Reflections on family firm goals and the assessment of performance

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ARTICLE INFO

Keywords:  
Goals  
Performance  
Family business  
Socioemotional wealth  
Non-financial benefits  
Effectiveness  
Efficiency

ABSTRACT

Assessments of family firm effectiveness depend critically on how goals and performance outputs are measured. Similarly, assessments of family firm efficiency depend critically on how performance outputs and resource inputs are measured. We illustrate this by showing that the assessment of performance is affected by how different family firm goal systems are specified. Gaining a better understanding of these fundamental concepts gives family business scholars the rare opportunity to set the rules of the game about how the performance of family firms, and other organizations that pursue the non-financial goals of a dominant stakeholder, should be assessed.

1. Introduction

One of the most frequently studied topics in family business research is family firm performance (Mazzi, 2011; Wagner, Block, Miller, & Schwens, 2015). Performance can be measured in terms of organizational efficiency, the relationship between outputs and inputs, or in terms of organizational effectiveness, the relationship between outputs and goals (Hofer & Schendel, 1978). Most of the studies of family business performance conducted thus far focus on efficiency instead of effectiveness because they do not specify the goals to be achieved, the contexts within which the goals were to be achieved, and/or do not assess performance in terms of the extent to which the outcomes have achieved the goals.

Assessing performance as achievement of goals is important for both family and non-family firms, but it is even more critical for the family firms because of the multiplicity of goals they are explicitly or implicitly assumed to possess. For example, if a family has both financial and non-financial goals for the firm it owns, and one is achieved but the other is not, what is one to conclude about the firm’s performance? If the family business research community is to reach a deeper understanding of family firm performance, there is a need for researchers to clarify their assumptions about the goals that family firms pursue and how outcomes can be compared with goals to assess performance. Therefore, the purpose of this article is to discuss the implications and obstacles associated with assessing performance in terms of effectiveness (goal achievement) in family firms. However, because efficiency is more commonly measured and is also essential, we will digress where necessary to consider the measurement of efficiency in family business studies. We also note that survival is another indicator of firm performance but since it represents a minimum condition we shall treat it as a constraint that must be satisfied for goal achievement.

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Goals can be defined in a variety of ways (Kodlar, De Massis, Wright & Frattini, 2018). In this article we view goals as measurable milestones sought by firm owners and managers in the continual pursuit of organizational purpose. As such, goals should be (1) linked to organizational purpose, (2) have an index for measurement (e.g., return on investment), (3) include a target to be achieved, which can include both minimum and aspirational levels of achievement, and (4) specify a time frame over which the goal should be achieved (Hofer & Schendel, 1978). We focus primarily on the index and target. We do not attempt to link goals with purpose or stipulate a specific time frame although we largely focus on long term goals and performance.

This problem exists in most of the studies that have focused on efficiency because these studies have generally only measured financial outputs. By contrast, non-financial outputs and non-financial goals are both usually treated as independent variables, and rarely treated as dependent variables. Furthermore, the distinctions in the literature between the two concepts is not always clear. This confusion is both unfortunate and curious since non-financial goals and outcomes are sometimes considered to dominate financial goals and outcomes in family firms (e.g., Gomez-Mejia et al., 2007).
2. The multiplicity of family firm goal systems

Both family and non-family firms pursue financial and non-financial goals. Financial goals can be expressed in terms of Financial Value Creation (Value Creation hereafter), which we define as revenues minus the cost of capital. Scholars in economics and finance mainly deal with economic efficiency; but since they assume that regardless of time-period, the goal of firms is to maximize firm financial value, which is the accumulation of Value Creation over time, economic efficiency is essentially equivalent to effectiveness. However, management scholars have long recognized that bounded rationality makes maximization impossible and firms frequently sacrifice by setting acceptable targets for firm performance over a specified time period (Cyert & March 1963; Simon, 1947). Management scholars also recognize that all firms have non-financial goals presumed to yield non-financial benefits for stakeholders (Cyert & March 1963). Furthermore, there appears to be a consensus among family business scholars that family firms may also pursue goals that yield family-oriented non-financial benefits (FONFB). These goals are rarely, if ever, relevant for non-family firms but are considered of critical importance for family firms (Chrisman, Chua, Pearson & Barnett, 2012; Kotlar & De Massis, 2013).

There are many ways the goals pursued by family firms can be specified. Below are a few, far from collectively exhaustive, examples of the variations possible. We express these in symbolic form for more clarity and to make it easier to see the differences. Furthermore, to simplify the exposition, we shall ignore the non-financial goals and benefits that pertain to all firms so that we may focus on the interplay between Value Creation and FONFB, which is the crux of the differences between family and non-family firms as well as among heterogeneous family firms (Kotlar, Signori, De Massis & Vismara, 2017; Williams, Pieper, Kellermanns & Astrachan, 2018).

Finally, we assume that the ultimate goal of family firm owners is to optimize their utility, but that they will usually have goal targets or minimums believed to yield a satisfactory level of utility over a specific period, as well as face resource constraints that limit goal achievement.

2.1. Financial goal in terms of value creation ONLY

GOAL: Optimize Total U = _U_V(Creation)

SUBJECT TO THE CONSTRAINTS:

- Value Creation Goal Target ≥ ∆V̄ ≥0
- Rv(Value Creation) ≤ Total resources available

Where _U_ (.) is the utility function for Value Creation; ∆ is the minimum level of Value Creation or change in value acceptable to the firm, which must not be negative to ensure long-term firm survival; and Rv(.) is the resource utilization function for the Value Creation achieved.

With this goal system, the firm pursues only Value Creation with available resources acting as the constraint to goal achievement. Consequently, this is the goal system assumed to dominate among non-family firms, notwithstanding our simplification from excluding the non-financial goals and private benefits relevant to both family and non-family firms.

As noted above, a basic assumption in economics, especially financial economics, is that firms pursue only financial goals except when altruism is explicitly included. We express the goal system in the form of a utility function to accommodate the possibility that the controlling family’s welfare or sense of well-being from goal achievement will not increase linearly with Value Creation for reasons such as risk aversion.

By using the term “optimize” instead of “maximize”, we acknowledge bounded rationality. We also specify a minimum and aspirational level of goal achievement to reflect the fact that firms often specify a performance target that, if not attained, will trigger a search for alternative strategies to achieve the goal (Cyert & March 1963). Note that the goal system modeled allows resources used to be less than resources available to accommodate slack. How resource constraints affect performance assessment will be discussed in the next section.

2.2. Business-first goal system

GOAL: Optimize Total U = _U_1(Value Creation)

5 For the purpose of exposition, we also ignore financial goals that generate private benefits for managers and/or owners but do not increase Value Creation.

6 We acknowledge that, in the short run, a firm does not have to be creating value to survive. In fact, in the short run, a firm can survive with negative accounting (or economic) profit as long as it has positive cash flows, or even negative cash flows so long as it can secure additional equity or debt capital through financing to meet short-term cash flow needs. But, in the long run, access to financial capital, even family financial capital, will vanish if there is no value creation. On another point, note that although we conceptualize Value Creation based upon economic and financial theories, our exposition of goal systems, including both the goals and the constraints, apply equally when using accounting profits or even cash flows as measures of Value Creation.

7 Although economists are beginning to recognize that this assumption is not valid, most of their empirical work continues to be based on this assumption, perhaps because non-financial goals and outcomes are so difficult to model and measure.

8 This is not the classical economics utility function based on stock but similar to the behavioral economics utility function such as the one used in prospect theory which is based on change or flow (e.g., Starmer, 2000). To measure utilities as a stock we would, for instance, use financial value and socioemotional wealth (SEW) instead of Value Creation and FONFB.

9 Firms have many different types of resources that are difficult to combine into one variable, including human, social, and financial capital; intangible and tangible resources; tacit and explicit knowledge, short and long-term assets, etc. This simplification is for representational and expository convenience.
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