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Family Firms: A Blueprint for Managing the Shareholder vs. Stakeholder Debate?

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Traditionally, the sole objective of any firm has been to maximize shareholder value. (This is reflected in the shareholder primacy model, as famously articulated by the late Chicago economist Milton Friedman.) However, there is now an open debate as to whether firms have an obligation to consider other stakeholders as well. In 2019, the Business Roundtable announced a new statement of purpose; it was signed by 181 CEOs, committing their firms to benefit all stakeholders – including customers, employees, suppliers, communities and shareholders. For any given firm, the set of relevant stakeholders may be quite diverse with preferences which may be misaligned with those of shareholders, as well as other stakeholder groups. How can firms best adopt a stakeholder mindset when actions which benefit one group may come at the expense of another?

One class of firms that can teach us about navigating these challenges are those which are family operated. For family firms, it has always been about more than maximizing profits; advancing the interests of family stakeholders and their descendants is consistently front and center.[1] Family firms are a vehicle through which wealth, responsibility and career opportunity are transferred across generations, which, unquestionably, has an influence on decision-making within family firms.[2] However, despite balancing interests beyond short-term profit maximization, family firms are often found to outperform non-family firms, both in the U.S. and abroad in terms of operating profitability and market valuations.[3,4] So, what lessons can we learn from family firms in successfully balancing shareholder and stakeholder interests?

Family Firms' Long-term Mindset Advantage

To make stakeholder capitalism work, firms must first define a long-term mission to maximize value to shareholders as well as stakeholders. Crafting a long-term mission may be difficult for many firms, particularly those which are publicly traded, due to pressures to meet quarterly earnings targets. For family firms, the prime interest in generational transfers naturally extends their time horizon beyond such short-term goals. This extended time horizon makes family firms especially well-equipped to maximize long-term stakeholder value. Within this long-term mindset, successful family firms are able to maximize stakeholder value by identifying win-wins, where the advancement of stakeholder interests simultaneously makes shareholders better off. When faced with the challenge of appeasing competing groups of agents, one may be tempted to engage in either/or thinking, by which we accept ex ante that only one of the groups may be ultimately satisfied. Successful family firms show us that there is an alternative, both/and approach to addressing the challenge; it is possible to take actions which advance the interests of both shareholders and stakeholders.

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[1] Mitchell, R. K., Agle, B. R., Chrisman, J. J., & Spence, L. J. (2011). Toward a theory of stakeholder salience in family firms. *Business Ethics Quarterly, 21*(2), 235-255. https://doi.org/10.5840/beq201121215

[2] Bertrand, M., & Schoar, A. (2003). Managing with style: The effect of managers on firm policies. *The Quarterly Journal of Economics, 118*(4), 1169-1208. https://doi.org/10.1162/003355303322552775

[3] Anderson, R. C., & Reeb, D. M. (2003). Founding-family ownership and firm performance: Evidence from the S&P 500. *The Journal of Finance, 58*(3), 1301-1328. https://doi.org/10.1111/1540-6261.00567

[4] Villalonga, B., & Amit, R. (2006). How do family ownership, control and management affect firm value? *Journal of Financial Economics, 80*(2), 385-417. https://doi.org/10.1016/j.jfineco.2004.12.005

Complexity of Family Firms' Stakeholder Relations

How can family firms manage the interests of both shareholders and stakeholders? High-cost investments in stakeholder interests, which do not aid performance, are almost surely not the optimal route. It is useful to find actions which build stakeholder capital while simultaneously boosting firm performance.

The same reasoning holds for managing relations between firm owners and non-family employees. An important component of good working relationships is the alignment of interests and beliefs with respect to the company vision. The more alignment that can be achieved, the easier it is for firms to satisfy stakeholders without hurting the bottom line. This is an important lesson: identify win-win cases where advancing the interests of stakeholders also happens to boost performance.

Finding Balance

But in cases where shareholder and stakeholder interests are not perfectly aligned, it is important to balance objectives. Finding this balance in the context of family firms has been discussed extensively by economists Ronald Anderson and David Reeb.[5]They find an "inverted-U" shaped relationship between firm performance and both family ownership and family board representation. In the context of share ownership, this means that firm performance first increases as the proportion of shares owned by the family increases, but eventually begins to decrease. Performance in family firms suffers when family interests receive too much or too little attention. When the interests of the family stakeholders are neglected, this can have a detrimental impact on labor supply and the productivity of family employees. When the family has too much representation, this opens up the possibility of conflicts between the controlling shareholders (the founding family) and minority shareholders. Achieving balance in the interests between family and shareholders is critical for giving family firms the potential to outperform their competition.

What Makes Family Firms Different? Increased Job Security

One advantage to family firms is that they generally need fewer resources to successfully recruit employees who already share the company's vision because they often offer extensive job security. Private employment insurance of this form is an effective way to attract employees who are in it for the long haul; such employees, anticipating a long tenure with the firm, may more readily adopt the values and vision shared by the controlling family and preexisting family employees. Job security has also been shown to increase innovation.[6] Accordingly, the provision of greater employment insurance allows family firms to attract workers with a stronger entrepreneurial spirit.[7]

While non-family firms may also offer similar implicit contracts, commitment to these contracts in family firms have been shown to survive past managerial successions, while the same is not necessarily true of non-family firms.[8]In family firms which undergo managerial transitions, successors inherit the contractual obligations of the predecessor, and commitment to these preexisting arrangements is especially strong when the successor is a member of the founding family. This powerful commitment reduces uncertainty for employees, and the provision of job security may also save the firm money in the form of reduced wage expenses, if workers are willing to accept lower wages for greater security.

The Potential Pitfalls of Family Firms

Though many family firm practices have proven successful at incorporating stakeholder interests, some practices commonly used at family firms can be costly and avoiding these pitfalls is critical to success. For example, nepotism can put firm operations at risk.[9] Awarding promotions and accolades to employees based upon favoritism rather than merit has been shown to be detrimental to firm outcomes and harmful to employee morale, and the promotion of equitable workplace practices is critical for any successful firm. Any deviation from this can potentially harm both shareholders and stakeholders. Additionally, the close involvement of family members in business operations leaves open the risk of family infighting spilling over into the workplace. When ownership is concentrated, as is common in family firms, conflict between owners may lead to costly feuds

[5] Anderson, R. C., & Reeb, D. M. (2004). Board composition: Balancing family influence in S&P 500 firms. *Administrative Science Quarterly, 49*(2), 209-237. https://doi.org/10.2307/4131472

[6] Manso, G.(2011). Motivating Innovation. *Journal of Finance, 66*(5), 1823-1869. https://doi.org/10.1111/j.1540-6261.2011.01688.x

[7] Block, J. H., Fisch, C. O., Lau, J., Obschonka, M., & Presse, A. (2019). How do labor market institutions influence the preference to work in family firms? A multilevel analysis across 40 countries. *Entrepreneurship Theory and Practice, 43*(6), 1067-1093. https://doi.org/10.1177/1042258718765163

[8] Serrano-Velarde, N. A. B., & Bach, L. (2009). *The power of dynastic commitment*.

[9] Pérez-González, F. (2006). Inherited control and firm performance. *The American Economic Review, 96*(5), 1559-1588. https://doi.org/10.1257/aer.96.5.1559

that inhibit timely, strategic decision-making, the attraction of managerial talent and personnel, and the availability of income to support growth and reinvestment. Finally, restricting top positions to family members may also hurt efforts to make the workplace more diverse.

A Blueprint for Stakeholder Capitalism

Family firms are often cited for their weaknesses, but a closer examination reveals an exemplary blueprint of how firms can successfully navigate stakeholder capitalism. The long-term focus of family firms naturally incorporates stakeholders as sustainable profits require strong customers, suppliers and employees. Second, for family firms, good familial relations are often followed by strong financial performance. Next, variation in family firm performance demonstrates the importance of balancing the interests of competing groups of owners and stakeholders. The highest-performing family firms are those which equitably allocate influence and voting rights to diverse firm agents; those which concentrate too much power within a single group are found to underperform.[10]

Lastly, a firm's commitments to stakeholder interests must be perceived as credible. Though family successions are often cited as the product of nepotism, they actually reinforce the credibility of commitments to stakeholders in family firms

[10] See Anderson, R.C. & D.M. Reeb.(2004)

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