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Are Family Firms Really Better? Reexamining "Examining the 'Family Effect' on Firm Performance"

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As I have thought about why I wrote my article, "Examining the 'Family Effect' on Firm Performance" (Dyer, 2006) and its impact on the field of family business, my thoughts turned to how I got interested in studying family firms in the first place. At my career stage, I am more convinced than ever that we can only truly understand the present by understanding the past. My interest in family business began shortly after I entered MIT as a doctoral student in the fall of 1979. The primary reason I chose to go to MIT was to work with Professor Edgar Schein since both he and I had an interest in doing research on organizational culture. As I worked as Ed's research assistant, I also found myself working with Dick Beckhard as his teaching assistant for his class on consulting.

One afternoon I had a lunch with Dick that was to change my life. As we were eating Dick asked the question, "Gibb, what do you know about family businesses?" I admitted that I did not know much. Dick told me that many of his clients were family business owners and that they were challenging clients to work with. He would attempt to help these clients solve various business problems only to have family conflicts undermine his work. He proposed that we collaborate on a research project on the problems of family businesses and suggested that we invite some of his clients to Boston to listen to their issues and problems. Based on what his clients would tell us, we would then develop our research agenda. (This is a very different approach to doing research than we typically experience in academia where we generate research ideas by interacting with our like-minded academic colleagues rather than formulating research questions by gathering data from, and listening to, those who we purport to study.) After Dick's clients arrived in Boston in the spring of 1982, I spent 3 days listening to issues and problems that I never encountered in my MBA program, whose training was focused primarily on large, public corporations.

In my mind's eye, I still can see one tall, silver-haired founder of a family business standing during those meetings to express his feelings about succession:

> Succession planning . . . is really digging your own grave. It's preparing for your own death and it's very difficult to make contact with the concept of death emotionally. . . . It is a kind of *seppuku*—the *hara-kiri* that Japanese commit. [It's like] putting a dagger to your belly . . . and having someone behind you cut off your head. . . . That analogy sounds dramatic, but emotionally it's close to it. You're ripping yourself apart—your power, your significance, your leadership, your father role. (Dyer, 1992, p. 172)

This statement, along with many others, left a deep impression on me. The emotion, the conflicts, the depth

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of commitment by these people to the family business were all new to me and cried out for exploration.

Early Research on Family Business

As I began to do research on family businesses in the early 1980s, literature reviews were easy to do since there was very little written about family businesses. Leon Danco, a consultant, had written about the challenges of consulting with family businesses, and a few doctoral students, such as myself and John Davis at Harvard, had focused on family businesses in their dissertations. In my article with Dick Beckhard titled "Managing Continuity in the Family-Owned Business," which was published in 1983, we cited only six articles—one of which was another article that we had written together (Beckhard & Dyer, 1983). Today, we have dozens of articles with hundreds of citations published each year on family business. In those early days, there was little research to draw upon to develop good theories about the functioning of family firms. Based on what we did know, we assumed that family firms

1. Were relatively small but did represent a large percentage of businesses.
2. Were filled with conflict due to family influence. Succession, in particular, was the primary source of conflict.
3. Were poorly managed since nepotism was rife in them. Harry Levinson, in a *Harvard Business Review* article on family businesses, viewed them as being so dysfunctional, that, "the wisest course for any business, family or nonfamily, is to move to professional management as quickly as possible" (Levinson, 1971, p. 97). Levinson believed that family ownership and management would inevitably lead to poor firm performance, and so professional managers were needed to alleviate this problem. In 1972, the noted sociologist, Charles Perrow, made the same argument when he wrote that employing people based on family affiliation would be "negatively related to performance" (Perrow, 1972, p. 10). Moreover, he suggested that the more family members involved in a firm, the worse the firm's performance would be.

As we started doing serious research we discovered that these three "truths" were only half-truths: Family businesses were often very large and even dominated the economies of certain countries; harmony, not conflict, characterized many family firms; and family firms, rather than poor performers, actually outperformed their nonfamily counterparts under certain circumstances.

The Ground Begins to Shift: The Anderson and Reeb Study of 2003

In 2003, I heard about a study that empirically demonstrated that family-founded firms in the S&P 500 performed better than their nonfamily counterparts (Anderson & Reeb, 2003). I was stunned by the study's core findings: When comparing the performance of 141 family firms with the 262 nonfamily firms from 1992 to 1999, Anderson and Reeb found that family firms were clearly better performers on a variety of performance measures. Previous research that had compared family with nonfamily firms was either based on small samples or the results were equivocal. Anderson and Reeb (2003) were unequivocal when they wrote,

> Controlling for industry and firm characteristics, our analysis suggests that firms with continued founding-family presence exhibit significantly better accounting and market performance than nonfamily firms. (p. 1303)

These findings caused myself and many of my colleagues to ask ourselves, "Why haven't we found similar results in our own studies? And if family firms are indeed better performers, what theoretical frameworks will help us account for these findings?" Many academics studying family firms at the time rushed to come up with plausible explanations for Anderson and Reeb's results. After reading numerous articles from various authors that attempted to address Anderson and Reeb's findings, I came to two conclusions: (1) Since I did not believe that all family firms were inherently "better" than nonfamily firms, I thought that a "contingency theory" of family firm performance was needed. Such a theory would describe under what conditions family firm performance would be superior to nonfamily firms and also under what conditions we would likely find family firms performing poorly vis-à-vis nonfamily firms. (2) Agency theory and the resource-based view of the firm were likely to be the theories to help us explain why family firms perform better (or worse) under certain circumstances. With this in mind, I began to create

a contingency theory of family firm performance based on agency theory and the resource-based view.

Developing the Theoretical Framework

As I began to theorize about family firm performance, I initially asked myself the question, “How do we separate out family influence on firm performance from the other factors that influence performance?” As I thought about this question, other factors that influence firm performance, such as industry, firm governance, firm management, and, in particular, the role of the founder, came to mind. Prior studies did not seem to provide proper controls for many of these factors and thus it was difficult to determine whether the owning family was responsible for the differences in performance or if one of the other factors was responsible for the differences. So I asked myself: “How can a family make a difference in firm performance, and how do we know it is the family influencing performance rather than the founder/entrepreneur, the management team, the industry, firm governance, or some other firm characteristic?” These questions led me to think about the role that agency theory and the resource-based view might play in developing my contingency theory of family firm performance.

Agency theory argues that when the goals of a firm’s principals (owners) and their agents (managers) are aligned, there will be few “agency costs” due to shirking, opportunism, adverse selection, or moral hazard. In the case of a family firm where the principals are also the agents, agency costs should be zero since their interests are perfectly aligned—all things being equal, the family firm should perform more effectively than a nonfamily firm where principals and agents are at odds with one another. However, when the issue of “altruism” is put into the principal–agent equation, a potential agency problem occurs: Family members, due to their relationship with each other, may not be willing to monitor and hold accountable other family members. Under these conditions, shirking, opportunism, and the like can occur in a family firm, thus incurring agency costs. Moreover, conflicts between family owners might also prove deleterious to firm performance when family members do not share the same goals. Thus, I began to think about relations between family members on a continuum where at one end of the continuum there would be low agency costs due to common family goals and high trust within the family, while at the other end of the continuum there would be high agency costs due to the fact that family members were taking advantage of their preferred position, or the family had to incur expenses related to monitoring family members or dealing with family conflicts.

In applying the resource-based view to family firms, I saw certain family firms as having significant family resources or assets: human capital (family members that were well-trained and highly motivated), social capital (family members with important social connections within and outside the family), and financial capital and other assets (family financial resources and other assets to support the business), while other family firms had significant liabilities: family members with few skills who relied on nepotism for their position; family members who distrusted those outside the family and therefore did not foster important social capital; and family members who would use firm funds or assets for their own interests to the detriment of the business. This suggested two other continua ranging from “high to low assets” and “high to low liabilities.”

Using this framework, I created a 2 × 2 matrix with assets and liabilities on the vertical axis and low to high agency costs on the horizontal axis. This led to a typology of four “types” of family firms: The low agency costs/high assets family firm was labelled the “clan family firm”; the high agency costs/high assets family firm was called the “professional family firm”; the low agency costs/high liabilities family firm was the “mom and pop family firm”; and the high agency costs/high liabilities family firm was called the “self-interested family firm.” Given this framework, I was able to generate the 13 propositions regarding the “family effect” on firm performance that are found in my article. In short, I posited that “clan” family firms would be the highest performers, while “self-interested” family firms would be the poorest performers. (The other two firm types would have mixed results.) This framework helped me understand under what conditions family firms would be better or poorer performers when compared with other family firms as well as when they were compared with a population of nonfamily firms. By using this framework, I was able to account for the mixed results that I had seen in the literature regarding the performance of family firms.

Trying to Get It Published: The Next Step in the Process

For over a year I read, theorized, made notes, and did outlines of different topics before my paper on the "family effect" began to take shape. After completing a draft of the paper and getting some feedback, I believed it was ready to be sent off to a journal. I thought that I had done good work: The paper presented a plausible argument for why we were seeing mixed results in the studies that compared the performance of family firms with nonfamily firms. In thinking about where to send the paper, I decided to send it to a top management journal where I had published before, the *Academy of Management Review*. Like all authors, after sending my beautiful "baby" off to be scrutinized by some unknown (and probably uncaring) reviewers, I expected a positive response. But after a couple of months a letter came in the mail from the associate editor announcing that my baby was deemed to be "ugly" by the reviewers: My article had been "rejected." Like most (if not all) of us when we get a rejection letter, we feel hurt and somewhat angry. But in this case, I was more than angry, I was incensed—How could the reviewers be so stupid? Couldn't they see the value of my arguments? What planet were they on anyway? So, for the first time in my academic career, I decided to write a point-by-point rebuttal to the reviewers to let them know how wrong they were. After writing the rebuttal and sending it off, I felt much better. But a week or so later, the associate editor sent me a polite note letting me know that it was not the policy of the journal to forward such criticism to reviewers, and his advice was, in the vernacular, to "just let sleeping dogs lie."

As in most cases when I get a rejection letter, I tend to go through a five-step grieving process similar to Elizabeth Kübler-Ross's stages described in her book, *On Death and Dying* (Kübler-Ross, 1969). The stages are the following: (1) Denial (I can't believe I got rejected.); (2) Anger (I go to the gym and hit a punching bag for 2-3 hours.); (3) Bargaining (I call or email the editor—can't I please have a second chance? The reviewers must have been on something when they read my paper.); (4) Depression (Another rejection, no doubt about it. I won't get out of bed today. I'll just stay here and eat ice cream.); and (5) Acceptance (Maybe the reviewers did have something reasonable to say. Let me go back and look at their comments and see how I might improve the paper. After making the changes, I'll look for another outlet for my work.) After going through this process with the paper, I made several changes, got more feedback, and eventually decided to send it to the *Family Business Review* (*FBR*). The editor and reviewers at *FBR* also gave me good feedback and after making more changes the paper was eventually published. Currently, it is cited more than any of my other works with about 100 citations annually. The article reminds me to not get too discouraged when I get negative feedback or receive a rejection letter if I really believe my ideas should see the light of day. As scholars, we should be passionate in our efforts to bring good ideas to the world and make every effort to overcome any obstacles in our path to improve both theory and practice.

After Examining the "Family Effect": Current Research on Family Firm Performance

It has been over a decade since my article was published in *FBR*. Since that time, numerous studies have continued to examine the performance of family versus nonfamily firms, and some scholars have even done meta-analyses on the subject (O'Boyle, Pollack, & Rutherford, 2012; Wagner, Block, Miller, Schwens, & Xi, 2015). O'Boyle et al. (2012) analyzed 78 articles in their study. They found that there was no difference in performance when comparing family and nonfamily firms across the studies. However, if these authors had taken my article seriously, they would have realized that they were probably asking the wrong question. Answering the question: "Are family firms 'better' than nonfamily family firms?" is not as important as answering the question: "Under what conditions are family firms likely to be better performers than nonfamily firms?" or, stated differently, using the 2 × 2 matrix framework from my article, "What 'type' of family firm is likely to perform better than a nonfamily firm or other 'types' of family firms?"

Another meta-analysis comparing family and nonfamily firm performance was published by Wagner et al. in 2015. They looked at 380 studies from across the world and concluded "that in 61% of our primary studies, a positive effect of family governance on financial performance was observed" (Wagner et al., 2015, p. 3). What is interesting about this study is that the authors began to explore why differences were observed in the data. They noted that the findings of the various studies

were influenced by (1) the definition of "family business" used in the studies; (2) what performance variable was used—studies using return on assets showed family firms doing better than those studies that used return on equity as the dependent variable; (3) whether the studies were based on public or private firms (public family firms perform better); (4) the size of the firms (larger family firms do better); and (5) national culture (various measures of performance were correlated positively with certain cultural dimensions outlined by Hofstede, 2001). While this meta-analysis provides us with some interesting findings demonstrating that the performance of family versus nonfamily firms varies depending on certain factors, a theory-driven approach that accounted for these differences would have been more helpful.

I have found that studies that are (1) longitudinal and (2) theory-driven are more compelling to me regarding the "family firm performance" question. One study, in particular, is a good example of this type of work. In 2001, Gomez-Mejía, Nuñez-Nickel, and Gutierrez compared CEO succession in family versus nonfamily newspapers in Spain. They discovered that in the family-owned and managed firms CEO tenure was not positively correlated with business performance whereas it was in nonfamily firms. Moreover, business survival was enhanced in family firms after CEO succession as compared with the nonfamily owned newspapers. These findings, they argued, were due to the fact that the board of directors in a family firm is much more reluctant to fire a family CEO than a board in a firm with no family connections. Thus, when a new leader took over in a failing family firm, a significant rebound in performance was the result.

The authors believed that such findings are strong evidence that agency problems exist in certain family firms even though the principals and agents are one and the same. Nepotism can lead to the entrenchment of family CEOs making them much more difficult to replace. Studies such as this, which compared family and nonfamily firm performance within a specific industry from 1966 to 1993, allow us to more carefully explore specific variables related to firm performance and generate good theory in order to help us understand why there might be performance differences between family and nonfamily firms.

While this study helped me more clearly understand important dynamics associated with the performance of family firms as compared with nonfamily enterprises, it would be even more interesting to study, in-depth, those Spanish family firms that did hold their CEOs accountable and compare them with those that did not. By doing such work, we would likely have an even better understanding concerning how family firm performance can vary significantly depending on how the firm is governed, the nature of family relationships, and how firm and family assets are utilized.

A New Dependent Variable: Socioemotional Wealth

One development in the field of family business since my article was published has been the emergence of "socioemotional wealth" as a new dependent variable to measure family-firm performance (Gomez-Mejía, Cruz, Berrone, & De Castro, 2011; Gomez-Mejía, Haynes, Nuñez-Nickel, Jacobson, & Moyano-Fuentes, 2007). As this new concept has had a significant impact on the field and theoretically affects how we might compare family and nonfamily firms, I thought I would briefly comment on it. Socioemotional wealth concerns the noneconomic outcomes that are also desired by families that own and manage a business. Those who adhere to the socioemotional wealth perspective of family firm performance typically use five dimensions to define socioemotional wealth using the acronym FIBER:

1. *F*amily control and influence
2. *I*dentification of family with the firm
3. *B*inding social and kinship ties as a result of family ownership
4. *E*motional attachment by family members to the firm and each other
5. *R*enewal of family bonds through dynastic succession (Berrone, Cruz, & Gomez-Mejía, 2012)

If one takes seriously the argument that leaders of family firms attempt to create and preserve socioemotional wealth, it becomes clear that family and nonfamily firms are largely noncomparable entities. They are "apples and oranges" since the outcome variables that drive firm behavior are quite different. Family business owners may see their businesses as being quite successful if their stock of socioemotional wealth is high, even if financial success is modest, but nonfamily CEOs would only base success on standard performance metrics since they do not factor socioemotional wealth into their decision-making calculus.

Figure 1. Family firms categorized based on firm financial performance and socioemotional wealth.

In thinking about this issue, I came up with another 2 × 2 matrix. In Figure 1 are two dimensions: (1) Firm Financial Performance, from high to low, and (2) Socioemotional Wealth, from high to low.

Previously, Martin and Gomez-Mejía (2016) and others (e.g., Berrone, Cruz. & Gomez-Mejía, 2010; Gomez-Mejía et al., 2007) have presented much more nuanced arguments regarding the relationship between socioemotional wealth and financial performance than can be generated from my 2 × 2 matrix, but, for simplicity's sake, I will use it to discuss this issue. The matrix suggests the following research questions that deserve further exploration:

1. What is the relationship between socioemotional wealth and financial performance? Is it possible for a family firm to have both (like firms in Quadrant #1)? If so, under what conditions? Furthermore, recent research and theorizing by Minichilli, Brogi, and Calabro (2016) and van Essen, Strike, Carney, and Sapp (2015) indicate that there might be a positive relationship between socioemotional wealth and firm "resilience," suggesting another line of inquiry for future research.
2. Can family firms that have high socioemotional wealth but poor financial performance survive over the long run? What can leaders of family firms in Quadrant #2 do to enhance financial performance without sacrificing socioemotional wealth?
3. What are the personal, family, and business tradeoffs that exist between socioemotional wealth and financial performance? Do leaders of family firms in Quadrant #3 feel dissatisfied having a dearth of socioemotional wealth even though their firms are performing well from a financial standpoint?
4. What are the options for leaders of family firms whose firms are performing poorly financially and the family has little connection to the firm (Quadrant #4)? Should they sell out or become a professionally managed business? Should they start by engaging in strategies to turn around financial performance or begin by trying to develop a strategy to enhance socioemotional wealth (or do both simultaneously)?

I believe my 2006 article would have been enhanced (and my theorizing made more complex) if the socioemotional wealth construct had been fully developed at that time. Socioemotional wealth would likely be positively associated with low agency costs given that it reflects high family trust and shared values. Firm financial performance would be associated with the assets or liabilities that the owning family brings to the business. Assuming this to be true, I would hypothesize that "clan" family firms would be high on socioemotional wealth and high on firm financial performance (Quadrant #1), and that "professional" family firms would be in Quadrant #2 having high financial performance but sacrificing socioemotional wealth in the name of professionalization. We would likely find the "mom and pop" firms in Quadrant #3 with high socioemotional wealth and low financial performance because family needs would outweigh business imperatives, and in Quadrant #4 we would find the "self-interested" family firm that has poor financial performance and squandered socioemotional wealth. Whether there is a connection between socioemotional wealth and my family firm types is a question to be answered by future research, but with the advent of socioemotional wealth as a new dependent variable, we now have additional ground to cover as we make comparisons within the population of family firms, and it raises the issue as to whether comparing family firms to nonfamily firms is even a useful line of inquiry.

Questions for Future Research on Family Firm Performance

After examining where the field has been in studying the performance of family firms, I have concluded that comparing the performance of family to nonfamily firms is not a fruitful endeavor. The question: Do family firms perform better than nonfamily firms is not a particularly "interesting" research question (a la Murray Davis, 1971). More interesting questions that explore the relationship between family and nonfamily firms are the following: (1) Under what conditions should one own and/or manage a business with family members versus having only nonfamily involved? (2) Under what conditions should family members sell out and/or move out of management positions to transform the business into a nonfamily firm? The answers to these questions have both theoretical and practical import regarding the relationship between family and nonfamily firms and deserve more consideration. Moreover, my 2006 typology suggests what "types" of family firms might succeed with family involvement and others where the family might need to relinquish ownership and management.

In addition to these questions, another question that deserves more exploration is, "What are the significant differences in family and firm behavior when comparing public versus private family firms?" Many studies of family firms, such as the Anderson and Reeb study, only use data from public firms—which is much easier to obtain than data from private companies. Thus, our theorizing concerning family firm behavior can become biased toward public family firms. My own research on public and private family firms suggests that there are significant differences in family dynamics, firm leadership style, reward systems, and so on, between the two types of firms, so I would encourage more work in this area as well (Dyer, 1986).

Family Heterogeneity and Firm Performance

Interesting research questions regarding family firm performance reside in the heterogeneity that we see in families that own businesses (Jaskiewicz & Dyer, 2017). Families differ in family structure, functions, interactions, and events. These are important factors to consider when studying the relationship between families and firm performance. For example, in examining family structure we might ask the question, "How does the structure of the owning family affect firm performance?" To answer this question, we might compare family firms operated by traditional nuclear families with firms operated by blended families, cohabiting couples, single-parents, polygamous families, or same-sex–led families. We could also look at family structure and firm performance across various racial and ethnic groups and across national boundaries.

Differences in family functions might also lead us to ask interesting research questions. For example, today some parents have taken from government the role of schooling their children and are teaching them at home. Given this trend, one potential research question based on family functioning is, "Do family businesses managed by successor children who are home-schooled perform better than those businesses managed by successor children who attended public schools?" We might hypothesize that home-schooled children would have more common values with their parents, which has certain advantages, but they may also have more difficulty generating social capital with those outside the family since they would likely have a smaller social network—a potential liability for a family firm.

Family interactions also vary across families, which can lead to differential results for family firms. A recent study by Calabro, Minichilli, Amore, and Brogi (2018) illustrates how family interactions and norms can affect firm performance. Their study examines how families choose future leaders: Does the family use primogeniture to select the next-generation business leader (i.e., the oldest child becomes the leader) or does the family choose a child that was not first-born to lead the firm (ostensibly using competence as the criterion to select the leader)? They discovered that families that used primogeniture to select new leaders had a higher socioemotional wealth endowment than families that opted for leaders who were not first-born; but, after succession, firms managed by first-born children had lower profitability than those firms led by children who were not first-born. The implication of this study is clear: The decision-making criteria used by a family to select future leaders has a significant impact on firm performance.

Finally, family events are another potential area for future research. Cherlin (2009) points out that families today are in-flux and experience a variety of events that affect them. We might look at the outcomes for the family and the business when a family experiences: (1) divorce, (2) the death of the family leader or potential successor, or (3) the birth of an out-of-wedlock child to

a key family owner. My recent work on "family capital" suggests that research that tracks changes that families experience over time will lead to some interesting findings regarding the impact of certain events on family capital and firm performance (Dyer, Nenque, & Hill, 2014). In summary, I would like to see more research that connects heterogeneity in families to both family and firm outcomes.

The Importance of Linking Theory and Practice

As I begin my research projects, I try to think of problems that have both theoretical and practical implications. As a consultant to leaders of family firms, I frequently find myself being asked difficult questions that demand answers. Here are just a few of the questions I have been asked over the years:

1. Should I fire my brother who is not doing his job as vice president of sales?
2. Our board of directors never meets and is adding no value. What should I do?
3. I would like to grow my family business significantly. How can I do this and still keep the "family feeling" that we have in our firm?
4. How do I prepare my son to eventually become the CEO?
5. I just fired my son who was doing something I thought was unethical. My wife is so angry that she's kicked me out of the house and I'm sleeping on the sofa in my office at work. What should I do? (Fortunately, this is not a common question.)

These are real questions from real people who are facing real challenges. Many are in real pain. I would hope that we, in the field of family business, would develop theories that are useful to not only an academic audience, but to practitioners as well. Furthermore, I have argued in previous articles that we tend to emphasize firm performance and give "family performance" short shrift in our field (e.g., Dyer & Dyer, 2009). For most of us, our family relationships are much more important than any financial rewards, so I would hope that future research would put more emphasis on how to help families, who are affected by their relationship to a business. I believe that our goal should be to develop a more integrated approach to our research, where we provide direction to family firm leaders on how to simultaneously strengthen their families and create firm value.

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