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The transacting cognitions of nonfamily employees in the family businesses setting

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Abstract

This paper identifies the thinking patterns necessary for nonfamily employees to work effectively within family businesses. Herein, we use transaction cognition theory (Mitchell, R.K., 2001) to systematically identify the extent of cognitive complexity experienced by nonfamily employees, and thereby highlight factors within the cognitive situation that can improve family/nonfamily compatibility and effectiveness. We conclude with a discussion of the transaction cognition theory contribution to theory building.

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1. Executive summary

In this paper we have attempted to shed more light on the family↔business interface by taking a cognitive approach to explore the thinking patterns that are necessary for nonfamily employees to work effectively within family business. Through our analysis we systematically

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identify the extent of cognitive complexity experienced by nonfamily employees, and thereby highlight factors within the cognitive situation that can improve family/nonfamily compatibility.

Our task is to demonstrate the extent to which the transacting cognitions expected of nonfamily employees are substantially more demanding in family business than in business in general. Herein we (1) utilize transaction cognition theory (Mitchell, 2001; Mitchell and Morse, 2002) to establish the cognition types that are expected of employees in business in general, (2) introduce the idea of family business as the intersection of two systems, (3) derive the cognitions expected of nonfamily employees when working within family business, and (4) relate transacting expectations to type of transacting system.

Our analysis suggests that what scholars have heretofore considered to require a simple additive explanation (i.e., understanding family business = business thinking + family thinking) is really a factorial-based explanation that dramatically increases with the number of new elements added. Through rigorous analysis we have identified the 10 cognitions/mental maps that are actually needed for effective transacting by a nonfamily employee in family business—requiring far more cognitive capability and understanding than had previously been supposed.

By this refining of our vocabulary, to enable better description of the factors at work within family business, our theory development also informs practice. In our experience, the development of vocabulary enables all concerned to identify the key elements of a phenomenon, to properly describe these elements and the relationships among them, and is a first step to problem identification and the finding of solutions. By providing tools that enable (1) improvements in our vocabulary and (2) more accurate description of family business phenomena (mental maps necessary for nonfamily employees to successfully participate in family businesses), we hope to promote more effective thinking patterns, communication, and situational understanding within the family business setting.

2. Introduction

Our task is to demonstrate the extent to which the transacting cognitions expected of nonfamily employees are substantially more demanding in family business than in business in general. In this article we use transaction cognition theory—as derived from social cognition and transaction cost economic theory—to identify the transaction cognitions (Mitchell, 2001; Mitchell and Morse, 2002) that bear upon the fit (Fiedler, 1972, p. 453; Vroom and Yetton, 1973) between family and nonfamily employees in family business.

Family businesses are firms in which members of a family have legal control and are involved in the management of the business (Churchill and Hatten, 1987). However, family members are a minority. For example, an average Canadian family firm employs 1.5 family member managers (6.8%), 2.5 nonfamily member managers (11.4%), and 18 employees (81.8%) (Deloitte and Touche, 1999). Hence, developing and maintaining the commitment and loyalty of nonfamily members is one of the two highest priority concerns of family business owners (Chua et al., 2001).

Remarkably, the perspective of nonfamily employees in family business seems rarely to have been considered in the family business literature, even though—as just noted above—it

can be estimated that over 80% of people employed in family business are not family members (Deloitte and Touche, 1999). This perspective is important, because the large proportion of nonfamily employees working in family business may not always think in the same way as family members. For example, when nonfamily members make judgments about the family business system using the achievement of economic objectives as the standard of evaluation, the family business system can sometimes appear to be in conflict with rational business practice (Hollander, 1983). And conversely, the economic objectives system can appear to be insensitive to important family priorities, leading family members to be defensive in dealings with nonfamily decision makers in family business (Sharma et al., 1996). Thus, the family business setting can be seen to be cognitively demanding when viewed from the perspective of the nonfamily employee.

Because of the preponderance of nonfamily employees in family business it becomes important to step into the mental shoes of these employees and attempt to understand the cognitive expectations that they face and need to master for the successful management of everyday transactions. We seek to systematically identify and define these multiple cognitions, and to utilize this analysis to contribute to theory building in the family business literature.

3. Theory development

In this section, as a foundation for theory development, we explore the thinking patterns necessary for successful completion of a transaction by nonfamily employees in both business in general, and in family business. Herein we (1) utilize transaction cognition theory (Mitchell, 2001, Mitchell and Morse, 2002) to establish the cognition types that are expected of employees in business in general, (2) introduce into the argument the idea of family business as the intersection of two systems, (3) derive the cognitions that are expected of nonfamily employees when working within family business, and (4) relate type of transacting system to transacting expectations.

3.1. *The cognitions expected of employees in business in general*

In both nonfamily and family business there are certain expectations of employees. Work must be both effective and efficient (Drucker, 1980). Customers and other salient stakeholders must be properly served (Freeman, 1984; Mitchell and Agle, 1997), and work should be conducted such that it contributes to competitive advantage (Porter, 1980, 1985). We may expect employees to be well aware of these expectations through education and training, the media, and through knowledge of generally prevailing business practices.

Our theory-building starting point is to specify these expectations in cognitive terms, beginning with the basic structure of the transaction itself. A transaction occurs when an “individual,” the most customary transaction creating entity, creates a “work” (some product or service) and enters into an exchange relationship with “other persons” for the sale or acceptance of that work (Gardner, 1993). We explain in the following paragraphs how cognitions are related to this transaction structure.

Cognitions are defined as all processes by which sensory input is transformed, reduced, elaborated, stored, recovered, and used (Neisser, 1967). The information-processing branch of social cognition theory suggests that specialized mental models account for the capability of effective employees to transform, store, recover, and use information that ineffective employees miss (Lord & Maher, 1991). Transaction Cognition Theory proposes that in business in general, three sets of cognitions working together are sufficient for an individual to create a successful transaction (produce a work that is sold to other persons): planning cognitions, promise cognitions, competition cognitions.

Planning, Promise and Competition cognitions are the specialized mental models or scripts (Arthur, 1994a; Neisser, 1967; Read, 1987) that guide individuals' responses to three principal sources of market imperfection: bounded rationality (BR introduced by the transaction creating entity), opportunism (O introduced by others), and specificity (S defined by the uniqueness of the work) (Williamson, 1985). Williamson (1985) suggests three sets of attribute/process relationships that form the foundation for linking the realities of real-world markets to decision-making cognitions. These three relationships are: (1) between bounded rationality and planning, (2) between opportunism and promise, and (3) between specificity and competition (1985: 31), and can be mapped on the basic model of the transaction as shown in Figure 1.

Insert Figure 1 about here

Effective transacting in business in general can then be defined to occur when: *transaction cognitions (mental models/scripts about planning, promise, and competition) are used to organize exchange relationships (among the individual, the work, and other persons) such that the sources of market imperfections (bounded rationality, opportunism, and specificity) yield value* (Arthur, 1994b; Csikszentmihalyi, 1988; Gardner, 1993; Mitchell, 2001; Williamson, 1985: 31). Planning, promise, and competition cognitions, when applied to transacting in business in general are defined as follows:

PLC-1 – Business product/service planning cognitions: This first type of planning cognitions, arises from the connection between the regular business stakeholders and the business work. Such planning understanding enables the transaction creator(s) to satisfy system stakeholders with work produced in the business system.

PrC-1 – Stakeholder promise cognitions: This first type of promise cognitions, arises from the connection between the transaction creator(s) and the business work. This promise understanding is the knowledge necessary to promote trust with the stakeholders of the business system.

CC-1 – Stakeholder alignment competition cognitions: This first type of competition cognitions arise from the connection between the transaction creator(s) and the regular business stakeholders. This type of competitive understanding is the knowledge necessary to effectively position the work of the business system with stakeholders.

Together, all three of these cognitive maps are needed for transacting to proceed in the ordinary business setting. However, as we discuss next, the family business setting is not ordinary.

One Business, Two Systems

In the late 70s and early 80s, researchers and consultants working with family firms were baffled by the inadequate results achieved when the techniques suggested in the then prevalent

management literature did not bring about the stated results in family firms (Hollander, 1983). (For example, although the management literature stressed the importance of regular employee performance evaluations, such evaluation of family member employees was rarely found to be effective in family firms. Evaluations were either not conducted, or in cases in which they were conducted they rarely were an accurate reflection of their performance (Ward, 1987)). Researchers discovered that this type of finding was due to the co-existence (sometimes peaceful, and sometimes not so peaceful) of two distinct sub-systems in family firms: the family system and the business system, while the management literature was focused mainly on the business system only (Lansberg, 1983).

This inconsistency lead researchers next to question the nature of this family system as it related to co-existence with a business system. Scholars examined the basic differences between the family and the business (e.g., Lansberg, 1983). Such differences include: differences over the reasons for the existence of the family firm (e.g., nurturing versus providing goods and services), conflicts in the basic orientation of the two systems (emotional versus task); double standards with respect to selection, training, and appraisal of individuals (non-market versus market based); different criteria for membership (non-voluntary versus voluntary); culture clashes (non-competitive versus competitive); and variations in acceptable behavior rules (informal versus formal) (Sharma, Chrisman, Chua, 1996).

These differences are fundamental in nature, and as such cause problems in the ongoing social interface within these organizations. The incidence of misunderstandings, miscommunications, working at cross-purposes, increased politicization of the work roles, and other social misalignments (Mitchell & O'Neil, 1998) increase the incidence of social friction (Williamson, 1981) in family businesses. Thus, for example, while a non-family employee working in a family firm may want to suspend dividends in favor of investment in the expansion of the business because it may lead to the enhancement of career advancement opportunities, a family member owner not involved in the business may desire increased dividends instead. And, theories that have been developed largely to explain the conduct of business without the interaction of the family system, do not fully explain behavior and the underlying cognitive basis for transactions in a family business.

The interaction of family and business systems in family businesses increases the cognitive expectations of non-family employees. In addition to the business-related performance objectives, family firms often have *family* related objectives (Taguiri & Davis, 1992). Non-family employees must understand the additional required “family performances” might include such things as providing family employment, the grooming of heirs, accumulation of family wealth or lifestyle, and sustaining family’s reputation in the community. Thus in many instances, family businesses have been found to arbitrarily constrain their strategic goals and therefore: (1) to view effectiveness to revolve around the needs of family, and (2) may sub optimize business related outcome as a result (e.g., Lee & Rogoff, 1996). Further, family members often hold substantial power derived from a combination of property rights in the business and authority position(s) within the family (Schulze, Lubatkin, Dino, & Buchholtz, 2001, Ward, 1987). Accordingly, theorists interested in family firms have recognized that the simultaneous presence of business and family related objectives (e.g., Taguiri and Davis, 1992) is important to fully understanding the family business phenomenon. In our analysis we therefore define employee effectiveness to mean the simultaneous achievement of family and business goals.

The “one business, two systems” nature of the family business setting thus imposes additional complexity on the cognitive maps that employees need to successfully transact in family businesses. Using Transaction Cognition Theory we can derive and illustrate the actual complexity required within this dual system, of which even non-family employees may not be fully aware.

The Cognitions Expected of Employees in Family Business

Derivation

Using Transaction Cognition Theory, depending upon level of analysis and the transacting vantage point (who or what is assigned to the position of “creating entity,” for example), the cognitive implications for improved transacting can be identified within a variety of settings (e.g., Mitchell and Morse, 2002). In this case, family business presents two transacting systems that must be taken into account: the business transacting system, and the family transacting system (cf. Lansberg, 1983). The combination that occurs at the intersection of these two systems is naturally expected to be more complex than either system alone. But the extent of the increase in complexity is not intuitive. In fact, without a rigorous derivation, we suggest that the cognitions required of the transacting parties in family business are neither easily inferred nor fully comprehended. Transaction Cognition Theory helps us to identify and illustrate—from the vantage point of the non-family employee—the extraordinary cognitive challenge in the family business employment setting.

From the non-family employee perspective¹ (i.e., where the non-family employee is situated in the position of Creating Entity in Figure 1) the family business context requires that two additional transacting elements (due to the systems’ intersection) be added to the 3-element model illustrated in Figure 1: (1) the family “others” who are family members but not business system members, and (2) the family-based behavioral performances (that is the family “work”) often required to be produced when family and business co-exist within the same organization (Taguiri & Davis, 1992). Once these transacting elements have been explicitly represented, the requisite cognitions may be inferred.

Since the number of cognitions to be expected is a mathematical combination derivable from the number of elements ($n=5$) and the necessary elements per interaction ($r=2$), the formula ($n!/r!(n-r)!$) suggests that 10 transaction cognitions are to be expected as a result of the family and business intersection. Thus, instead of the relatively simple transacting environment illustrated in Figure 1, we see—as illustrated in Figure 2—that the transacting environment is substantially more complex. Rather than requiring three cognitive maps/mental models, our analysis suggests that successful transacting for a non-family employee in a family business requires ten such mental maps. Little wonder that many employees in family business consider their jobs to be highly demanding (Lansberg, 1999). Each cognitive map suggested in the analysis (Figure 2) is defined in Table 1.

Insert Figure 2 & Table 1 about here

Implications for Cognitive Expectations

From the above discussion we see that to successfully complete a transaction in family firms, non-family employees must simultaneously deal with ten cognitions (as compared to their counterparts in non-family firms who deal with only three cognitions simultaneously). According to this logic, the failure to understand the necessity for, or the failure to possess any of, these ten cognitions is likely to some degree to disable non-family employees working in a family business:

¹ Although, in this article, we have chosen to focus on the perspective of non-family employees in family business, the basic ideas of Transaction Cognition Theory can be used to understand the perspectives of other internal stakeholders in family firms – family member employees, non-family owners, etc.

Missing planning cognitions: Without the “planning” group of cognitions, for example, problems arise in providing products or services to the regular stakeholders of the firm (PIC)-1, in meeting the expectations of the family (PIC)-2, in ensuring that family behaviors are beneficial to the business (PIC)-3, and in preventing family behaviors from coming into conflict with the expectations of stakeholders (PIC)-4.

Missing promise cognitions: Without the two “promise” cognitions, the trust of the firm’s regular stakeholders may diminish (PrC)-1, or—due to unacceptable “family”-related behavior—suspicion that the non-family employee is failing to be loyal may develop in the family mind (PrC)-2.

Missing competition cognitions: Without the required two “competition” cognitions, the capability of the non-family employee to contribute to the creation of sustainable competitive advantage for the firm may be low (CC)-1, or non-family employee “performance” may be unfairly judged (CC)-2.

Other missing cognitions. Furthermore, without the understanding and capability to orchestrate the competing interests interface between family and non-family stakeholders (Self-interest Cognitions), or without the awareness and production of the work required by the family system (Work Proportion Cognitions) the additional opportunism and work specificity required (respectively) at the family/business intersection will create effectiveness-draining social frictions.

Each of the suggested cognitive maps appears to have a role to play in the effectiveness of non-family employees in family business. Accordingly we suggest that,

Proposition 1: The effectiveness of non-family employees is positively related to their level of understanding of the transaction cognitions required in family business.

In addition, we recognize that non-family employees may be unable to directly influence understanding or acquisition of the foregoing cognitions in anyone but themselves. But it seems logical for us to expect that individual awareness of the complete set of necessary cognitions will have far-reaching implications on non-family employee effectiveness. We therefore further suggest:

Proposition 2: The effectiveness of non-family employees is positively related to their level of capability to facilitate the use of the transaction cognitions required in family business.

To illustrate the theoretical ideas that have been developed in this section, and to promote a better understanding of the cognitive complexity that non-family members must deal with in a family business setting, we present the case of Summit Enterprises. Summit Enterprises is a fictitious company, but the context and issues are based on real family-based manufacturing companies.

Summit Enterprises is a North American manufacturer of agricultural equipment with sales throughout the U.S. and Canada. The company employs 46 employees and has revenue in excess of twenty million dollars. Mr. Mark Summit, President, founded Summit Enterprises 40 years ago, with financial backing from his brother Steve and brother-in-law Kevin Leach, who both hold management positions. Other members of the management team include: John Corsaro, a non-family member who has worked his way up the organization since its founding; Jeff Foreman, a recent university graduate and Mr. Summit’s son-in-law; Ted Yasuda, Vice President/Business Development and Customer Retention, a non-family member with a graduate degree in business who has been employed for ten years.

Over the past several years, problems at Summit Enterprises have become more and more prevalent. Mr. Summit retains personal relationships with many people throughout the organization,

who often bypass their immediate managers with both ideas and complaints. His informal decision-making style has been increasingly questioned as the company has grown into a substantial producer of specialty equipment. Mr. Summit has recently launched several new product offerings without consulting his management team or formal market research. The company has lost over a million dollars on these efforts to date.

Further problems have centered on Ted and Jeff's desire to grow the business through the acquisition of complementary businesses and the development of new competencies. While there is substantial capital and cash flow that would allow this growth, senior members of the management team (who have used dividends to treat their kids "equally" and thus build family harmony) and other influential stakeholders (namely family members who are not involved in the day to day running of the organization) have traditionally seen this money as income as opposed to working capital. Ted and Jeff are concerned that without growth and investment in new competencies, the firm is opening itself to aggressive foreign competitors who have recently entered the market.

The theory we have developed in this article predicts seven cognitions that the non-family employee working in a family business must master in addition to mastering the knowledge (planning, promise, and competition cognitions) necessary for transacting in business in general. We illustrate these seven additional cognitions (Table 1) using the case outlined above.

3 New Planning Cognitions

PIC-2 – Family productions planning cognitions: Arise from the connection between family stakeholders and the family work. This second type of planning understanding is the knowledge necessary to ensure that the family stakeholders supply the behavioral performances required in the family system. In the example above it is evident that there exists an understanding: that non-participant family members will not interfere with the business so long as they receive equal treatment by the family leaders. The cognitions that support this planning arrangement have produced harmony in the family. However, lacking this understanding could frustrate the non-family employee, Ted, and also the younger family employee, Jeff, who are trying to make the case for growth and investment.

PIC-3 – Family stakeholder planning cognitions: Are suggested by the connection between family stakeholders and the business work. This third type of required planning understanding invokes the knowledge necessary to supply the behavioral performances necessary in the business system. In the example above, compensation in the form of dividends from the work seems to be the "negotiated" contract that permits a sense of "equal" treatment. Again, failure to understand this relationship could frustrate growth/ investment oriented employees, e.g., Ted (non-family), and Jeff (younger family).

PIC-4 – Family performances planning cognitions: Occur due to the connection between the family work and the family stakeholders. This fourth type of required planning understanding is therefore the knowledge necessary to ensure that the interaction of family performances and regular stakeholders supports the goals of the family business. In the example above, the family business leaders have decided to use the capital of the organization to support non-business family members in an equal manner to those family members engaged in the business. We infer that it is the family business leaders' belief that this will lead to effective family performance. This tends to be a very difficult problem for non-family employees and younger family employees who are engaged in the business, and who think that using funds to better serve regular stakeholders and to preserve and open markets, is a better use of resources. Understanding the reasons for the arrangement may help non-family employees to better deal with the situation, since parties to the family business transaction rarely perceive "equal" to be either fair or wise (Friedman, 1991).

1 New Promise Cognition

PrC-2 – Family promise cognitions: The interface between the non-family employee and the family work suggests the existence of Family Promise Cognitions. This new type of promise cognition is the knowledge necessary to help the non-family employee to avoid running afoul of family norms and prevailing psychological contracts among family members (Rousseau & Parks, 1993). In a general sense this cognition is necessary by the very fact that this is a “family” business. The better understanding the non-family employee has of the family work, the better able that employee will be to negotiate effective economic/business outcomes for him/herself within that framework. For example it would be important for Ted and John to know if they will be candidates to replace Mr. Summit when he retires. Without this understanding misalignment of aspirations and possibilities is probable.

1 New Competition Cognition

CC-2 – Family alignment cognitions: The connection shown between the non-family employee and family non-business participants creates the necessity for Family Alignment Cognitions. This additional competition cognition helps the non-family employee to manage interactions with the family where external power figures prominently in these interactions. In the case example above, difficulties arise due to the existence of different outcome preferences. Thus, while continued investment is important for Ted, non-business family stakeholders see this type of investment as lost income. Despite the argument that one must “spend money to make money,” dependent stakeholders (please see Mitchell, et. al, 1997) see it differently, and therefore lobby those in power for the continuation of family distributions. Another potential problem in this case is an issue related to CEO succession. If non-family members are seen by non-business family stakeholders as potential threats, because they have not bought into their negotiated agreement for equal treatment, then these stakeholders may become much more aggressive and involved, and smooth succession will be ruined due to a lack of family alignment cognitions. Acquiring and using the cognitions that produce a clear understanding of these stakeholders are a necessary burden for the non-family employee.

2 Entirely New Required Cognitions

SiC-1 – Self-interest cognitions: When the interests of non-business family stakeholders and those of regular stakeholders of the business interact, opportunism is expected to figure prominently (Schulz et al, 2001). The additional understanding of Self Interest Cognitions is needed to help the non-family employee to manage the self-interested and potentially conflicting claims on the family business by the business system and family system stakeholders. We have already seen in the above example the potential for controversy because of the lack of formal planning. When Mr. Summit retires, regular stakeholders may, for example, see an opportunity to “professionalize” the organization and thus gain more control, and family stakeholders are likely to see this as a threat to their “negotiated” agreement. Understanding the family reasoning will help the non-family member to negotiate the best possible outcome for him and the organization.

WPC-1 – Work proportion cognitions: Arise from the connection between the work of the business and the work of the family. It is difficult for anyone who tries to balance the expectations generated by work and home; but for non-family employees, effecting this work-home balance is the second such balancing act needed; and success therewith is often directly linked to pay and job security, and so cannot easily be ignored. In the Summit example Ted might be expected to benefit by understanding that the success of the business work is greatly affected by the success of the family work. If he pushes too far toward effecting only the success of the business work, he may upset the family work to such a degree that no work, other than political work, is done. Further, Ted and Jeff

are expected to benefit by gaining the knowledge necessary to balance both business work and family work. Work Proportion Cognitions help the non-family employee to ensure that the added layer of family productions (work) required by the family system are balanced with (effectively proportionate to) the products and services work that the business was ostensibly formed to produce.

DISCUSSION

According to Simon (1979: 511) the key to rational action in the face of complexity is to identify a few basic mechanisms that can account for a wide range of complex phenomena. Our task in this article has been to demonstrate the extent to which the transacting cognitions expected of non-family employees are substantially more demanding in family business than in business in general. We have done this through the identification of a basic mechanism and its logical extensions: transaction cognitions, and the ten systematic mental models that appear likely to be necessary for effective transacting in family business. Our analysis has shown that what scholars have heretofore considered to require a simple additive explanation (understanding family business = business thinking + family thinking) is really a factorial-based explanation that dramatically increases with the number of new elements added, and demands far more cognitive capability and understanding than had previously been supposed. In this final section of the article we discuss the implications of our analysis for theory building: finding new useful explanatory models for the field of family business.

Simon (1991) further suggests that finding useful explanatory models leans heavily upon choosing from among various possible representations of a set of phenomena, a representation that is amenable to the kinds of data available, and to the best ways of examining those data (1991: 379). By our relating two sets of categorical variables: the type of transacting system (non-family v. family business) to the cognitive expectations (number and type of transaction cognitions), we provide a new representation for the analysis of family business phenomena. Popper (1979) suggests that useful explanatory models ought to: (1) increase our ability to explain both previously observed phenomena and phenomena that prior theory has been unable to explain (1979: 46), (2) resolve some of the present theoretical difficulties in research, (3) simply relate previously unconnected things, (4) predict phenomena which have not so far been observed, and (5) be better testable (1979: 47-48). Therefore in the following paragraphs we develop some of the theory-building implications of our analysis using these criteria as an idea-organizing and research question-generating template.

Better Explanation

Of Previously Observed Phenomena

Within the family business literature appear (non exhaustively) several examples of phenomena that have been the subject of research attention, some of which were discussed at the recent Edmonton Conference, 2001 that is the genesis of this Special Issue. These include (non-exhaustively): (1) the relative failure of intergenerational succession (Levinson, 1971) and the related observation that relatively few family businesses survive to the next generation (Benson, 1991), (2) the dark side of parental/owner altruism toward family (offspring) employees (Schulz. et al., 2001), (3) the relatively higher incidence of the cycle of distrust of non-family outsiders (Lansberg, 1999), and (4) the related non-family employee perspective that is the subject of the research reported in this article. We find it instructive for theory building to extrapolate likely explanations—in the family setting—for these phenomena, in light of Transaction Cognition Theory as we have applied it to identify the set of requisite cognitions in the non-family setting.

In the case of intergenerational succession and the related probability that a given family business will not pass successfully to the second generation, we wonder whether these phenomena might be better explained as the failure of the first generation to fully understand and to foster in the second generation a full and balanced set of family business cognitions, and/or the failure of the second generation to identify and acquire same. In the case of the so-called dark side of altruism, we again wonder whether there might be some type of imbalance in the strength or effectiveness of family business transaction cognitions that might explain favoritism and selective blindness i.e., we wonder whether there is a nonmonotonic range of effectiveness of family business transaction cognitions (as suggested by Astrachan, 2001 in his verbal commentary on our paper at the Edmonton 2001 Conference) that exaggerates some unproductive or dysfunctional behaviors and limits necessary or functional behaviors.² We further wonder whether the cycle of distrust of non-family “outsiders” would be less likely where healthy and efficacious family business transaction cognitions operate to enhance mutual perceptions of understanding. And finally, we expect—as suggested in the earlier-stated propositions—that the identification and further understanding of the ten mental maps necessary for non-family members to transact within family business will be positively related to their level of effectiveness in working within family business.

Of Phenomena that Prior Theory Has Been Unable to Explain

Agency theory provides an illustrative case in arguing that purposeful actions are responses to incentives (Jensen & Meckling, 1976). Agency theory explains principal/agent cooperation and conflict, and has been utilized successfully within the general business literature and somewhat successfully within the family business literature to explain the opportunism-based actions of these parties (Gomez-Mejia, Nunez-Nickel, & Gutierrez, 2001; Schulz et al., 2001). However, within the family business literature, some agency problems (e.g. entrenchment that leads to political rent seeking and self-dealing (e.g. phony transfer pricing)) are unresolved by present theory. We wonder whether the agency theory explanation fails because it is incomplete when viewed through the transaction cognition lens. That is, as a powerful theoretical engine that supports “promise cognitions,” agency theory might be considered to contribute admirably. But perhaps due to scope limitations, agency theory does not fully address the comprehensive set of cognitions necessary within the family business transacting environment, and as such offers only a partial explanation. For example, the phenomenon of entrenchment that leads to extensive political rent-seeking behavior (Morck & Yeung, 2001) may arise because of blurred lines between principal and agent in family business: that the implied agency argument based only on Self-interest Cognitions (in our parlance) misses the other three cognitions leading from “d. Other Persons-2” as shown in Figure 2: CC-2—Family Alignment Cognitions, and PIC-4 and PIC-2, Family Performances Planning Cognitions, and Family Productions Planning Cognitions respectively.

Resolution of Theoretical Difficulties

At the previously noted Edmonton Conference, persuasive arguments were made that the resource-based view of strategy can contribute to the family business literature, especially in the area of human capital (Habbershon, Williams, MacMillan, 2001; Sirmon & Hitt, 2001). But the nature of human capital as a resource is still under investigation, because resource based theory is just beginning to understand how human capital is converted from a resource to an organizational capability that can lead to firm performance (Hitt, Bierman, Shimizu and Kochhar, 2001). We suggest that the

² For example, we are aware of cases where second generation family members, while being adept at family system-based cognitions thus gaining power, are inept at the business system cognitions thus losing the business.

Transaction Cognition Theory lens might assist researchers to resolve this obstacle. We wonder whether the key that might unlock an understanding of this conversion, is to consider human capital to be a “unique cognitive set.” The workability of this approach has been demonstrated in the case of family business transaction cognitions, where the elements of this set are explicitly identified through the use of Transaction Cognition Theory. Human capital as a construct can become more tractable because Transaction Cognition Theory moves it from tacit and implicit, to express and explicit.

Another theoretical difficulty is one of focus. Many family business researchers have been charged with focusing on family relationships in family business to the exclusion of family business performance (Sharma, Chrisman, & Chua, 1997). Although space limitations limit development of the argument beyond a sentence or two, the Transaction Cognition Theory lens might also help to resolve the apparent disparity. The Transaction Cognition Theory lens offers a means whereby family business performance can be seen to be related to certain key family transacting relationships. Might this unifying suggestion energize one research stream with data and findings from the other?

Simply Relating Previously Unconnected Things

An idea within organizational economic theory—that transaction costs are to economic systems as what friction is to physical systems (Arrow, 1969: 48; Williamson, 1985: 19)—makes analysis possible that enables us to simply relate previously unconnected things. Like physical friction, transaction costs/social frictions can either help or hinder transacting. And, since social friction/transaction costs can be either relatively higher or lower, we conceptualize the four states of kinetic (sliding) friction in both physical and social transacting in a two-by-two matrix where friction is either high or low, and either helps or hinders as: (1) glide—lower friction is helpful, (2) traction—higher friction is helpful, (3) slippage—lower friction hinders, and (4) drag—higher friction hinders. Thus, using Transaction Cognition Theory, previously unconnected ideas: higher/lower and helpful/hindering transaction costs can be connected to help us to envision both descriptive and inferential models. Descriptively, we can now begin to chart the conceptual linkage among family business constructs such as social frictions (transaction costs), non-family employee transaction cognitions, and the productive use of friction, to lay the foundations for theory building. Inferentially, Transaction Cognition Theory suggests that adding requisite information to transactions ought to increase the level of effective transaction cognitions, because the nature of the “social surface” may be altered to expedite the success of a given transaction (Mitchell, 2001) according to the following inferential logic:

Transaction cognitions ⇒ Information Conditions ⇒ TC/Social Friction ⇒ Results.

Connecting these previously unconnected ideas through an extension of the transaction cost/ social friction metaphor thus contributes to theory building in family business research.

Predicting Previously Unobserved Phenomena

Given our analysis, we may now ask what phenomena are likely to exist in family business that have not previously been observed. If we take “observed” to mean only that the phenomenon has not yet been identified and studied within this literature, several examples are suggested: one of which is the set of cognitions newly identified in our analysis; and relatedly suggested, is the existence of the non-family tacit “underground” in family business centered around reaction to missing or problematic family business transaction cognitions. Certainly, non-family members have been observed on occasion to appear to band together (thus leading to the distrust element discussed above.) However, it is a likely extension of Transaction Cognition Theory to suggest that such tacit organizations within family business are likely to exist due to missing or problematic family business transaction cognitions.

Better Testability

To be better testable, a theory can contribute to data gathering, measurement, and/or data analysis. We suggest first, that our analysis permits the definition of new sets of useful data such as the cognitive maps of each group of participants in family enterprise; second, that our analysis permits the introduction of new measurement techniques into the family business domain, such as cognitive scripts (e.g., Mitchell, Smith, Seawright, and Morse, 2000); and third, that with the new data sets and measurement techniques developed, an expanded set of analysis techniques will also become available to family business research. The cognitive approach to the explanation of business phenomena is likely to occupy a prominent place within research over the next decade (Davidsson, Low, & Wright, 2001; Gartner, 2001). New methods made possible by Transaction Cognition Theory enable better testability for such family business phenomena as: inter- and intra-generational maps on various cognitions, inter- and intra-family maps on various family business transaction cognitions, and the further investigation of family and non-family cognitive similarities and differences, to name but a few. Accordingly, additional theory building in family business research appears to be possible due to new Transaction Cognition Theory-based methods that enable better data gathering, measurement, and data analysis (Freeman, 1986; Nunnally, 1978).

Conclusion

Does the two-system nature of the family business phenomenon mean that necessarily non-family employees can be expected to think differently? Certainly, using the model that we have introduced in this paper, we have portrayed more explicitly the scope of cognitive tasks that confront non-family employees who are seeking to contribute to better family business results. But through this analysis we have also been able to propose a theoretical structure that helps to more comprehensively specify the cognitive implications of the family system/business system interaction itself.

We do not think that calling something simple, which is in fact complex, is helpful; while we do think that the identification of the fundamentals that yield the complexity is. And in this respect we are hopeful that our model—which specifies the thinking and knowledge requirements of family business in much more detail than has previously been attempted—can form the foundation for a map that might help to chart the cognitive convergence of two paths: family-thinking and business-thinking.

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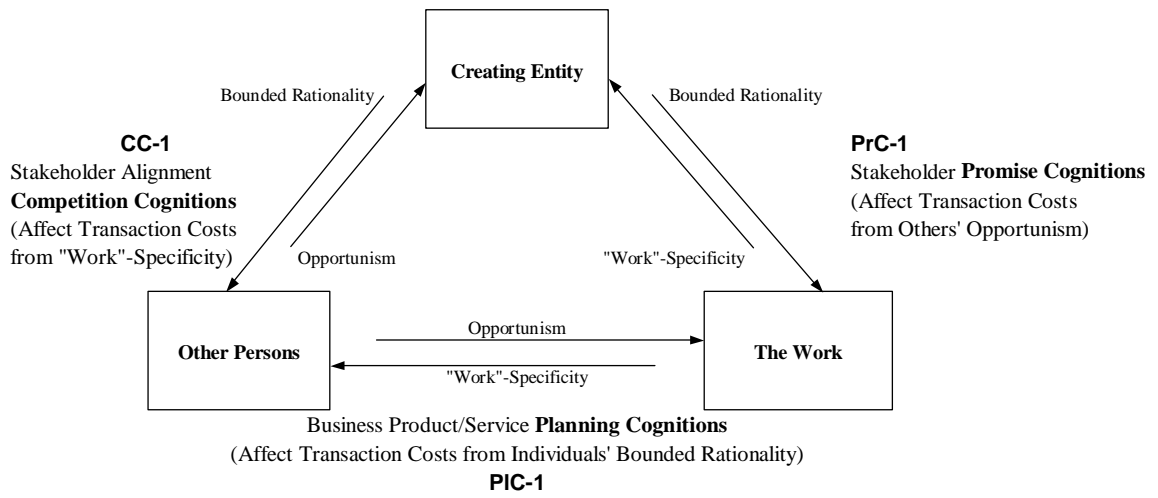
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Table 1: Transaction Cognitions Required in General and Family Business Settings

Transaction Cognitions	Description
<p>Planning Cognitions</p> <p>(PIC)-1: Business product/service planning cognitions</p>	<p>Mental models that assist in developing analytical structure to solve previously unstructured market problems in the provision of the work to those other persons who are included in the non-family stakeholders group, as a part of the ongoing business system.</p>
<p>(PIC)-2: <i>Family productions planning cognitions</i></p> <p>(PIC)-3: <i>Family stakeholder planning cognitions</i></p> <p>(PIC)-4: <i>Family performances planning cognitions</i></p>	<p><i>Mental models that are necessary to ensure that family stakeholders supply the behavioral performances required in the family system.</i></p> <p><i>Mental models that are necessary to ensure that the family stakeholder supply the behavioral performances required in the business system.</i></p> <p><i>Mental models that are necessary to ensure that the interaction of family performances and regular stakeholders supports the goals of the family business.</i></p>
<p>Promise Cognitions</p> <p>(PrC)-1: Stakeholder promise cognitions</p>	<p>Mental models that help in promoting trustworthiness in economic relationships with, for example, stakeholders (Agle et al., 1999; Mitchell et al., 1997). Stakeholder identification and salience cognitions (Mitchell & Agle, 1997) are essential in market relationships.</p>
<p>(PrC)-2: <i>Family promise cognitions</i></p>	<p><i>Mental models that help in promoting confidence that family relationships/expectations related to the business are aligned/met, and are not an impediment to the evaluation of the performance of the transaction creator.</i></p>
<p>Competition Cognitions</p> <p>(CC)-1: Stakeholder alignment cognitions</p>	<p>Mental models that can create sustainable competitive advantage in creator-customer/stakeholder interactions about the work (e.g., I/O strategy: differentiation or cost competitiveness (Porter, 1980)).</p>
<p>(CC)-2: <i>Family alignment cognitions</i></p>	<p><i>Mental models needed to manage creating entity ↔ family system interactions where there is external power exercised with respect to the work (e.g., a resource dependence situation exists (Pfeffer & Salancik, 1978)).</i></p>
<p>(SiC)-1: Self-interest Cognitions</p>	<p><i>Mental models that are based in the management of mutual opportunism, where business system and family system stakeholders each attempt to exert self-interested based claims on the family business.</i></p>
<p>(WPC)-1: Work Proportion Cognitions</p>	<p><i>Mental models that are based in ensuring that the added layer of productions (work) required by the family system are balanced with (effectively proportionate) the products and services that the business was ostensibly formed to produce.</i></p>

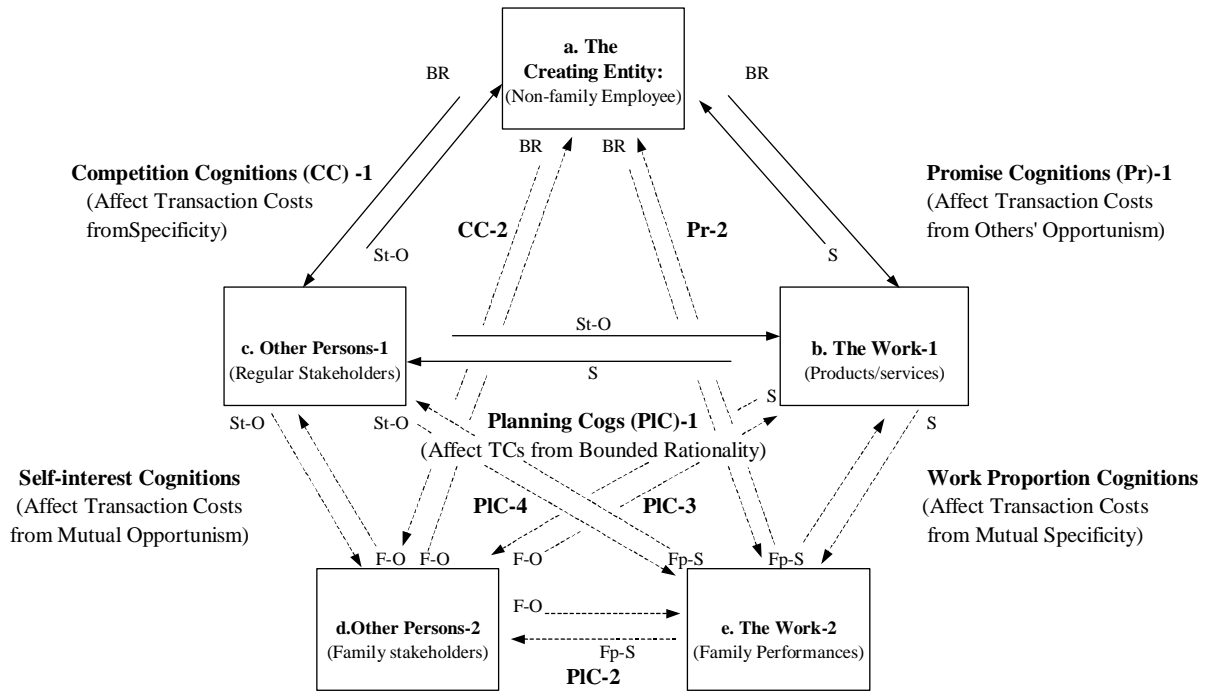
(Note: Cognition types in **bold**; General business cognitions in regular font; Family business only cognitions in *italics*.)

Figure 1. The Effect of the Specialized Mental Models:
 Planning, Promise, and Competition Cognitions
 on Transaction Costs



Based on Gardner (1993); Williamson (1985)

Figure 2. Suggested Cognitions Related to Non-Family Employee-created Transactions in Family Business



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