Nonfamily Managers, Family Firms, and the Winner's Curse

– *James J. Chrisman, Esra Memili and Kaustav Misra*

Hiring non-family managers is considered an important aspect of professionalization process of family firms. However, family businesses often hesitate to employ non-family managers and prefer family members for managerial positions. This behaviour is said to be rooted in family firm's desire to protect itself from agent opportunism and retain family control. Family business researchers Chrisman, Memili and Misra conducted detailed examination of this phenomenon and discovered the underlying reasons for family firm's reluctance in hiring and providing competitive wages to talented non-family managers.

The authors studied both demand and supply side issues of employing non-family managers. They found that family firms' tendency to employ family members rather than nonfamily members as managers, had both economic and non-economic reasons. Those reasons were also found to be interrelated and are explained as following: -

Supply Considerations (Difficulty in attracting high-quality non-family managers):

1. ***Higher Wages*** - An important non-economic goal of family firms is to maintain family control over business. This limits growth and income opportunities for high-quality non-family managers. Therefore, they would demand higher wages to compensate for lower future earning opportunities.

2. ***Lower Capabilities*** - As family firms offer limited growth opportunity and decision-making domain, high quality non-family managers find them less challenging work environments. They perceive non-family firms as more attractive work places to aptly utilize their abilities for higher income and growth. Therefore, family firms are more likely to attract non-family managers with lower capabilities.

Demand Considerations (Reduction in willingness to pay):

1. ***Diminishing Utility*** - As the significance of family objectives like family involvement, control and socioemotional wealth increases, the utility for a family firm to employ a non-family member decreases. Therefore, the firm's willingness to pay higher wages to non-family manager would also decrease.

2. ***Competitive Labour Market*** - As more professionals enter the 'managerial labour market' and competition increases over time, the family firm's willingness to pay higher wages for hiring high-quality non-family managers will decrease.

Winner's Curse (Perceived costs exceeding perceived benefits):

1. ***High Performance Expectations*** - As family firms hire non-family managers for their specialized skills and often sacrifice valued noneconomic family objectives in the process, they would have exceedingly high

performance expectations from non-family managers. This high bar of performance expectations would be a tough challenge for non-family managers.

2. ***Capability Limitations*** - As the significance of family centered, non-economic goals increase, it would require a larger trade-off between fulfillment of economic and non-economic goals of the family firm. At some point, non-family managers are bound to reach the limits of their capabilities in delivering higher economic performance. Beyond this, their contribution to the economic goals will not be sufficient to compensate for the family firm's sacrifice of noneconomic goals. Therefore, they are not likely to meet the overall performance expectations of the family firm. The family managements would perceive them costlier than the benefits they deliver to the firm.

In addition, contrary to hiring non-family managers, employing family members as managers serves both economic and noneconomic goals of the family business. This is because it maximizes the family firm's utility by allowing them – (i) to follow their idiosyncratic business strategies and (ii) to increase their socioemotional wealth. In totality, all these factors inhibit family firms from hiring non-family managers and result in an inclination towards hiring family managers.

Practical Implications

Non-family managers are a good source of talent and skills that a family firm requires for professionalization. Therefore, concerted efforts need to be made to tap and retain this talent. More specifically, the article suggests family businesses to take the following measures –

(i) Family firms need to be more diligent at employing nonfamily managers. Being forthright in communicating their priorities may increase the odds of employing nonfamily managers with better personality fit.

(ii) It is important to lend an ear and recognize what non-family managers need. On their part, non-family managers would have more satisfying employment experience if they communicate their requirements and understand and adapt to the priorities of the family firm.

(iii) Setting up more formal monitoring and incentive mechanisms will reduce ambiguities and result in fair and satisfactory outcomes for both the family owners and non-family managers.

Source: *Entrepreneurship Theory and Practice (2014), Vol. 38, No. 5, pp 1103–1127.*