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The weakness of strong ties: Sampling bias, social ties, and nepotism in family business succession

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ABSTRACT

Decision-making is a complex cognitive activity filled with bias. Leader decision-making is unique because it occurs in a social context. We examine how biases resulting from social network dynamics complicate leaders' decision-making. In particular, we focus on a specific case of leader cognition: nepotism in the succession decisions in the context of family businesses. Succession often leads to a decline in performance because leaders frequently choose family members as their successor, a form of nepotism. We show that even when a leader can overcome individual decision biases, a bias in sampling resulting from families' strong ties can still allow a leader to wrongly conclude that family members are better qualified than external candidates when the opposite is true. We demonstrate this phenomenon using simulation modeling and explore solutions to family business succession planning.

Introduction

One of the most important activities of a leader is decision-making. Leader decision-making is unique from decision making more generally because it occurs in a social context. Due to the nature of their roles, leaders have to deal with multiple complex social problems that have great importance on the success and survival of organizations (March & Weil, 2009; Mumford, Friedrich, Caughron, & Byrne, 2007). The ability of leaders to solve these social problems is a crucial aspect of leader performance (Eubanks & Mumford, 2010; Mumford, Zaccaro, Harding, Jacobs, & Fleishman, 2000).

The primary goal of this paper is to examine how decision biases resulting from social network dynamics complicate leaders' decision-making. In particular, we focus on a specific case of leader cognition — nepotism in the succession decisions in the context of family businesses.

Succession is one of the most important decisions a leader will make to ensure sustainable business performance (Giambatista, Rowe, & Riaz, 2005). These decisions are particularly challenging for family businesses as evidenced by the more than 70% of them that fail after the first generation (Family Buisness Institute, 2007) primarily due to poor succession decisions (Cucculelli & Micucci, 2008; Royer, Simons, Boyd, & Rafferty, 2008; Wasserman, 2003). One common characteristic of leaders' succession decisions in family businesses is that they tend to assign offspring as their heir, a form of nepotism. Many empirical studies have shown that nepotism in family business succession tends to lead to decline or even bankruptcy (Bennedsen, Nielsen, Pérez-González, & Wolfenzon, 2007; Cucculelli & Micucci, 2008; Gomez-Mejia, Cruz, Berrone, & De Castro, 2011; Padgett & Morris, 2005; Riggio & Riggio, 2013; Smith & Amoako-Adu, 1999). This calls for a closer investigation of the decision processes of leaders (Antes & Mumford, 2012; Eubanks &

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Mumford, 2010; Mumford et al., 2000, 2007) and why their succession decisions often appear to be biased, and can ultimately destroy their businesses.

While many decision biases have been reported in the literature (Bazerman, 2006; Kahneman, Slovic, & Tversky, 1982), there are some that are particularly relevant in the context of leader cognition and succession decisions. Many studies focus on individual level, non-social biases. For example, affect heuristic (Slovic, Finucane, Peters, & MacGregor, 2007) suggests that leaders may postpone the succession decisions longer than they should because they feel too attached to the businesses to retire (Duffy & Stevenson, 1984). The representative heuristic (Tversky & Kahneman, 1974) suggests that leaders may predict the ability of successor candidates not based on their actual performances but based on how similar they are to the leader (Lee, Lim, & Lim, 2003). Table 1 summarizes several classic decision biases that can lead to nepotism in succession decisions. These biases suggest that leaders as individual decision-makers tend to follow judgmental shortcuts and substitute a difficult question (e.g., who is the best candidate for sustaining family business) with an easy one (e.g., which candidate is most similar to me) (Kahneman, 2011), resulting in nepotism that is detrimental or even disastrous for family business performance.

One shared characteristic of the classic biases summarized in Table 1 is that they focus on how cognitive constraints and time pressure operating on an individual can lead to suboptimal decisions. While these decision biases are important, the unique nature of leader cognition suggests that biases resulting from social dynamics deserve more attention. In particular, nepotism can result from constrained access to information that is moderated by networks and social connections (Fiedler, 2000; Fiedler & Juslin, 2006; Raafat, Chater, & Frith, 2009; Stewart, Chater, & Brown, 2006). People may underestimate others if sampling is a function of prior impressions, implying that negative impressions are more likely to persist because of decreased future interactions (Denrell, 2005). The implication is that even if a leader can overcome all the aforementioned individualistic biases, decisions can still be suboptimal if the information sources on which the decision is based are biased in the first place.

We argue that the network structure a leader is embedded in can affect information processing and in turn facilitate nepotism. The key observation is the following: one may stop interacting with someone due to a negative impression and so any negative impression remains. By contrast, when interactions are likely to continue (we cannot avoid further interactions), then any unwarranted negative impressions will ultimately be corrected (Le Mens & Denrell, 2011).

In the context of family business succession, this implies that external candidates without family connections to the leader are more likely to be underestimated than family members: if, by chance, they perform badly, they are likely to leave the business before redeeming themselves: an unduly negative impression may never be corrected. By contrast, the 'strong ties' of a family member ensure that they will remain in their role, and hence will provide an increasing amount of data on which their performance can accurately be judged.

Indeed, the stronger the family ties are, the more likely a leader may learn to wrongly conclude that family members are better qualified than external candidates, with potentially dangerous consequences for succession decisions. We call this phenomenon a "weakness of strong ties."

Note that we are not arguing that leader's decisions are free from other decision biases. Instead, we point to an alternative, and further source of bias that can lead to nepotism — a bias in information sampling moderated by networks. Due to the asymmetry of access to information a leader has to family and non-family candidates, a leader may systematically underestimate non-family members. This bias is likely to be augmented by other decision biases, further strengthening the propensity to engage in nepotism.

Table 1
Nepotism and classic individual biases.

Decision biases	Definition (modified from Bazerman, 2006)	Implication for nepotism
Availability heuristic	Individuals judge events that are more easily recalled from memory, based on vividness or recency, to be more numerous than events of equal frequency whose instances are less easily recalled.	A family related candidate compared to her equally qualified outside competitor is likely preferred by a leader because the leader is more likely to recall family candidates' performance due to connections to the leader.
Representative heuristic	Individuals judge actors based on similarity or representativeness rather than more relevant criteria.	A family related candidate compared to her equally qualified outside competitor is likely preferred by a leader because the leader judges the former is more similar to him/herself.
Confirmation bias	Individuals tend to seek confirmatory information for what they think is true and fail to search for disconfirmatory evidence.	Unwarranted initial positive impressions towards a family related candidate by a leader is likely augmented when the leader seeks evidence to support this impression.
Anchoring	Individuals make estimates for values based upon an initial value (derived from past events, random assignment or whatever information is available) and typically make insufficient adjustment from that anchor when establishing a final value.	A family related candidate might be overweighed when a leader evaluates the difference between the family versus the outside candidate.
Overconfidence	Individuals tend to be overconfident of the infallibility of their judgment when answering moderate to extremely difficult questions.	Leaders can be more certain than warranted when facing a difficult question such as selecting a family related candidate as a successor.
Escalation of commitment	Individuals justify increased investment in a decision, based on the cumulative prior investment, despite new evidence suggesting that the cost of continuing the decision outweighs the expected benefit.	Leaders can stick to an earlier decision of appointing a family member as the successor despite new evidence suggesting the decision is suboptimal.
Affect heuristic	Individuals make decisions and solve problems quickly and efficiently in which current emotions such as fear, pleasure, surprise, and regret influence decisions.	Leaders may make the succession decisions based on their emotional attachment to the family members more than they should.

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