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Family governance oversight, performance, and high performance work systems☆

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ABSTRACT

Recent analyses of U.S. public family firms (PFFs) show that family firms outperform other forms of organization. However, scholars call for more studies to determine why PFFs outperform the market. High performance work systems (HPWSs) reflect the extent to which an organization adopts and implements a strategic approach in HRM practices and could be why PFFs outperform. Using the stewardship perspective, agency theory, and the resource-based view of the firm, this study empirically examines the relationship among family governance oversight, HPWS, and performance at PFFs. Using a sample of 159 Taiwanese public firms, the empirical results indicate that independent directors on the board and the level of family member board participation associate with HPWS adoption. Adopting HPWS also mediates the effect of independent directors and subjective firm performance. This finding has both theoretical and practical implications.

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1. Introduction

Many recent studies of U.S. public family firms (PFFs) show that family firms outperform other organizations (Anderson & Reeb, 2003, 2004; Lee, 2006; McConaughy, Walker, Henderson, & Mishra, 1998). However, previous findings were controversial and scholars continue to call for more research to determine why PFFs outperform the market (Sharma, 2004; Tsao, Chen, Lin, & Hyde, 2009). Family governance oversight often refers to the level and mode of family ownership and control, which can influence owners' incentives and monitoring costs, strategic behavior, and company performance outcomes (Miller & Le Breton-Miller, 2006). Family firms may have concentrations of ownership and management control, management styles, and organizational culture different from that in other organizational forms. Thus, researchers lack complete understandings of why companies with strong family traditions outperform the market, and what mechanisms they use to develop, communicate, and reinforce a vision and organizational culture, and most importantly, their practices providing the firm with competitive advantages (Tsao et al., 2009).

Astrachan and Kolenko (1994) examine the effects of human resource management (HRM) and professional governance practices on family business success and survival, and argue that HRM is a neglected factor explaining family business success. Later, Sharma (2004) observes that issues involving human resources (HR) strategies receive almost no research attention, though understanding family firms' HR strategies may illustrate the mechanisms family firms use to reinforce their vision. In fact, family firms provide few leadership opportunities for non-family executives relative to non-family firms, and the methods family firms use to motivate and retain their talent to gain competitive advantage through effective HRM practices may be the critical factor in their success. This study argues that high performance work systems (HPWSs) as a strategic HR method are an important factor influencing family governance oversight and organizational performance since family governance oversight can further influence owners' incentives and monitoring costs, strategic behavior, and company performance outcomes. Thus, a family firm may use an HPWS as a critical means to motivate and retain valuable employees, which in turn leads to their superior performance.

Strategic HR systems have an important role in business outcomes (Huselid, 1995; Huselid & Becker, 1996; Lu, Chen, Huang, & Chien, 2015), though scant empirical studies directly investigate the role of HPWSs in family governance oversight and firm performance (Tsao et al., 2009). Therefore, this study examines whether adoption of HPWSs mediates the relationship between family governance oversight and firm performance by testing an intervening model that posits no direct link between family governance oversight and firm performance and predicts that family governance oversight will affect firm performance through HPWS.

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2. Literature review and hypotheses

2.1. Family governance oversight and firm performance in PFFs

Family governance dimensions often refer to the level and mode of family ownership, leadership, the broader involvement of multiple family members, and the planned or actual participation of later generations (Miller & Le Breton-Miller, 2006). This study focuses on the effects of diverse governance oversight as the level and the mode of family ownership and control on firm performance.

Family business research most often uses the agency and stewardship theories to explain and explore associations between ownership, management profiles, and family firm performance (Davis, Allen, & Hayes, 2010). Studies applying agency theory and stewardship theory to management focus mainly on the performance advantages from the alignment between ownership and control, since family-managed firms naturally align the owners' and managers' interests in terms of opportunities and risk. This alignment reduces their incentives for opportunism, sparing firms the need to maintain "costly mechanisms for separating the management and control of decisions" (Fama & Jensen, 1983; Jensen & Meckling, 1976) and increases attitudes of stewardship so managers and owners are driven by more than economic self-interest, thereby extending investment time horizons and building firm capabilities (Lumpkin & Brigham, 2011; Miller & Le Breton-Miller, 2006).

While family firms may have somewhat fewer agency costs from uniting ownership and management, the central tenets of agency theory in the family firm context are questionable because they introduce the "self-control" problem that creates incentives for owners to take actions that may threaten privately held family-managed firm performance (Miller & Le Breton-Miller, 2006). For example, Schulze, Lubatkin, Dino, and Buchholtz (2001) argue that private ownership and owner management have agency threats and costs, implying that family relationships tend to make agency problems associated with private ownership and owner management more difficult to resolve as an outcome of self-control and other altruism-related problems. That is, control over the firm's resources makes enable owner-managers to show generosity to their children and other relatives, such as through providing them with secure employment, in addition to the perquisites and privileges that they would not otherwise receive (Gersick, Davis, Hampton, & Lansberg, 1997; Ward, 1987). Despite the fact that previous studies are critical in terms of potential expropriation, destructive nepotism, exploitation of minority shareholders is a potential issue in private family firms. Other studies concentrate on public family firms, since they face pressure from market scrutiny and are accountable to public shareholders. For long-term survival, major PFFs have more external restrictions and internal complexity than privately owned family businesses.

Recent empirical findings show that PFFs outperform non-PFFs (Anderson & Reeb, 2003; Lee, 2006; Martínez, Stöhr, & Quiroga, 2007) and assert that PFFs are more efficient and valuable. Interestingly, compared to earlier family businesses studies that include only private firms or a mixture of public and private firms, recent studies that include only public firms report significant differences that favor family firms. They identify significant positive associations between family ownership and firm performance, and suggest that, compared to most public corporations owned by numerous shareholders, public family firms have a combination of ownership and control by concentrated shareholders (Anderson & Reeb, 2003; Lee, 2006; Martínez et al., 2007). Concentrated equity and managerial control, along with the founding family's historical presence, offers the family an advantageous position to monitor the business (Demsetz & Lehn, 1985). Since the family's welfare relies on their firm's health, these large, concentrated investors have more incentives to avoid conflicts between owners and managers to maximize firm performance than diverse shareholders (Lee, 2006). In terms of competitive disadvantages, family firms must survive the pressure of "public market conditions," such as severe market scrutiny, and be accountable to public shareholders. These considerations help discipline family firms to avoid inefficiencies and weaknesses, thus boosting their performance (Martínez et al., 2007).

Furthermore, in light of the previous findings on outperforming PFFs, Miller and Le Breton-Miller's (2006) review of family governance and firm performance provide the basic rationale for expecting direct relationships between family governance oversight and firm performance. In their review, they propose four different levels and modes of family ownership oversight: (1) Ownership and control concentration — moderate or complete family ownership; (2) Ownership and control concentration > 30%; (3) Presence of strong independent directors on the board; and (4) Family control with little ownership. They propose these four levels and modes of family ownership mainly because the most critical issue for a public family firm is determining how much ownership and control to give to non-family members. Family governance oversight can further influence owners' incentives and monitoring, strategic behavior, and the firm's performance outcomes.

Research covering agency theory and stewardship theory suggest that different degrees of family ownership and control leads to different forms of oversight and firm capabilities that can have both positive and negative implications for firm performance. Specifically, when the degree of ownership and control concentration is moderate to 100%, the agency arguments postulate that the large owner-managers often have the knowledge and incentives to monitor their managers (Jensen & Meckling, 1976), reducing free-rider agency costs and increasing financial returns (Anderson & Reeb, 2003). Besides economic self-interest, stewardship theorists assert that these owner-managers often have a deep emotional investment in the company and employees, leading to higher attitudes of stewardship (Bubolz, 2001) and increasing financial returns.

On the other hand, agency theory also predicts higher agency costs with a diverse ownership structure because owners' and mangers' (agents) incentives and objectives do not align. Moreover, stewardship theory argues that when owner-managers have less personal attachment to the company, they have a greater potential for nepotism, thus raising agency cost and reducing financial returns. Taken together, from both the agency and stewardship perspectives, this study extends Miller and Le Breton-Miller's (2006) work and proposes that companies with strong ownership concentration and family management control will outperform non-PFFs because they have a lower free-rider agency cost and superior attitudes of stewardship when managers' and owners' have the same interests, and family values guide critical operational decisions, which benefit overall performance, thus leading to the following hypotheses:

H1a. Concentration of family ownership positively relates to firm performance.

H1b. Family member board participation positively relates to firm performance.

Past research documents the effect of strong outsiders (i.e., independent directors and non-family shareholders) on the board of directors on performance (Anderson & Reeb, 2004; Dalton, Daily, Ellstand, & Johnson, 1998). These strong outsiders on the board may avoid minority shareholder exploitation from a poor de facto agent (Miller & Le Breton-Miller, 2006). According to the agency perspective, independent directors provide expertise and objectivity that enables them to monitor family executives and further avoid the expropriation of firm wealth by family members (Anderson & Reeb, 2004; Dalton et al., 1998). Indeed, if these independent directors are also significant shareholders, the stewardship perspective argues that these non-family director-owners have additional incentives to serve as informed stewards of the company's resources (Burkart, Panunzi, & Shleifer, 2002; Claessens, Djankov, Fan, & Lang, 2002), thereby improving performance outcomes. Building on this overarching logic,

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