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CEO succession in family firms: Stewardship perspective in the pre-succession context☆

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ABSTRACT

CEO succession is a key theoretical and empirical issue in the fields of organizations and strategic management. Previous studies investigating the influences and effects of CEO succession mostly focus on post-succession contexts. This study focuses on the pre-succession context and offers a comprehensive theoretical framework based on agency theory and stewardship theory. Specifically, this study empirically tests the influence of several pre-succession factors on the founding CEO's decision to either sell the family firm or hire a professional manager as a successor. The results show that executive compensation schemes and industry dynamism separately influence the degree of stewardship through perceived pay premium and industrial growth potential. The findings help explain CEO succession decision-making in family firms, and provide empirical evidence for the incentive mechanisms between executive compensation schemes, industry dynamism, and professional managers' stewardship behaviors. This study broadens agency theory, stewardship theory, and upper echelons theory's explanation of CEO succession decision-making in family firms.

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1. Introduction

CEO succession is a key theoretical and empirical issue in the fields of organizations and strategic management. Research that follows the adaptive view of organizations and upper echelons theory investigates the influences of CEO succession on performance consequences (Bailey & Helfat, 2003; Chang & Shim, 2015; Finkelstein & Hambrick, 1996; Karaevli, 2007; Shen & Cannella, 2002), managerial discretion (Finkelstein & Hambrick, 1990; Karaevli, 2007; Quigley & Hambrick, 2012), and stockholder wealth (Friedman & Singh, 1989; Shen & Cannella, 2003; Worrell & Davidson, 1987; Zhang & Rajagopalan, 2004). These studies mainly examine the question of whether executive succession helps or hurts firm performance. However, little is about investigating the influence of pre-succession factors on CEO succession. In fact, inconsistent findings on the performance consequences of new CEOs (e.g., Karaevli, 2007) highlight the need to consider both pre- and post-succession contextual factors when evaluating these performance effects. Therefore, the current study attempts to fill this gap by building and testing a comprehensive theoretical framework of how pre-succession contextual factors influence the CEO succession decisions.

Although previous studies on CEO succession lack a comprehensive theoretical conceptualization and empirical tests of pre-succession contextual factors on CEO succession consequences (Karaevli, 2007), five decades of empirical research does provide some insights into the factors that precipitate succession and the outcomes of the successor's actions (Chang & Shim, 2015; Finkelstein & Hambrick, 1996). For example, CEO succession research identifies successor origin as an important component of the pre-succession context (Boeker & Goodstein, 1993; Zajac, 1990). Both resource dependence and upper echelon theories highlight the different advantages of family heirs and professional managers on leadership style, knowledge, skills, and perspective (Bigley & Wiersema, 2002; Shen & Cannella, 2003). However, previous studies focus on large public firms even though family-run firms with founder CEOs are the dominant firm type around the world (Chang & Shim, 2015; Chen, Liu, Ni, & Wu, 2015). Family firms often encounter situations where the apparent family heir is unable or unwilling to succeed the founding CEO because of low competence and low commitment (Miller, Le Breton-Miller, & Scholnick, 2008). In this pre-succession context, a founder CEO may prepare for this contingency by considering either selling the family firm or hiring an outside professional manager as the successor (Chang & Shim, 2015). Therefore, this study uses a contingency approach, which incorporates the upper echelon theory and agency theory, to specify pre-succession factors that affect the founder CEO's succession decision when there is no apparent family heir to take over the role.

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According to the behavioral agency model (Martin, Gomez-Mejia, & Wiseman, 2013), families are loss averse with their prospective wealth, so they might sacrifice current socioemotional wealth by choosing a professional manager rather than selling the family business. The key reasoning behind this decision is that families must balance prospective wealth and current wealth when taking strategic risks, and they believe in the stewardship of professional managers (Chang & Shim, 2015). Stewardship in the business context refers to the unusual devotion to the continuity of the company through the assiduous nurturing of a community of employees and by seeking closer connections with customers (Miller et al., 2008). Since stewardship places the long-term interests of a group ahead of an individual's self-interests (Hernandez, 2008), the founder CEOs of family firms should choose successors who have a sense of personal responsibility. Founder CEOs can foster stewardship in their successors, especially professional managers, through various relational, motivational, and contextually supportive leadership behaviors.

In order to manage professional managers' self-interests, agency theory suggests that family firms can use control mechanisms such as executive compensation schemes (e.g., pay-for-performance) to ensure that the manager's and family's interests are aligned (Chng, Rodgers, Shih, & Song, 2012; Eisenhardt, 1989). The executive compensation scheme reflects the transactional nature of a psychological contract (i.e., the professional manager completes certain tasks in exchange for monetary compensation; Hernandez, 2012), and is the motivational incentive that leads to stewardship behaviors (Chng et al., 2012). Thus, the executive compensation scheme is a key determinant of stewardship behaviors in the pre-succession context.

In addition to the executive compensation scheme, industry effects are also contingency variables that influence the psychology of stewardship in the pre-succession context. Industrial organization economics theory assumes that industry effects, such as industry structure, affect firm conduct, which, in turn, determines firm performance. Variance decomposition studies confirm the influence of industry effects on firm profitability, even in hypercompetitive markets (Chen & Lin, 2010). Hypercompetition is apparent in dynamic industries that have heightened technological intensity, shortened product life cycles, and increased domestic and foreign competition (Wiggins & Ruefli, 2005). With increased industry dynamism and complexity, price competition leads to greater competitive hostility and limits industrial growth potential, which, according to managerial discretion research, affects a successors' managerial leeway (Nadkarni & Chen, 2014; Quigley & Hambrick, 2015). Therefore, to explore how managerial incentives motivate professional managers' behaviors, this study employs an experimental investigation of the fit between the executive compensation scheme, industry dynamism, and stewardship behavior from the perspective of the founder CEO in the pre-succession context.

This study provides three main contributions to the literature. First, it builds on three foundations of the pre-succession context, namely executive compensation scheme (Chng et al., 2012), industry dynamism (Nadkarni & Chen, 2014), and professional managers' stewardship behaviors (Hernandez, 2012; Miller et al., 2008). This departs from prior studies on the consequences of CEO succession by focusing on specific pre-succession factors and how these factors influence the founder CEO's succession decision. Second, this study broadens the upper echelon's explanation of CEO succession decision-making in family firms by encompassing the founder CEO's perspective, which considers the contingency of selling the family firm or hiring a professional manager as the successor. This enriches the understanding of the influences of CEO succession, in particular the stewardship behaviors of professional managers. Third, the experimental results support this study's proposed framework, which integrates upper echelons theory and agency theory, and they show that executive compensation scheme, industry dynamism, and stewardship behaviors of professional managers affect family firms' CEO's succession decisions.

2. Conceptual development and research hypotheses

The choice of a CEO is a key organizational decision that has important ramifications for organizational strategies and firm performance (Datta, Rajagopalan, & Zhang, 2003). Not surprisingly, an extensive research over the past three decades focuses on the strategic consequences of CEO succession. For example, agency theory predicts that incentive mechanisms influence a successor's subsequent strategic actions, and the use of internal control mechanisms (e.g., an executive compensation scheme) helps ensure strategic consistency. Upper echelons theory predicts that a firm's external environment (i.e., the industry context) is a crucial factor that influences a successor CEO's strategic decision-making behavior (Chen et al., 2015). However, little research from the agency and upper echelon theoretical perspectives examines the rational analysis of CEO succession choice in the pre-succession context.

The rational analysis, or rational normative model, suggests that CEOs set up strategic objectives, analyze their firm's internal and external environments, and then make strategic decisions and deliberately implement them (Barkema & Vermeulen, 1998). However, past research in this field finds that the CEO's personal characteristics and the external environment both affect a firm's international expansion strategy (Chen et al., 2015; Souder, Simsek, & Johnson, 2012). Thus, combining insights from agency theory, upper echelons theory, and research on strategic decision-making behavior of CEOs in family firms, this study posits that the influences of endogenous forces (i.e., executive compensation scheme and perceived pay premium), and the characteristics of a firm's external environment (i.e., industry dynamism and industrial growth potential) drive stewardship behaviors of professional managers, which reflect in CEO succession decisions. In the following sections, this study proposes several hypotheses describing these relationships, which form a rational normative model of the combined influences of endogenous and exogenous forces that affect founder CEO succession choice in the pre-succession context.

2.1. Stewardship and CEO succession

Stewardship theory draws from sociology and psychology, and it identifies psychological and situational factors that can lead professional managers to act less like self-interested agents and more like organizational stewards (Lee & O'Neill, 2003; Wasserman, 2006). In contrast to agency theory, stewardship theory views organizational actors as seeking long-term utility in other-focused prosocial behaviors rather than in self-serving, short-term opportunistic behaviors (Hernandez, 2012). Founding CEOs of family firms likely have a high degree of stewardship because they care deeply about the long-term prospects of their business and their family's fortune, reputation, and future (Miller et al., 2008). In this vein, when founder CEOs face a situation where there is no assumed family heir to the CEO position, they might choose a professional manager as the successor. If this is the case, the stewardship perspective of the professional manager is the most important concern. Accordingly, this study makes the following prediction:

Hypothesis 1. *In the pre-succession context, the founder CEO prefers to choose a professional manager as the successor when the CEO perceives the manager as having a high degree of stewardship. Otherwise, the founder CEO is likely to sell the company.*

2.2. Executive compensation scheme and perceived pay premium

Agency theory is the dominant lens for examining executive compensation (Wasserman, 2006). According to this theory, incentive schemes and monitoring reduce agency costs (Jensen & Meckling, 1976). Executive compensation schemes usually include cash compensation (comprising salary and bonuses) and equity-based incentives

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