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Please do not disturb! Differentiating board tasks in family and non-family firms during financial distress

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ABSTRACT

Boards of directors represent a central factor for firm success by performing different tasks such as control, networking, or advice. Stemming from socioemotional wealth (SEW) literature, the aim of this article is to investigate the board tasks–financial performance relationship, showing their different contributions in family and non-family firms when firm survival is at stake. The main hypotheses are tested through moderated linear regression analyses. The findings suggest that while advisory tasks generally enhance financial performance in family firms, especially during turmoil, networking and control tasks have a detrimental effect when these firms suffer internal financial crises. Hence, we contribute to the SEW paradigm by underlining that family firms seem to accept performance hazards in order to protect family discretion and a positive public reputation even when they suffer severe hardship. In contrast, board advice supports utilizing family firms' unique social capital and significantly bolsters financial performance, without disturbing the family and its SEW preservation needs.

1. Introduction

A considerable amount of scholars regard boards of directors as key determinant for firm financial success (e.g. Forbes & Milliken, 1999; Hillman & Dalziel, 2003). While most attention has been devoted to large corporations with dispersed ownership and problems related to principal-agent conflicts (Fama & Jensen, 1983), a growing number of studies began to investigate their influence in family firms. Furthermore, alternative concepts like resource dependence theory (Pfeffer & Salancik, 1978; Pfeffer, 1972) or the resource-based view (Barney, 1991; Wernerfelt, 1984) have gained increasing attention and resulted in the development of additional board tasks, such as networking, strategy, or advice. Since family firms are the backbone of most economies and source of jobs for millions of employees (Morck & Yeung, 2003), their survival is of general interest; yet, they differ in some fundamental aspects, mostly in their ownership and management structure where the family usually holds the majority of shares. This dominance, in turn, assigns them virtually unrestricted discretion over decisions, which is susceptible to influence boards of directors in their tasks and related activities (Bammens, Voordeckers, & Van Gils, 2011; Gabrielsson, Calabrò, & Huse, 2016)

The motivation of this study is therefore to better understand the different contributions of boards of directors for their financial performance. Over the years, researchers referred to the importance of boards of directors in critical firm situations, like during times of distress (e.g. Minichilli & Hansen, 2007). By looking onto this context, our study aims to complementing recent findings from Zattoni, Gnan, and Huse (2015) on board tasks in family firms by integrating the situational context of internal financial crisis as trigger for changing board task effects, while we additionally identify disjoint patterns between family and non-family firms. By applying the socioemotional wealth paradigm (hereafter SEW), which describes that family firms separate potential outcomes as either gains or losses to nonfinancial family wealth (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007), we try to rationalize the assumed altering board task contributions to financial performance. Since the family and firm are threatened in the event of financial turmoil, the board of directors is in charge to serve economic and non-economic purposes alike (Gabrielsson et al., 2016). Through our study we respond to the following research questions: Do boards of directors contribute to financial performance differently in family as well as non-family firms? And,

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if so, do these relationships change in family firms when they are under financial distress?

For the purpose of this study, we define internal financial crisis as perceived internally caused decline, which is underpinned by the actual deviation from financial performance. Under these circumstances family principals are confronted with the potential loss of their entire SEW; in other words, as the board of directors is in charge of performing control next to networking and advisory tasks, the desire to protect family wealth might partly determine the board task–financial performance relationship in a different way as suggested by wisdom about non-family firms, which departs from agency theory. We test our hypotheses through multiple linear regressions on a sample of 222 Norwegian family and non-family firms.

The results suggest that the influence of board tasks on financial performance under stable firm conditions is only significant for board advisory tasks, where family firms particularly benefit from their unique internal social capital (Arregle, Hitt, Sirmon, & Very, 2007). As proposed by Kellermanns, Eddleston, and Zellweger (2012), our findings moreover underline that SEW can bear a dark side related to the protection of family objectives at any costs, resulting in threats to family firm survival. Accordingly, the findings reveal that networking becomes next to control tasks detrimental in distressed family firms, whereas the already identified benefits from advisory tasks become even more pronounced when the family firm suffers hardship. We found this to be partly due to the functioning of advice, which is effective by not interfering the family's desire to preserve SEW. However, the negative implications support the assumption that family firms regard board control as threat to decision autonomy, whereas the desire to preserve a positive public reputation lets networking become a non-viable option during crisis.

The article contributes to the debate on boards of directors in family firms by showing that task effectiveness is indeed framed around the prospects of SEW gains and losses (Gómez-Mejía et al., 2007). The lower financial performance in distressed family firms performing control tasks, reveals that family principals are, contrary to agency theory predictions, not primarily risk-averse, but loss averse against their endowed SEW. The negative aspects of networking tasks underline the assertion that they are moreover concerned with their reputation, which makes them unwilling to activate external sources as this implies the admittance of the crisis and additional dependence on external stakeholders. Moreover, Schulze and Kellermanns (2015) just recently stressed the necessity to increase our understanding of family firm idiosyncrasies and the role SEW plays for decision outcomes. Therefore, our study contributes to this gap by showing that board control interferes with the family's need to keep decision autonomy. On the contrary, the positive effects from board advice underline the prevailing assumption that family firms benefit from their unique internal capabilities during times of financial hardship (Minichilli, Brogi, & Calabrò, 2015). As many family firms lack managerial competence, their directors support firm survival by providing valuable advice to improve decision quality. Finally, we contribute to the core assumptions of the SEW paradigm and show that, in line with prospect theory (Kahneman & Tversky, 1979), control as well as networking are framed as loss, whereas advice is the only alternative to preserve SEW and particularly fruitful during times of high financial distress. Yet, our findings support previous studies, showing that family firms accept performance hazard risk in the way of hampering effective board control and networking, if SEW is at stake (Gómez-Mejía et al., 2007).

The remainder of this article is structured as follows: The next section provides the theoretical background and hypotheses formulation. The research method is shown afterwards, followed by the results. In the discussion section, the results are contrasted with the existing literature. The last section is dedicated to contributions to theory and practice, limitations and future research as well as concluding remarks.

2. Theoretical framework of the board task – financial performance relationship

Over the last decades a remarkable number of studies developed categories and measurements for board duties and related tasks (e.g. Forbes & Milliken, 1999; Hillman & Dalziel, 2003; Zahra & Pearce, 1989). Most of them found their inspiration in the legacy of Myles L. Mace, who reported in his seminal book 'Directors: Myth and Reality' a contradiction within the board working style (Mace, 1971). His main observation was an existing gap between board task expectations and what they actually do, since directors, according to his observation, are not just fulfilling legal duties by controlling management, but are additionally involved along the decision-making process.

Although the debate on board tasks has a long tradition and developed rich empirical and theoretical contributions, disagreement on the number, characteristics, and definition of tasks and how they are linked to financial performance prevail (Huse, 2007; Minichilli et al., 2012). Therefore, we want to discuss our selection of board tasks and their theoretical roots first. The debate outlines that these tasks range from control, sometimes referred to as monitoring, over directors' involvement in the strategy formulation and implementation, to service, which is often sub-divided into networking, and advice and counsel (Hillman & Dalziel, 2003; Johnson, Daily, & Ellstrand, 1996; Zahra & Pearce, 1989).

While there is general consensus that vigorous board control (Lorsch & MacIver, 1989) and their ability to provide access to internal and external resources under financial distress increases survival chances (Minichilli & Hansen, 2007), the role of board strategy tasks is equivocal and deserves some clarification. Boards are in the position to shape the strategic content as many directors have the relevant knowledge and skills. Therefore, a richness of empirical studies supports the notion that firm performance benefits from directors' strategic involvement (Forbes & Milliken, 1999). Nevertheless, board tasks are interrelated. For instance, Zattoni et al. (2015) define strategy tasks by including advisory activates, whereas other authors only consider advisory tasks without strategic involvement due to their expected benefits in firms suffering financial distress (Minichilli & Hansen, 2007). Additionally, family owners were found to be very agitated when they lose discretion over the strategic direction. This is underlined by findings having identified lower degrees of directors' strategic involvement in the context of family firm internationalization (Calabrò, Torchia, Pukall, & Mussolino, 2013). In this line, other studies conclude that the strategic involvement of board members is less pronounced in smaller firms (e.g. Machold, Huse, Minichilli, & Nordqvist, 2011), among them predominantly family firms. Finally, prior works suggest that directors forego strategic involvement as self-protection in order to not be held accountable in case of financial default (Huse & Zattoni, 2008; Tuggle, Sirmon, Reutzel, & Bierman, 2010). As our motivation is to identify different patterns between family and non-family firms in the very particular event of an internal financial crisis, we have to isolate these effects and as such only consider control, networking, and advisory tasks, which are in our opinion most applicable to both ownership types in the nexus of financial turmoil.

Control tasks have their origin in agency theory and regard directors as watchdogs for detecting managerial inefficiencies (Fama & Jensen, 1983; Jensen & Meckling, 1976). From this perspective boards are evaluated on grounds of ensuring firm survival by checking financial numbers or by evaluating investments (Pearce & Zahra, 1991). While the discussion on control