage), i.e. as a code of conduct statement (Berent-Braun and Uhlaner, 2012). Both these priorities are in line with Global Reporting Initiative (GRI) standards. VCFB C's adherence to the Principles for Responsible Investment further demonstrates its support for global governance ideals. VCFB D strongly focuses on continuity and long-lasting relationships with the portfolio companies, emphasizing "human commitment" and reflecting ethical awareness and the impact of global principles. As these principles are vital to VCFB D, the acquired portfolio companies are included in these governance priorities. VCFB D's response to institutional expectations concerning external management, ethical issues and transparency (Figure 1) (Ljungkvist and Boers, 2017) affects the post-deal outcomes and perception of the deal (Anderson and Reeb, 2004; Boers *et al.*, 2017; Schickinger *et al.*, 2018). Conformation to public expectations and global standards therefore gives rise to centripetal forces that drive norm-oriented strategic and governance adaptations. Altogether, the three deal phases lead to the following proposition:

P2. The administrative VCFB's governance of the deal process of portfolio companies is significantly affected by centripetal forces that drive norm-oriented governance.

6. Discussion

The propositions regarding VCFB deal-making processes (Schickinger *et al.*, 2018) can be explained in terms of governance generated by centrifugal and centripetal forces (Boers and Ljungkvist, 2019; Czarniawska, 1999), which are ultimately related to VCFB age, size and succession arrangements. This holistic approach allows for a general understanding of the fundamental forces shaping VCFB governance (Schickinger *et al.*, 2018). The presented propositions highlight how the family owners' actions and behavior are related to VCFB governance, which in turn influences the three phases of making an investment.

A number of family business studies (Chrisman *et al.*, 2003; Stewart and Hitt, 2012; Suess, 2014; Suess-Reyes, 2017) indirectly support the fundamental implications presented in Figure 1 regarding the generational shifts and the age and size of family businesses. Given the nature of qualitative research and some minor discrepancies, the results indicate a close fit between the stated propositions and the cases. Regarding P1, the unique and personal experiences arising from the founder's entrepreneurial initiatives in a founder-centered firm (Salvato, 2004) give rise to action- and proactivity-oriented governance. Thus, the personal VCFB's pre-deal governance is characterized by decisive and opportunistic investment decisions and by a search for the right fit between the VCFB's family members and the management team of the TFF. The personal negotiations that appear in the ensuing deal phase are strongly affected by the level of trust and commitment. However, the replacement of management teams and boards, which takes place from time to time during the post-deal phase, occurs through "immediate and non-public actions" relating to opportunism, informal operations (Stewart and Hitt, 2012) and ignoring previous TFF owners. Briefly stated, the post-deal governance of the personal VCFB appears as changeable and volatile. Thus, the portfolio governance is generated by centrifugal forces emanating from the founder and his or her initiatives.

However, the reactive norm-oriented governance posited in P2 is generated by external influence and, thus, by conforming to external centripetal forces. The administrative VCFB's pre-deal governance emphasizes adjustment to established and institutionalized business models and key ratios, suggesting that the ensuing deal negotiations are characterized by objectivity and transparency. Such depersonalized features are further strengthened in the post-deal phase, when the portfolio governance conforms to public expectations and international norms of professionalization, externally recruited management and ethical awareness, mainly concerning VC markets. However, the formalization of the VCFB's governance practices is also a consequence of the complexity of the transgenerational family business (Jaffe and Lane, 2004; Suess, 2014). Family members from different generations are involved in the management, while others are more or less inactive. To maintain control, the organization's growing age and size also call for increased formalization (Brigham *et al.*, 2014; Corbetta and Montemerlo, 1999). Nevertheless, it is the centripetal conforming forces (Boers and Ljungkvist, 2019; Czarniawska, 1999) that cement the administrative VCFBs' governance practice, which the acquired portfolio companies fully experience in the post-deal phase. Altogether, centripetal forces, intensified by the recruitment of external management and specialists (Hall and Nordqvist, 2008), transparency and management systems emphasizing ethical awareness (cf. Giddens, 2013; Røvik, 2011), conform to international norms, making the administrative VCFB's governance phases more predictable but, concurrently, less innovative and adaptable to local conditions and personal relationships.

In line with the structural complexity that occurs with third- and later-generation family owners (Jaffe and Lane, 2004), the family owners lose immediate and personal contact with the founder's crucial initiatives and with the contingencies that created the company. The impetus and power of action tend to shift from being internally generated to becoming responses to external stakeholders' expectations (DiMaggio and Powell, 1983). Thus, the third-generation family owners appear as a likely changer of governance approach. Furthermore, the age and growth of the company also contribute to the major shift from personal (i.e. founder and second generation) centrifugally generated forces to external centripetally generated ones. However, regardless of a firm's age, size and succession arrangements (Suess-Reyes, 2017), the owning family's struggle for control (Brundin *et al.*, 2014) continues, yet changing form from being personally oriented and executed by the founder him- or herself or by the second generation, to manifesting itself in the practices of impersonal governance systems (Giddens, 2013; Røvik, 2011), as reflected in the three phases of the deal (Schickinger *et al.*, 2018).

6.1 Practical approaches/implications

This study is of practical relevance to VCFB firms and their investment targets. Awareness of the investing process can help in determining the expectations that may arise and how firm growth can be supported transgenerationally (Zellweger and Sieger, 2012). By "strategically us[ing] the founder's legacy" and referring to him or her as an entrepreneurial role model, the entrepreneurial spirit and attitude can be maintained (Boers and Ljungkvist, 2019, p. 84). Hence, VCFB management should be aware of the conforming governance process that likely appears with third- and later-generation family owners; management should react by applying more entrepreneurial governance that takes care of business opportunities while avoiding ruthless opportunism. Furthermore, with the help of the stated propositions, the managers and owners of firms can reflect on their approach to governance. Target firms seeking close relations with investors should look for a personal VCFB, whereas target firms that prefer a decentralized approach could look for more formalized (i.e. established) administrative VCFBs. Furthermore, as many family businesses do not survive beyond the third generation (Eddleston *et al.*, 2013), a smoother deal process between VCFBs and TFFs would also improve the chances of continuity for companies located in rural areas with poor development prospects, thereby supporting society at large (Ljungkvist and Boers, 2016).

Prior research has emphasized the reluctance of TFFs to engage with VC companies (Neckebrouck *et al.*, 2017), which is in contrast to the actual number of deals made on various markets (Schickinger *et al.*, 2018). Moreover, extant research has viewed family firms from the investor's perspective (Molly *et al.*, 2018; Neckebrouck *et al.*, 2019; Schickinger *et al.*, 2018). However, this paper applies a different perspective by considering the family firm as the *investing* company–so far, a rare and new perspective on ownership (Rottke and Thiele, 2018) missing from the literature (Fraser *et al.*, 2015; Wright, 2017).

6.2 Limitations and avenues for future research

First, this paper is theory developing in nature (Klag and Langley, 2013). Consequently, no empirical conclusions can be drawn. Second, the paper uses illustrative examples that do not allow for any generalizations. Third, the focus of this paper is VCFB governance, thereby excluding other important aspects, such as target firm selection, business models or succession issues.

Future research should empirically test and refine the developed propositions, investigating them both broadly, using quantitative methods, as well as in depth, using qualitative methods. In this way, the characteristics of relationship-oriented governance could be investigated further, exploring, for example, what social attributes have the most significant impact on the different deal phases and on reaching a final deal agreement.

Furthermore, as mainstream VC research has mainly been driven by financial value maximization motives, future research could examine how the mixed gamble of socioemotional wealth (SEW) (Gómez-Mejía *et al.*, 2015) affects VCFB governance. In this way, the conscious (strategic) as well as unconscious cultivation of SEW across family generations could be examined, for example, how SEW gains in terms of strengthened control, family ties and identity (Berrone *et al.*, 2012) influence governance.

The VCFB has been introduced as a hybrid, combining elements of the family firm in a business that invests capital in other firms (Ljungkvist and Boers, 2017).

Notes

1. Responsible Investment Transparency Reports contain a set of guiding principles for sustainable investment issued by the independent UN-supported organization PRI (PRI, 2021).

2. We use venture capital (VC) firms as a generic term also referring to firms that others call private equity firms (e.g. Schickinger *et al.*, 2018). We agree with Wright and Robbie (1998) that the terms have been used interchangeably.

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