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Family management and profitability in private family-owned firms: Introducing generational stage and the socioemotional wealth perspective

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ABSTRACT

Prior research has not fully explained whether the relationship between family management and profitability is positive or negative in private family firms. This issue is critical for further theoretical development in the field and holds high practical relevance, given that the appointment or exclusion of family managers is a decision virtually any family firm is faced with. To explain inconsistencies in the literature, we build on the socioemotional wealth perspective to argue that family management is positively related to profitability at later generational stages, when a decreased need for socioemotional wealth preservation induces family managers to focus more on increasing financial wealth. We tested and confirmed our hypothesis via OLS regression on a data set of 233 Italian family-owned firms utilizing lagged data on profitability.

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1. Introduction

Private firms, often owned by families (e.g. Bjuggren, Johansson, & Sjögren, 2011; Shanker & Astrachan, 1996), must decide whether to open the management team to non-family members. Consequently, many researchers have explored the relationship between family management (FM) (i.e. the percentage of managers belonging to the family) and firm profitability (i.e. the capability to increase financial wealth). As reported by (Mazzi, 2011) and (Basco, 2013) in their literature reviews, results to date have been conflicting and puzzling.

The family management–profitability relationship has been investigated with the help of a variety of theories, e.g. agency theory, stewardship theory, and the resource-based view. However, these theoretical lenses lead to ambivalent and potentially contradictory predictions pertaining to the costs and benefits of family management, and thus are not able to explain the relationship between family management and profitability consistently. We consequently adopt the socioemotional wealth perspective (SEW), an overarching theoretical umbrella to research family firms (e.g., Berrone, Cruz, & Gómez-Mejía, 2012; Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007), to develop our hypothesis. The article assumes that family management is an expression of the family ability to influence firm behavior and performance (De Massis, Kotlar, Chua, & Chrisman, 2014). We further assume that family managers' goals may vary across family firms, resulting in a different emphasis on financial goals vs. socio-emotional goals (Chrisman & Patel, 2012). Accordingly, we argue that the effects of family management on profitability are contingent on factors that reduce or enhance SEW aspiration and orient family managers toward the pursuit of financial goals or non-financial goals respectively. Specifically, we outline the role of generational stage, that is, the generation that is in charge of the firm (e.g., Cruz & Nordqvist, 2012; Eddleston, Kellermanns, Floyd, Crittenden, & Crittenden, 2013; Kellermanns & Eddleston, 2006), as such a contingency factor.

Prior research suggests that once the family firm leaves the founder stage, profitability tends to decline (e.g., Miller & Le Breton-Miller, 2011). We provide a more nuanced view and argue that this negative effect may be mitigated as later generational stages positively interact with family management to influence profitability through lower SEW aspiration. At later generational

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stages, SEW preservation is expected to be less relevant than financial wealth because family managers decrease their emotional attachment to and their identification with the firm. Without a strong emphasis on socioemotional aspects, profitability considerations become more important as a frame of reference for family managers and financial performance is likely enhanced. Thus, we argue that family management is positively related to profitability at later generational stages.

Utilizing a data set of 233 Italian firms considered representative of the Italian economy, the present study tests the aforementioned arguments with a lagged measure of profitability. Our study makes two contributions to the literature. First, by drawing on the SEW perspective, and assuming that the need to preserve SEW decreases with each generational stage, we explain the inconsistent findings in the literature by showing how family management can positively affect profitability beyond the founder generation. Second, we contribute to the SEW literature by outlining how this perspective can enhance and reconcile knowledge on family effects on firm performance and thus represents a crucial building block of a theory of the family firm. Next, we develop our hypothesis in three steps: we introduce the SEW perspective (Section 2.1) and the generational stage concept (Section 2.2) to provide the building blocks for our hypothesis (Section 2.3).

2. Hypothesis development

2.1. Beyond the established theoretical perspectives: introducing the socioemotional wealth perspective

The effects of family management on profitability have been investigated using a variety of theoretical lenses that have dominated family business research: agency theory, stewardship theory, and the resource-based view (Chrisman, Kellermanns, Chan, & Liano, 2010; Massis, Sharma, Chua, & Chrisman, 2012). Empirical research adopting the agency perspective shows that family managers act as agents (Chrisman, Chua, Kellermanns, & Chang, 2007) and has found a negative relationship between family management and profitability (Lauterbach & Vaninsky, 1999). Yet, the empiricial evidence is not conclusive as others have arrived at non-significant results (e.g., Daily & Dollinger, 1992) because family management may increase some agency costs (Gómez-Mejía, Núñez-Nickel, & Gutierrez, 2001; Kidwell, Kellermanns, & Eddleston, 2012; Le Breton-Miller & Miller, 2009; Schulze, Lubatkin, Dino, & Buchholtz, 2001) and concurrently reduce some others (Chrisman, Chua, & Litz, 2004; James, 1999). Empirical research adopting the stewardship perspective found that family management, either directly (Mazzola, Sciascia, & Kellermanns, 2013) or interacting with family ownership (Chu, 2011) is beneficial for profitability. Yet, if family managers' stewardship is oriented toward the family rather than the firm, negative consequences on profitability can be expected (Corbetta & Salvato, 2004). In the resource-based view, Allouche et al. (2008) show a positive relationship between family management and profitability, ascribing it mostly to "familiness" (Habbershon & Williams, 1999; Habbershon, Williams, & MacMillan, 2003). However, family management may also divert resources from the firm for family purposes (Sirmon & Hitt, 2003) and lack the necessary human capital (Kidwell, Eddleston, Carter III, & Kellermanns, 2013) to successfully run the family firm.

In sum, these three dominant theoretical perspectives do not provide consistent theoretical predictions regarding the effect of family management on profitability, as they use divergent explanatory processes and assumptions to assess the costs and benefits of family management. We consequently introduce SEW, a more recent theoretical approach, which offers the potential to provide a better theoretical explanation of the relationship between family management and profitability and explain prior inconsistent findings in the literature. SEW refers to all non-financial aspects of the firm that meet the family's affective needs, such as identity, status, ability to exercise influence, and perpetuation of the family dynasty (Gómez-Mejía et al., 2007). Gómez-Mejía et al. (2007) and Gómez-Mejía, Makri, and Larraza-Kintana (2010) argue that preserving SEW is the real point of reference for family decisions and behaviors. Since family managers act after evaluating how their decisions will impact their socioemotional endowment (Berrone, Cruz, Gómez-Mejía, & Larraza Kintana, 2010; Gómez-Mejía et al., 2007; Zellweger, Kellermanns, Chrisman, & Chua, 2012), they often make decisions that are not driven exclusively by a search for financial performance, especially when SEW is threatened (Chrisman, Chua, Pearson, & Barnett, 2012; Gómez-Mejía et al., 2007).

Family management may be indeed heterogeneous in terms of goals: the family business literature distinguishes between financial and non-financial goals (Chrisman et al., 2012; Kotlar & De Massis, 2013) and recognizes that the relative importance of non-financial goals (i.e. SEW preservation) can vary (Chrisman & Patel, 2012). SEW is a multi-dimensional concept including five factors: family control and influence over the company; identification of family members with the firm; binding social ties; emotional attachment of family members; and renewal of family bonds through dynastic succession (Berrone et al., 2012). We argue that the introduction of the SEW concept may offer a new perspective to our research problem. Reducing (increasing) SEW aspirations of family managers may turn family management into a beneficial (detrimental) factor for the pursuit of financial wealth and higher firm performance. Specifically, we propose generational stage as a key contingency factor that will make financial or non-financial goals more salient to family managers than thus will have an important impact on the family management–performance relationship.

2.2. Introducing the generational stage

Generational stage is defined as the generation that controls and manages the family business (Cruz & Nordqvist, 2012; Kellermanns & Eddleston, 2006; Kellermanns, Eddleston, Barnett, & Pearson, 2008). The literature on the role of generational stage in family firms has mostly depicted it as detrimental to performance, and explored its interaction with family ownership and family boards (Arosa, Iturralde, & Maseda, 2010a, 2010b; Bammens, Voordeckers, & Van Gils, 2008). Much research focuses on the differences between first, second, and multigenerational family firms (e.g., Aronoff, 1998; Eddleston et al., 2013; Gersick, Davis, Hampton, & Lansberg, 1997; McConaughy & Phillips, 1999; Sonfield & Lussier, 2004). Later generational stages, in particular, are clearly associated with a decrease in performance (e.g., McConaughy & Phillips, 1999; Miller, Breton-Miller, & Lester, 2011; Villalonga & Amit, 2006), unless there is high information exchange frequency (Ling & Kellermanns, 2010). The reasons for the negative effect of generational stage on performance are rooted in the relatively lower quality of the relationships among family managers at later generational stages, which in turn is due to higher conflict levels (Davis & Harveston, 1999, 2001; Ensley & Pearson, 2005) and lower intentional trust (Steier, 2001). In line with previous literature, we assume that later generational stages can have a negative impact on profitability. However, also in line with recent research, we see generational stage as a key moderating variable (e.g., Eddleston et al., 2013). Accordingly, we hypothesize that generational stage may interact with family management to influence profitability. That is, the generational stage is the contingency factor that explains the complex relationship between family management and profitability that

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