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How agency conflict between family managers and family owners affects performance in wholly family-owned firms: A generational perspective

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ABSTRACT

This study analyses the effects of agency conflict between "active family owners" (who participate in firm management) and "passive family owners" (who do not do so) on the performance in unlisted Spanish family firms wholly owned by family members. We employ agency theory to argue that ownership concentration by active family owners and governance mechanisms (direct control by passive family owners, existence of board of directors, and family governance mechanisms) improve the firm performance and that this effect intensifies in later-generation firms. Our findings show that family managers' ownership and family governance mechanisms have a positive influence on the performance in second- and later-generation firms. The results also show a positive effect of direct control by passive family owners over active family owners in second- and later-generation firms. However, the existence of a board of directors is not related to family firms' performance.

1. Introduction

The literature on family firms has extensively analyzed the effect of family owner management on firm performance. Researchers have employed agency theory arguments to suggest both positive and negative effects (e.g., Basco, 2013; Bennedsen, Nielsen, Pérez-González, & Wolfenzon, 2007; Block, Jaskiewicz, & Miller, 2011; Miller, Le Breton-Miller, Lester, & Cannella, 2007). Proponents of the negative view usually focus on the expropriation by the main shareholder (i.e., the family) of minority shareholders (nonfamily members). The alignment of family managers with family objectives rather than business objectives (Miller, Minichilli, & Corbetta, 2013) may impair family firm performance (Basco, 2013; Schulze, Lubatkin, & Dino, 2002; Schulze, Lubatkin, & Dino, 2003a; Schulze, Lubatkin, & Dino, 2003b; Schulze, Lubatkin, Dino, & Buchholtz, 2001).

But conflicts of interest may also exist between family members who are both owners and managers (henceforth "active family owners") and other family owners who do not participate in firm management ("passive family owners") (Basco, 2013; Lubatkin, Schulze, Ling, & Dino, 2005; Miller et al., 2013; Schulze et al., 2003a; Siebels & zu Knyphausen-Aufseß, 2012). Active family owners may misallocate firm resources for the particular benefit of their own nuclear family at the expense of other family branches. For example, they may hire incompetent relatives from their nuclear family for key positions, pay these family members salaries that are higher than competitive rates, or give them rewards that are not aligned with performance. In turn, these behaviors may impair the firm's performance (Eddleston & Kellermanns, 2007).

Governance mechanisms may control this intra-family agency conflict and improve performance. For instance, passive family owners may discipline the behavior of active family owners by directly controlling them (Chrisman, Chua, Kellermanns, & Chang, 2007) or by having a board of directors monitor them (e.g., Audretsch, Hülsbeck, & Lehmann, 2013). Furthermore, specific family governance mechanisms (succession plans, family protocols, and family councils) may help regulate the economic and family relationships between active and passive family owners (Corbetta & Salvato, 2012; Poza, Hanlon, & Kishida, 2004). However, empirical studies on the role that governance mechanisms play in the agency conflict between active family owners and passive family owners are still rare (Siebels & zu Knyphausen-Aufseß, 2012).

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The family firm literature suggests that agency conflicts are higher for family firms in later generations[1] because family growth at each generational stage accentuates the separation of ownership and control between family firm managers and a larger growing group of family firm owners who perform no management tasks (Miller et al., 2013). Not only is ownership more dispersed but also family bonds tend to be weaker both between family members of the same generation and between those of different generations (Gersick, Davis, McCollom, & Lansberg, 1997; Schulze et al., 2001, 2002). Therefore, even for similar ownership structures, the generational stage may increase agency conflicts between active and passive family owners.

Our paper contributes to the empirical evidence on the role of family involvement in management (e.g., Block et al., 2011; Chrisman et al., 2007; Miller et al., 2013; Sciascia & Mazzola, 2008). In particular, we first analyze whether ownership concentration among active family owners aligns their objectives with those of passive family owners and improves the firm's performance. Whereas previous studies of the effect of family management on the firm performance have usually used samples of large listed firms (Miller et al., 2007) that include shareholders other than family, and therefore have mixed the two types of conflict, we consider only family firms wholly owned by family members to avoid confounding influences on our analyses.

Second, we extend previous evidence on the effect of governance mechanisms on family firm dynamics to conflicts of interest between active family owners and passive family owners. We also analyze whether this influence varies for family firms in different generational stages.

Third, studies show that the relationship between family involvement and firm performance is influenced by the firm size, public versus private status, presence of the founder, country of operation, and generational stage (Block et al., 2011; O'Boyle, Pollack, & Rutherford, 2012; Wagner, Block, Miller, Schwens, & Xi, 2015). In this study, we test for the moderation effect of the generational stage while controlling the other influences through sample selection and control variables.

Finally, our study is based on a questionnaire and database information that includes private family firms in Spain. These data enable us to answer the call for a more contextualized research design in family business research (Miller et al., 2007, 2013).

Our empirical research is mainly based on agency arguments. However, we also combine arguments from stewardship theory (Chrisman, Chua, & Sharma, 2005; Pindado & Requejo, 2014) to enhance the understanding of family firms (Le Breton-Miller & Miller, 2009). Specifically, agency-based models can incorporate certain dimensions that are important in the family business context, such as altruism or the socio-emotional involvement of family members (Karra, Tracey, & Phillips, 2006; Lubatkin et al., 2005; Pindado & Requejo, 2014).

The paper is structured as follows. First, we analyze the relationship between active and passive family owners to develop our hypotheses. In the third section, we describe the data-collection process, information sources, variables, and methods. The fourth section summarizes the results, and the final section includes our analysis, discussion of the results, and conclusions.

[1] By later generations, we mean family firms in second generation compared with first generation and third and following generations compared with second generation.

2. Theory and hypotheses

Over the last few decades, numerous studies have focused on the effects of family involvement on firm performance. Agency theory points out that the separation of ownership and management results in potential agency conflicts between owners and managers, but family relationships between them reduce such conflicts by aligning their objectives and reducing information asymmetries (Fama & Jensen, 1983; Jensen & Meckling, 1976). Under these conditions, family firms should achieve higher performance (Chua, Chrisman, & Steier, 2003). However, while some empirical research has found that family firms outperform nonfamily firms (Anderson & Reeb, 2003), other studies have found family influence to have no effect on the firm performance (Miller et al., 2007), and still others have found that family firms underperform nonfamily firms (Gomez-Mejia, Haynes, Nuñez-Nickel, Jacobson, & Moyano-Fuentes, 2007; Morck, Wolfenzon, & Yeung, 2005).

Previous research has defined family involvement as family ownership, family management, or both (López-Delgado & Diéguez-Soto, 2015; Miller et al., 2007). Block et al. (2011) used Bayesian analysis to separate these two dimensions and found a positive impact for family ownership but a neutral impact for family management. This neutral effect suggests that family involvement in management may have negative effects that counterbalance the positive effects (Block et al., 2011).

Regarding the positive influences, the agency theory literature suggests that active and passive family owners share objectives and information (Daily & Dollinger, 1992; Fama & Jensen, 1983; Jensen & Meckling, 1976).

Researchers have also employed stewardship theory arguments (Davis, Schoorman, & Donaldson, 1997) to suggest that family involvement in management improves the performance (Charbel, Bouri, & Georges, 2013; Hoffmann, Wulf, & Stubner, 2016). Family managers act as stewards because they identify with the firm so strongly that they subordinate personal goals to family goals. They are generally highly motivated, their expectations of being in office for a long time reduce potentially hazardous moves (Hoffmann et al., 2016; Sciascia & Mazzola, 2008), and their family bonds with owners can also reduce opportunism (Corbetta & Salvato, 2004). The socio-emotional involvement of family management in the firm (e.g., identity formation and dynastic sensibilities) implies that managers serve the collective good of the company because they are driven by more than economic self-interest (Gomez-Mejia et al., 2007; Hautz, Mayer, & Stadler, 2013).

Still, the literature has also argued that there are disadvantages and agency costs of family involvement in management (Schulze et al., 2001, 2002, 2003a, 2003b). These arguments suggest that problems related to altruism and self-control make it difficult for family managers to reliably represent their own best interests as well as those of the firm and other family members, which negatively affects the firm performance. Altruism can create a sense of entitlement among family members by encouraging family CEOs to use the firm's resources to benefit family members with employment, perquisites, and other privileges, and it can bias CEOs' perceptions of family members' behavior, hampering their ability to monitor and discipline their employed family members.

Research has also employed stewardship arguments to explain a negative effect of family involvement in management: family managers may function as stewards of the family rather than of the business (Miller et al., 2013). In sum, both agency and stewardship arguments suggest that the negative effects on the performance of family involvement in management result not from an explicit intention to expropriate other family owners but from an effort to benefit them at the expense of nonfamily shareholders.