Industry and Information Asymmetry: The Case of the Employment of Non-Family Managers in Small and Medium-Sized Family Firms

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As family firms grow in size and begin to professionalize, an important decision they need to make is whether to employ non-family managers or not. Non-family managers bring in knowledge and skills that family members may lack. However, family owners may resist hiring non-family managers to preserve socioemotional wealth and to minimize agency costs. The authors probe this phenomenon and argue that the industry sector in which the firm operates influences its decision to employ non-family managers. The study was based on data from 965 small and medium sized family firms in retail and manufacturing sectors in the USA. This summary presents the gist of the study, its findings and practical implications.

Preserving Socioemotional Wealth

The authors argue that one of the major reasons family owners resist hiring non-family managers is to preserve socioemotional wealth (SEW). SEW refers to non-financial benefits like reputation, influence, exclusive treatment, and dynastic legacy that family owners seek from the business. Non-family managers may not attach much importance to family-centred non-economic goals, which may lead to loss of SEW. Further, hiring non-family managers reduces scope for placing family managers in business. It also affects the owning family's ability to maintain the family's values, dynastic control, internal harmony and altruism towards family members. Thus, the authors posit that unless the family owners perceive a threat to the firm's viability, family firms are likely to avoid employing non-family managers.

Minimizing Agency Costs

Information asymmetries and misalignment of interests may exist between family and non-family managers. These are likely to lead to agency problems. For instance, owners need to incur agency costs to monitor managers to keep a check on behaviours that do not contribute to the owners' goals. In case of family managers, agency costs are likely to be lower due to family members' reciprocal altruism, commitment and trust. However, non-family managers do not share affinity bonds with the owners and are more likely to behave in opportunistic manner, which necessitates a careful vigil. The agency costs incurred by the owners in monitoring non-family managers may far outweigh the skill advantage they bring to the firm.

The authors argue that the complexity and cost of monitoring non-family managers varies according to industry context. For instance, in industrial sectors where business operations are complex in nature, it is difficult to establish direct linkages between managerial actions and business performance. In such contexts, there is high probability of non-family managers to conceal their acts that might have had negative fallout on business. They may also resort to data manipulation or attribute poor performance to extraneous reasons. Thus, the authors posit that family firms operating in industries where the complexity of monitoring managerial performance is high are less likely to employ non-family managers to minimize agency costs.

Key Findings

The authors analyzed data from 965 small and medium sized family firms in retail and manufacturing sectors in the USA. The family firms that were older and larger were found to have hired more non-family managers compared to smaller and younger family firms. The authors reasoned that the older the firm, the more likely it was to be led by later generations, who might not have assigned high importance to SEW, hence they employed more non-family managers. The larger firms required more non-family managers due to the sheer size of the organisation.

Another key finding was that the extent of family ownership (i.e. stake family owned in the firm (in %)) was negatively correlated with the number of non-family managers employed. The higher the family ownership stake in the firm the lower was the number of non-family managers employed.

The most significant finding was that the proportion of non-family to family managers was lower in retail firms compared to that ratio in manufacturing firms. In the retail sector, the association between managerial actions and firm performance was harder to ascertain compared to manufacturing firms, hence they employed lower number of non-family managers.

Practical Implications

There are significant practical implications of this study for family firms. In their assessment of agency costs of hiring non-family managers, family firms must consider their external context like, the sector in which they operate. If they are present in a sector where monitoring non-family managers is difficult, they must either employ non-family managers very sparingly or make greater investments in setting up effective monitoring mechanisms and incentive programmes to minimize agency costs.

Tapping into the larger pool of non-family managers in the labour market helps the firm build capabilities and equips it with a wider knowledge and skill set. Hence, family firms would do well to strike a right balance between their economic and non-economic goals and achieve a judicious mix of family and non-family managers.

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