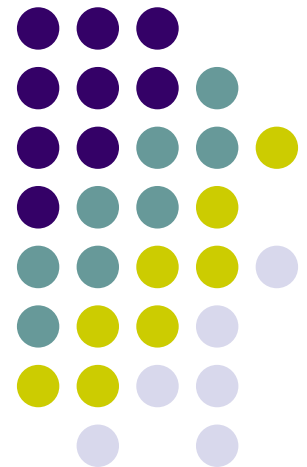


Family Business as a Field of Study

Michael Lubatkin
University of Connecticut
& EM Lyon

**(With Bill Schulze, Richard Dino,
Yan Ling, Ann Buchholtz)**



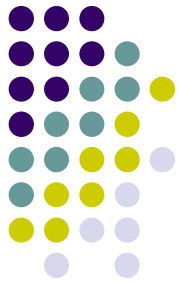
The Founding Insight



- Family firms are theoretically distinct from other ownership forms
 - because their system of governance is temporally *embedded* in the parent-child household relationships.
- This socialized view lies outside the relevant explanatory domain of the Jensen-Meckling's agency model.
- Thus, FF needs a relevant governance theory.

Agency Theory is *Naïve*

“a model only a micro-economist could love”



- **Agency Theory**
 - Closely Held +
 - Owner-managed +
 - By the family
- **Reality: Heavy with Agency Costs**
 - Moral hazard +
 - Adverse selection +
 - Hold-up

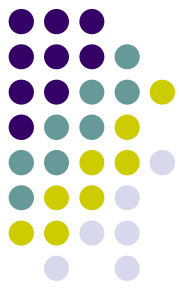
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Governance Panacea!

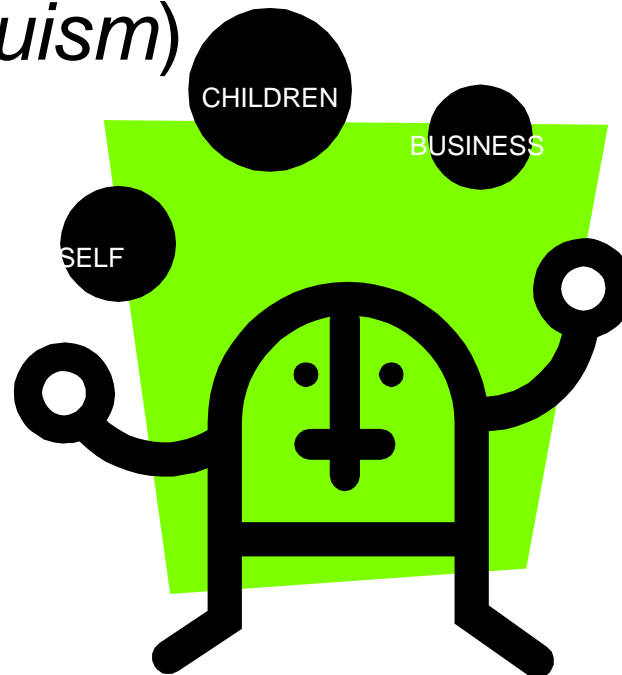
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Rags, Riches, Rags

Proposed a Theory-Based Explanation



- AT understates agency costs of private ownership (*Self-control Problems*)
- AT understates problems of family ownership (*Parental Altruism*)





- **The Dark-Side of Altruism**

- Theorem: The *Samaritan's Dilemma***

- Parents' welfare is co-dependent with that of their children.

- And, their children's interests take precedence.
 - Parents thus are compelled to be generous towards their kin in terms of salary, perquisites, promotion, and leniency.
 - *This can inadvertently spoil the children*
 - By giving them incentive to free-ride and shirk,*
 - and** cause the Controlling (Parent) Owner*
 - to lose "self-control".*

- Result: The *Dysfunctional* Family Firm**

Propositions

(J. of Organ. Behavior)



- P1: Private Ownership, owner-management, *and* parental altruism can combine to expose the COs of private firms to self-control problems
- P2: These self-control problems, in turn, can expose family and non-family agents to agency problems (rooted in moral hazard, adverse selection and hold-up).
- P3: The P2 relationship is moderated by the COs capacity to exercise self-constraint.

Hypotheses (Organization Science)



- The CO's willingness to invest in agency costs to monitor agents are positively associated with the firm's performance.
 - Pay Incentives (*)
 - Strategic Planning Systems (*)
- The CO's willingness to invest in agency costs to monitor Owners are positively associated with the firm's performance.
 - Promote Board Vigilance though:
 - Outside Directors (**); Reduced CEO (*) and Board Tenure (**)
 - Disclose estate and transfer intentions (+)
- Some FFs are characterized by a cluster of good governance practices, while others are not (*), and the good governance clusters will outperform the other cluster (*)

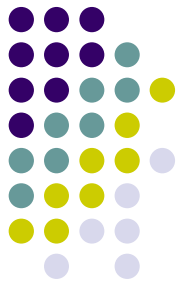
Moderating Hypotheses (JBV)



- A positive relationship between firm performance and the use of pay incentives exists with family agents when:
 - Agents anticipate that the firm will be sold, but no relationship when they anticipate it not sold (***)
 - Agents anticipate it not being sold, but only if the CO has revealed estate & transfer intentions (***)
 - CO has revealed that expected date of retirement is near, but no relationship if agents anticipate the date as being distant (+).

Hypotheses about Ownership

Dispersion (AMJ)



- The likelihood of FFs pursuing growth-seeking, risk-taking investments is:
 - High when Ownership is concentrated in the hands of the founding CO
 - Low when ownership is divided among the siblings (*Sibling Partnership*)
 - High when ownership is dispersed among the extended family (*Cousin Consortium*)

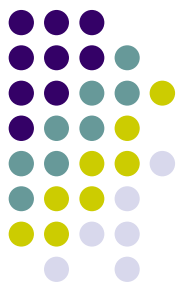
These relationships are positively *moderated* by the growth rates of the firm's markets ()**



Growing Discomfort

- While we concluded that Agency Theory's view of FF is *Naïve* (because it largely ignores the effects of family).
- Our depiction of FF tended to be *Dire* and inconsistent with Reality
 - We overstated Altruism's Dark-side Influences on agents and owner's behaviors
 - Over-relied on Theorem "Samaritan's Dilemma"

Future Directions: Explaining the Bright-Side “*A Typology of Parental Altruism*” (Lubatkin, Durand, Ling; *JBR*)



To Offer a more balanced theory-based explanation of the cross-sectional variance in the governance efficiency of family firms than do either agency theory or that proposed by Schulze, Lubatkin *et al.*



The Typology's Roots

Draw on 3 Philosophical world views about the 'principal' and the principal's relationship with 'others'

- * Subjectivity (Descarte, 1637)**
- * Inter-subjectivity (Hegel, 1806)**
- * Tran-subjectivity (Ricoeur, 1992)**

And, 2 orientations (whether the principal's interests either dominate, or are secondary)

- Results in 3X2 that define five altruistic archetypes, each differing from the other in terms of nature of good transfer, enforcement mechanism, and the influence on children's' behaviors.**

Five Altruistic



World View

Primary

Secondary

Subjectivity

Agency-based

Ideal-typic

Inter-subject

Paternalistic

Family-Oriented

Trans-subject

Empty Cell

Psychosocial

Inter-Subjectivity/Principal Secondary



- **Proposition 1.** *The degree to which parent-owners are driven by **family-oriented altruism** is positively associated with normal good allowance, motivational bias, and ineffective use of existing governance mechanisms, which, in turn, are positively associated with governance inefficiencies.*

Inter-Subjectivity/Principal Primary



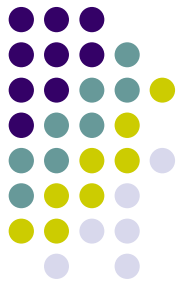
- ***Proposition 2.*** *The degree to which parent-owners are driven by **paternalistic altruism** is positively associated with merit good allowance, excess of control, and family bond erosion, which, in turn, are positively associated with governance inefficiencies.*

Trans-subjectivity/ Principal Secondary



- ***Proposition 3:*** *The degree to which parent-owners are driven by **psychosocial altruism** is positively associated with the norms, values, ex ante enforcements, and durable family bonds, which, in turn, are positively associated with governance efficiencies.*

“Integrating Insights from Justice into Agency Framework” (L, Ling, S JMS)



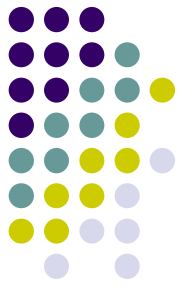
- **Agency theory fails to specify the intervening mechanisms by which altruism and self-control impact agency costs.**
- **Justice theory specifies those mechanisms.**
- **We argue that perceptions of procedural and distributive justice violations lie at the heart of moral hazards.**



Justice Violations and Moral Hazard

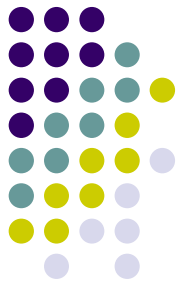
- A.T. view M.H. as an ever-present threat
 - Individuals are motivated primarily by self-interest
 - Don't require overt provocation to act opportunistically
- Justice assumes Agents value fairness
 - Will *only* act opportunistically if perceive violation
- Difference is Reconcilable
 - Assumptions differs, but acts are behaviorally equivalent
 - Both theories view the leader as the cause

Context (Family Status) Matters !



- Family perceptions of injustice are grounded on a different set of logic and reasons.
 - Family fairness perceptions have a broad “zone of tolerance” b/c family ties are generally binding
 - No exact standard (equity, equality, charity) or timing of reciprocity. E.g., may defer to another’s preferential treatment, knowing that they will later be able to draw on the Parent’s generosity
 - In contrast, non-family perceptions, while not naïve, are more close-ended and metered, based on “relative equity”

“Integrating Insights from Justice into Agency Framework”



We show how our integrative view offers a fine-grained understanding of *self-control*:

- It draws insight from agency theory about ‘*which*’ governance mechanisms a self-controlled family firm CEO should implement to guard against acting capriciously,
- and, from justice theory for insight as to ‘*how*’ those mechanisms should be implemented to improve the probability that both the family and non-family employees will perceive him/her as fair.

Future Directions: What are Family Firms?



- **By Ownership**

- Controlling Owner

- Sibling Partnerships

- Cousin Consortiums

- Publicly Held

- **By Family Members Employed**

- **By Number of Generations Involved**

Future Directions: What are Family Firms?



- **By Nation**

The core concepts like agency costs, self-control, altruism, and justice may take on different meanings and or calibrations in different nations.

Thus, we need to explore the cross-national utility of extant contributions.

Future Directions:



What are Friendship Firms? (Shperling, Lubatkin, & Rousseau)

Friendship Firms: Overlooked, yet - - -

How do the theories derived from Family Firms compare and contrast with that which might explain agency relationships and performance of Friendship firms?