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Evidence-based policy making

Do family and kinship networks support entrepreneurs?

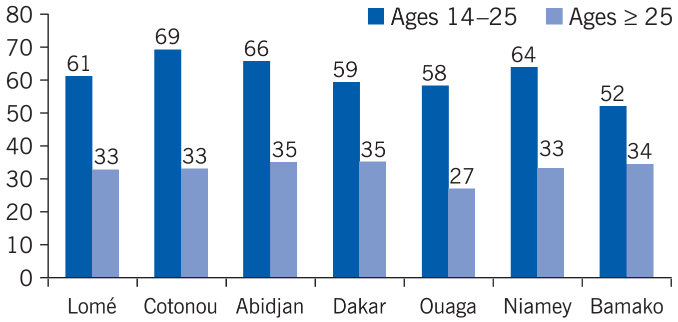
Family and kinship ties offer multiple benefits to developing country entrepreneurs but can also have adverse effects

Keywords: family and kinship networks, entrepreneurship, sharing norms, family labor

ELEVATOR PITCH

Family and kinship networks are important in helping people get jobs and start companies, as statistics for developing countries show. Promising new research has begun to assess the positive and negative effects of these family and kinship ties on entrepreneurial success. To what extent, and why, are family networks used, and do they result in better economic outcomes for entrepreneurs? Results point to the need for policymakers to identify and emulate efficient informal networks in order to develop innovative support policies for vulnerable entrepreneurs, especially for those who are attached to weak or inefficient networks.

Up to 70% of young urban workers in West Africa obtain their jobs through personal relationships



Source: DIAL. *Youth and Labour Markets in Africa: A Critical Review of Literature*. DIAL Working Paper No. 2007/02, 2007.

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KEY FINDINGS

Pros

- For entrepreneurs in developing countries, family and kinship networks have the potential to generate learning spillovers.
- Family and kinship networks may reduce uncertainties about market opportunities, the reliability of partners, and the productivity of employees, in particular family labor which needs less supervision by the entrepreneur.
- Risk-sharing and informal credit arrangements can be enhanced by family networks.
- Reducing transaction costs in various business relationships can be a positive result from family networks.
- Family and kinship networks may promote innovation and enhance the returns to production factors.

Cons

- Sharing norms with family and kinship networks may lead to business inefficiency if entrepreneurs are unable (or unwilling) to control the influence of relatives who make excessive demands.
- Family labor is often less productive than hired labor.
- Measuring and explaining the existence and effects of social networks on the performance of small businesses is not easy because of the endogenous nature of social interactions.
- Because of the high degree of heterogeneity in the effects of family and kinship networks, sophisticated research and data collection designs are required to analyze the effects on firm performance.

AUTHOR'S MAIN MESSAGE

Entrepreneurial behavior and success are often influenced by decisions of the entrepreneurs' kinship group. Family and kinship ties provide benefits through learning and complementarities, risk-sharing, and lower transaction costs, but economically inefficient social norms that call for supporting family members can worsen firm performance. Where family and kinship ties have strong positive effects, networks may be compensating for market and institutional failures. Policymakers can address these failures through support policies for entrepreneurs, such as health and unemployment insurance and finance and credit.

MOTIVATION

Statistics for developing countries emphasize the role of social and family networks in stabilizing or enhancing workers' professional situation, especially in self-employment [1]. As the illustration on page 1 shows, across seven large cities in West Africa, from half to almost 70% of young workers aged 14–25 report having obtained their main job through family or other relationships. Crucial questions are why networks are used and to what extent they lead to better employment prospects and trajectories in developing countries. While there is some evidence on the importance of social networks for seeking, obtaining, and changing jobs, little is known about the channels through which specific dimensions of family and kinship networks may affect entrepreneurial success. Two channels are explored in this paper. The first channel relates to access to jobs, and thus to earnings, in particular the role of the family in the transition from wage employment or unemployment to self-employment, the first step to becoming an entrepreneur. The second channel refers to the conditions under which family networks and business performance are connected.

DISCUSSION OF PROS AND CONS

Social and family ties are known to play a strong role in developing countries and to provide a range of benefits for individuals and households. These networks are crucial because they are often a private solution to market failures when there is a lack of formal institutions to channel information about individuals, jobs, or market opportunities. Social networks are especially decisive in areas where markets are absent, but they are also important where markets exist but the costs of finding out about individual characteristics is high, especially for the labor market. Studies in various countries have found that, under these conditions, social and family ties can provide informal risk-sharing to poor and rural households. These networks are able to enforce social norms of behavior, which in turn lower transaction costs and reduce risks when mechanisms such as efficient contract enforcement are not provided publicly.

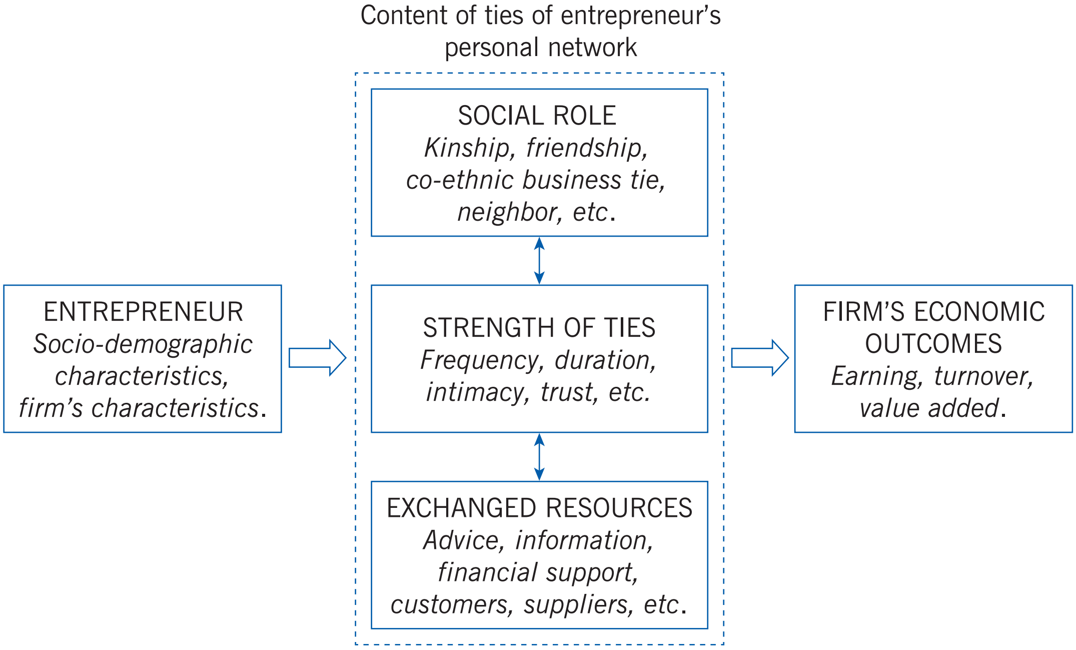
For developed countries, an earlier economic literature emphasized the role of social and family networks in conveying information about employment, market opportunities, and new technology. From a theoretical perspective, social networks are known to be crucial for understanding the dynamics of workers, in particular length of employment and persistence in unemployment [2], [3]. Evidence for developed countries shows widespread reliance on relatives, friends, and other acquaintances when searching for salaried jobs and seeking access to coveted positions. For self-employed workers, these social networks may be used to enhance risk-sharing and informal credit arrangements and to generate learning spinoffs—for example, to reduce uncertainties about market opportunities, the reliability of partners, or the productivity of prospective employees [3].

While the heavy reliance of self-employed workers on the assistance of social networks in general has been well documented, the specific role of family ties has been less well explored [3]. There are studies showing that family and kinship networks provide a range of benefits for individuals, but much less is known about the possible adverse effects of family and kinship ties, in particular for entrepreneurial success. Promising research avenues have recently been opened, including further investigation of the channels through which adverse effects may operate, their gender-specific dimensions, and the interaction of multiple features of family networks with business activity.

Family networks and access to self-employment

Are family networks a valuable resource for improving workers' labor market outcomes? Looking at the divide between self-employment and wage employment in developing countries is a meaningful way of characterizing the quality and vulnerability of jobs. Thus, it is informative to know how important family networks are in facilitating the transition from wage employment to self-employment and from self-employment to wage employment [1]. Recent studies on network effects (considered more broadly than just family and kinship networks) discuss network size, geographic proximity, the resource endowments of network contacts, and the nature of the links between contacts to explain differences in the effects of social networks. Most of the studies, particularly those for sub-Saharan African countries, focus on the size of social networks, approximated by the number of contacts that an economic agent maintains with other categories of agents. However, since the seminal sociological work of Mark Granovetter [4], it has been widely acknowledged that the intensity of ties is also an essential dimension of social networks. The literature on social networks argues that the strength of network ties should be considered alongside two other dimensions: their social roles (neighbors, friends, kin, business relations) and the resources conveyed or exchanged through the ties (Figure 1) [5]. However, few empirical studies have tried to clearly distinguish these three dimensions and their effects.

Figure 1. Content of ties in entrepreneur's network and firm's performance



Source: Berrou, J. P., and F. Combarnous. "The personal networks of entrepreneurs in an informal African urban economy: Does the 'strength of ties' matter?" *Review of Social Economy* 70:1 (2012): 1–30, Figure 1 [5].

Some studies have attempted to fill this knowledge gap, but they remain divided on the effect of social network resources and social roles. Most of the studies focus on enterprise outcomes and do not address the transition from wage or unemployment to self-employment. Recent research shows that migrants with a larger social and family network are more likely to be self-employed [6] and that family networks have a significant effect on the transitions of workers. However, the effect on worker transitions differs depending on the type of transition and on the dimension of the family or social network considered—the network size, the resources available in the network, and the strength of ties [1]. Network size and the strength of network ties seem to have a communication function, by conveying information throughout the network. However, the information may be of little value if the resources embedded in the tie are of poor quality. Strong ties, in particular family and kinship ties, are important for easing access to resources needed to start a business. On the other hand, unemployed workers with strong ties in their network may limit their efforts to find a job if these ties serve as a safety net [1]. The information and safety net functions of the family network often coexist and should be considered together to attain a full picture of the channels though which family networks influence access to self-employment and entrepreneurship.

The strength and resource content of social and family ties

Strength of social network ties. The strength of network ties, as defined by Granovetter (1973, p. 1361), is a "combination of the amount of time, the emotional intensity, the intimacy (mutual confiding), and the reciprocal services which characterize the tie." The notion of the "strength of weak ties," as developed by Granovetter, conveys the sense that links with infrequent interactions or with low intimacy tend to bridge individuals across social groups and are consequently the most informative and most useful in the labor market.

Resource content of social networks. Another dimension of social networks that should be considered, as laid out in Lin's (1990) theory of social resources, emphasizes the importance of the resources available in a network, defined by the socio-economic characteristics of the individuals connected through the network.

Source: Granovetter, M. S. "The strength of weak ties." *American Journal of Sociology* 78:6 (1973): 1360–1380; Lin, N. "Social resources and social mobility: A structural theory of status attainment." In: Breiger, R. L. (ed.). *Social Mobility and Social Structure*. New York: Cambridge University Press, 1990; pp. 308–356.

Family networks and entrepreneurship performance

The bright side of family and kinship networks...

Many developing countries lack the incentives, institutions, and support policies to encourage private sector growth. With weak institutional support to help entrepreneurs enter the labor market or improve their production conditions, small entrepreneurs often turn to family and kinship networks to access physical capital, and information on market opportunities, innovative technologies, suppliers, and clients. In this context, the performance of microenterprises and small enterprises, especially household businesses, depends greatly on the presence of an efficient family and kinship network in which the business owner is embedded.

Family and kinship networks may reduce transaction costs in business relationships because informal sanctions may be used to punish uncooperative behavior and thus to encourage cooperative ones. In Vietnam, for example, studies show how traders in the older quarters of Hanoi have managed to remain in place despite the adverse effects of multiple upheavals (the war, the communist period, trade liberalization) because strong social networks of family and friends helped traders establish and expand their businesses. Other studies shed light on the dynamics of craft villages in the suburbs of Hanoi, which are organized in clusters specializing in one activity based on guarantees of ongoing, long-term relationships [7]. Family and kinship networks may also promote innovation by enabling better-connected entrepreneurs, who have better and more creative ideas, to react more agilely to new market circumstances.

Family and kinship networks affect enterprise performance in various ways, depending on the characteristics of the networks and the businesses. Crucial questions are which features of the networks and firms interact the most and through which channels? Evidence for African formal manufacturing enterprises reveals that entrepreneurs with larger firms tend to engage with innovation networks that are extended, diverse, loose, and suited to providing access to information about technology and markets [8]. By contrast, entrepreneurs with smaller enterprises tend to maintain solidarity networks that are small, homogeneous, cohesive, and suited to reducing asymmetries of information, thus supporting informal credit and risk-sharing arrangements.

The effects of family and kinship networks on entrepreneurs also differ for businesses in the formal and informal economies [7]. These networks may be more critical in the informal economy, where it substitutes for scarce formal support mechanisms in access to and management of factor inputs, such as physical and human capital and productive infrastructure. Small and successful entrepreneurs in informal enterprises generally benefit from wide, ongoing social support ties, with efficient kinship ties providing start-up resources [5]. In urban West Africa, local family and kinship ties have been shown to enhance the informal entrepreneur's labor effort and use of physical capital [9]. A study in Vietnam that investigated the impact of social and family networks on the efficiency of informal household businesses found that close ethnic ties tend to have positive effects, perhaps thanks to mutual support from the local community and knowledge spillovers [7].

...and the dark side of family and kinship ties

Family and kinship ties may also become an obstacle to enterprise development [9]. The adverse side of family and kinship networks has recently been highlighted in several economic studies [9], [10], [11], though the drawbacks have long been noted in the anthropological literature. Entrepreneurs who are part of a family and kinship network and who achieve economic success are often called on to share their success with less successful network members. Adverse incentives arise if concerns about moral pressure for jobs, housing, credit, or free business services by family and kinship network members discourage entrepreneurs from dealing or trading with people in these networks and from pursuing and developing their economic activity. Opting out of such kinship systems and refusing to comply with these moral obligations may be possible, but doing so often results in strong sanctions from the community, which come at a high psychological price.

Figure 2 reports statistics for a case study of 74 entrepreneurs in Tanga, Tanzania, who were interviewed about the influence of their extended families on their companies [12]. The sample is divided into two groups, one with entrepreneurs of African ethnic origin, and the other with entrepreneurs of Asian or Arabic ethnic origin. A little more than half (55%) of all the entrepreneurs reported that providing financial support to their extended family does not constitute a burden for their business. One important difference between the two categories of entrepreneurs is that 40% of entrepreneurs of African ethnicity provide financial support to family members even if they are fully aware that such financial help is a burden for the business. By contrast, just 3% of entrepreneurs of Asian or Arabic origin support their family if doing so constitutes a burden on the business. This example indicates that a sizable proportion of entrepreneurs in developing countries may be unable (or unwilling) to limit the demands of their relatives, which can cause a business to falter or fail [12].

Figure 2. Financial support of the extended family provided by entrepreneurs in Tanzania, by ethnic origin

Provision of financial support to extended family	*Entrepreneurs of African origin*	*Entrepreneurs of Asian or Arabic origin*
Provides financial support, which is not a burden for the enterprise	54%	56%
Provides financial support, which is a burden for the enterprise	40%	3%
Does not provide financial support	6%	41%
Number of entrepreneurs	35	39

Source: Egbert, H. "Business success through social networks? A comment on social networks and business success." *American Journal of Economics and Sociology* 68:3 (2009): 665–677 [12].

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Other recent empirical evidence suggests that sharing obligations in Kenya may be one reason why impatient farmers forgo highly profitable investments in fertilizer: the impatience is found to be partly rooted in the difficulty of protecting savings from the consumption demands of extended family members. In Cameroon, some entrepreneurs without liquidity constraints take out loans just to signal to their kin that they are unable to provide financial assistance. In Burkina Faso, family and kinship ties represent only a quarter of all network ties that entrepreneurs rely on [5]. More educated entrepreneurs rely on weaker ties to looser networks, suggesting their capacity to extract themselves from more constrictive community ties [5].

Is the use of family labor harmful for small businesses?

Around the world, many entrepreneurs who start microenterprises and small enterprises employ members of their extended family. They generally do so because of the lack of labor market intermediaries that can channel information about jobs, but also because they consider family labor to be more reliable and to offer flexibility that is difficult to find on the labor market [7]. In addition, entrepreneurs may use family labor because the extended family expects to be given jobs in small or household firms, either because egalitarian norms demand it or because the extended family helped set up the business and wants to be rewarded for that effort once the company is running [7].

The literature specifically examining the effect of employing family workers on entrepreneurial success is scarce, particularly for developing countries where family labor is more widespread. Some studies have investigated the nature and effect of family labor compared with hired labor on business performance, but most of this research concerns farm businesses. A priori, one might expect family labor and hired labor to have different effects on business performance, because their composition may vary between men and women, adults and children, and skilled and unskilled labor. In developing countries, women and children constitute a larger proportion of family labor than of hired labor. If the marginal productivity of women and children is lower than that of men, then that difference in the composition of labor would drive down the marginal product of family labor relative to hired labor [7]. The skill differential between family labor and hired labor might also be an important source of differences in the productivity of workers. For agricultural traders in Madagascar, for example, a study suggests that family members do not work as hard as hired workers, which could reflect that familial pressure to hand out jobs to family members results in the hiring of more workers than needed to produce the product or service efficiently [13].

But other arguments can be put forward, sometimes contradicting the common assumption that family labor is necessarily less productive than hired labor [7]. Family labor may be more efficient than hired labor because, as "residual claimants to profits," family laborers may be more incentivized by the prospect of sharing the income generated by the business. Consequently, with shared incentives between entrepreneurs and workers (other household members), there is little need for additional supervision [7].

The composition of tasks performed by each type of labor may also affect business performance. If family workers may also perform management and supervisory duties (particularly the household head), their work can have larger effects on output than that of hired workers, who may perform only manual tasks. The performance of managerial and supervisory tasks by family members would reduce the substitutability between family labor and hired labor, an assumption that is confirmed for Vietnamese household businesses [7] and for female entrepreneurs in Madagascar.

All these factors would explain why it is not clear a priori whether family labor is a disadvantage to the entrepreneur, linked to lower productivity of family labor, or an advantage, arising from the fact that family laborers are more motivated (because they share in the profits of the firm) and therefore require less supervision. In practice, the use and productivity of family labor depend greatly on whether the business is in the formal or the informal economy.

LIMITATIONS AND GAPS

Measuring and explaining the existence of social network effects on the performance of small businesses is not easy. Analysis is hampered by methodological challenges, from the measurement and dynamics of social networks in general to the difficulty of estimating the effect of endogenous social interactions on individual performance.

Additional challenges arise from heterogeneity in the effects of social networks on individual or firm performance. Therefore, because mean effects might mask the true impact, specific impacts have to be assessed for different categories of workers (by age, gender, and type of firm, for example). Sophisticated research designs are then required.

Finally, data scarcity on the formation and development of family and social networks in developing countries is also a concern. Ideally, researchers would be able to observe the dynamics of personal networks across generations, using longitudinal information [1], but such data are rarely available.

SUMMARY AND POLICY ADVICE

In developing countries, social and family networks play an important role in helping workers get jobs, in particular through self-employment. A crucial question is to what extent entrepreneurs rely on family and kinship networks and whether that reliance improves their economic prospects and performance. Promising research has recently begun to assess the effects, both positive and adverse, of family and kinship ties on entrepreneurial success.

Policies aiming at improving the economic situation of vulnerable entrepreneurs should take into account the reality that entrepreneurial behavior is often heavily influenced by the decisions of family and relatives, through both learning and complementarities, but also through social norms and pressure to redistribute earnings. Thus, policies should consider the many benefits of social contacts while taking into account the various dimensions and interactions of family and kinship networks. If not, their effect on labor market dynamics and outcomes may be misunderstood, in particular if network size alone is considered.

Correctly distinguishing the effects of social interaction from other effects is important for accurately gauging the benefits of interventions and properly assessing the welfare consequences of such policies. Having this information is essential in a context of peer influence because intervening to alter one person’s behavior may affect the behavior of other people (“social multiplier effects”).

Policymakers should try to identify and replicate efficient (informal) support networks in order to help the most vulnerable entrepreneurs, such as women and youth, who lack access to local family and kinship networks.

Because strong positive effects of local family and kinship ties generally signal the presence of market and institutional failures that such networks are compensating for, policies should address these failures by strengthening formal market-supporting institutions and making them more accessible to small and vulnerable entrepreneurs [8].

The redistributive pressure of kinship sharing norms can reflect two different mechanisms: an insurance mechanism and egalitarian norms prevailing in the society or community. The insurance dimension of family and kinship ties can be reduced by supporting the development of formal insurance markets (health, unemployment, and finance and credit, for instance). The provision of formal insurance mechanisms would take into account both the information transfer and the safety net functions of efficient informal networks. These are particularly crucial in a developing country context, where social security and unemployment benefits are almost nonexistent. Such policies would be especially helpful in circumstances where the sharing obligation with kinship networks appears oppressive and becomes a disincentive to entrepreneurship. The second mechanism is more difficult to tackle, as it involves social norms, tradition, and culture, which are inherently (and rightly) unchangeable by policies. These norms might be expected to evolve as the economy develops. It will then be necessary to design policies targeting unequal opportunity among entrepreneurs in access to resources and correcting other market failures.

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Competing interests

The IZA World of Labor project is committed to the *IZA Guiding Principles of Research Integrity*. The author declares to have observed these principles.

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