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The negative consequences of pay dispersion in family and non-family top management teams: an exploratory analysis of new venture, high-growth firms

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Abstract

Top management team (TMT) compensation, specifically pay dispersion, is an important organizational issue that may explain differences in family and non-family firms. Pay dispersion within the TMTs of family firms may be more detrimental to team dynamics than pay dispersion in the TMTs of non-family firms. Hypotheses are developed and empirically tested to examine the relationships of horizontal pay dispersion to cohesion, conflict, and group potency in the TMTs of family and non-family firms in high-growth new ventures.

Keywords: Family teams; Family firm conflict; Pay dispersion; Top management teams

1. Introduction

Sharma et al. (1997) urge researchers to identify how family and non-family firms differ and to investigate homogeneous populations of family firms. Chrisman et al. (2005) extend the call to explore the nature by which these distinctions result from family involvement. Conducting research "at the intersection of cross-disciplines" is particularly needed (Zahra and Sharma, 2004, p. 344). Sharma (2004) also urges researchers to explore areas like human resources strategies of family and non-family firms. Following these recommendations, this study explores the issue of compensation, specifically, pay dispersion, in both family and non-family TMTs.

Shaw et al. (2002) note "an organization's compensation system is arguably the most significant human resource management system for effective strategy implementation" (p. 491). Pay structures are crucial for strategy implementation and ultimately firm performance. Hence, family involvement in the firm may impact compensation policies and may create pay dispersion issues with unique consequences for the dynamics and performance of the TMT. This study explores the impact of pay dispersion on critical team processes including conflict, cohesion, and team potency in family and non-family TMTs. Specifically, family involvement in the TMT will lead to decreased horizontal pay dispersion, as compared to non-family TMTs. However, pay dispersion in the TMT of family firms may have a significantly stronger negative impact on team processes than in non-family firms, owing to the nature of family involvement and social structures.

2. Pay dispersion in family and non-family top management teams

The top management team (TMT) is the unit of analysis for examining pay dispersion in family and non-family firms in this study. The TMT perspective is grounded in the theory of upper echelons (Hambrick and Mason, 1984), where firm performance is deemed the result of the *collective* characteristics and actions of the group of managers central to the firm, known as the top management team (TMT), rather than a single

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individual. The work of the TMT involves a significant amount of task interdependence, which in turn, requires cooperation among team members (Main et al., 1993).

Membership and dynamics of family TMTs are likely to differ from those in non-family TMTs. Family TMTs may consist of the founder, family members, multiple generations of the family, spouses, siblings, children and other familial relations (Gersick et al., 1997). "The family component shapes the business in a way that the family members of executives in non-family firms do not and cannot" (Chua et al., 1999, p. 22). But deciding exactly how much family involvement is required to constitute family firm status is not clear-cut.

This study uses the definition of family business proposed by Chua et al. (1999, p. 25): "The family business is a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families." This definition is particularly relevant for this exploratory study, as theory is developed to elaborate on the impact of pay dispersion on a broad array of family firms. The theoretical hypotheses are then tested in a subset of firms that meet the selected definition of family firms — that is highly successful new ventures.

Introduction of family into the TMT structure creates a unique situation in family enterprises unlike those found in non-family settings. Lansberg (1983) suggests that family firms must span the boundaries of the two distinct social institutions of both family and business. He further contends that the primary social function of the family is to "assure the care and nurturance of its members" (p. 40), often referred to as altruism. Family business research suggests that because of the overlap between family, ownership and managerial roles, the family firm has developed a unique bivalent structure (e. g., Tagiuri and Davis, 1996). The bivalent nature of family firms may create unique consequences for human resources practices, such as the compensation system.

Lansberg (1983) also observes that the principles of fairness, as well as principles of exchange, in a family institution are different from those in an economic institution. Cook and Hegtvedt (1983) state that all social institutions develop criteria for distribution of rewards or outcomes and the rules of distribution differ across situations (Deutsch, 1985) and type of relationship. Family is a prime example of a communal relationship (Clark and Chrisman, 1994), based on mutual reciprocity. On the other hand, relationships in the economics and business sphere are exchange relationships. Lansberg (1983) notes that human resource decisions are one area where family and non-family management decisions are likely to differ. Compensation for relatives is likely to be based on an amalgam of economic and non-economic principles and may "generate all sorts of dysfunctional processes in the firm" (p. 42).

Family involvement in the TMT may impact pay dispersion across the TMT in two possible ways. Altruistic behaviors associated with family involvement may decrease the level or amount of pay dispersion. Family involvement may also impact the consequences of pay dispersion on the TMT. Family involvement brings emotion-laden issues and conflict from the existing family dynamics into the TMT that may cause the negative consequences of pay dispersion to be more pronounced in family TMTs as compared to non-family TMTs.

3. Pay dispersion in TMTs

Pay dispersion has received much attention in management research, focusing primarily on vertical dispersion, or the difference in pay from the CEO down the organizational hierarchy and between executive levels (Siegel and Hambrick, 2005). Horizontal pay dispersion is pay dispersion within the team. Horizontal dispersion within TMTs has received little research attention, with a notable exception of the Siegel and Hambrick (2005) study. However, pay dispersion within the TMT of family firms has yet to be examined.

Does pay dispersion in the TMT lead to better performance? That depends on the theoretical perspective taken. Researchers from social psychology and organizational behavior support equity theory and social comparison theories (e.g. Adams, 1965; Deutsch, 1985) as the bases for arguing for less pay dispersion in groups. The basic argument behind these theories is that when work requires a high degree of task interdependence, cooperation is needed among the team to foster communication and shared ideas. When pay is dispersed, team members may perceive inequity, which in turn spawns competitive, destructive behaviors. Economists, including Lazear (1989) and Levine (1991), use equity-based arguments to conclude that less pay dispersion is necessary in groups to reinforce desirable social behaviors, such as cooperation, communication and effort. Alternatively, however, tournament theory posits that wage dispersion is a useful motivator of work behaviors and encourages needed competition among employees to achieve higher levels of both rank and pay (Lazear and Rosen, 1981). When greater rewards are provided for high performers, tournament theory suggests that improved effort and performance can be attained. Such is the basic argument for merit-based compensation systems. However, tournament theory is not without disadvantages. "Arguably the most telling of these criticisms concerns the collusion/sabotage reactions that tournament schemes run the risk of provoking" (Main et al., 1993, p. 609). Tournament pay conditions encourage individuals to aggressively self-promote, regardless of the consequences to others (Lazear, 1989).

For this study, an equity theory argument is adopted. In a task-interdependent setting where collaboration and coordination are paramount, TMTs will likely function more effectively with less pay dispersion. Less pay dispersion is needed to reduce interpersonal conflict and promote coordination. "At the level of the top management team, it can be argued that the nature of the work requires a large amount of task interdependence; hence significant cooperation among executives is necessary for organizational success" (Main, et al, 1993, p. 619).

4. Hypotheses

Compensation in family firms is often a difficult and conflict-ridden issue for decision makers. Members of the