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Is nepotism so bad for family firms? A socioemotional wealth approach

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A B S T R A C T

This paper focuses on the issue of nepotism or the practice of hiring and managing family members in family firms. Extant research suggests that while nepotism is related to numerous problems, it also offers some unique advantages to family owned firms. We use a socioemotional wealth (SEW) perspective to develop a theoretical framework that explains how nepotism influences firm performance. In doing so, we rely upon a nuanced conceptualization of SEW to clarify why some family firms are more likely to engage in nepotism than others, as well as explain the contingencies under which nepotism may prove beneficial or detrimental for family firms. Finally, we explore how human resource practices might impact the interplay between nepotism, environmental contingencies, and firm performance.

1. Introduction

Nepotism refers to an owner's or manager's preferential treatment of family members within an employment context by giving them positions based on kinship ties rather than merit or abilities (Bellow, 2003, Jaskiewicz, Uhlenbruck, Balkin, & Reay, 2013). Extant literature shows that nepotism is quite prevalent in family firms, where members of the owning family are treated favorably relative to non-family members when exposed to hiring, performance appraisal or promotion decisions (Cruz, Firfiray, & Gómez-Mejía, 2011; Gersick, Davis, Hampton, & Lansberg, 1997; Jaskiewicz et al., 2013). Yet, although anecdotal and empirical evidence shows that some families are more likely to engage in nepotism than others (Vinton, 1998), the drivers of nepotism in family firms remain unclear (Jaskiewicz et al., 2013).

While nepotism can assume several forms (Jaskiewicz et al., 2013) and can exist at various levels within a firm, for the purpose of the conceptual framework presented in this paper, we utilize a dichotomous conceptualization of the construct which defines nepotism as the hiring of family managers within the top management teams (TMTs) of family firms for the following reasons. First, in line with the upper echelons perspective (Hambrick & Mason, 1984), which emphasizes that the strategies and performance of firms are a reflection of the values and mindsets of powerful actors at the top, it might be particularly useful to understand the impact of nepotistic practices in the TMTs of family firms. Also, given that most upper echelons research has focused on large public companies, it may be worthwhile to explore the impact of nepotistic practices in the TMTs of large and medium family firms that often combine the characteristics of large public corporations with the attributes of family firms such as an emphasis on family

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control, altruism, and emotional attachment (Miller & Le Breton-Miller, 2006).

The bulk of studies on nepotism focus on understanding the advantages and disadvantages of practicing nepotism for family owners. For instance, some scholars (e.g., Bellow, 2003; Ford & McLaughlin, 1986) have suggested that nepotism is associated with highly committed family talent and access to a dedicated and affordable workforce. Such characteristics are likely to provide family firms with a significant competitive advantage relative to non-family firms (Dyer, 2006; Dollinger, 1995), implying a positive effect of nepotism on firm performance. However, the preferential treatment of family members based on relationships rather than merit has long been questioned on business grounds (Bloom & Van Reenen, 2007; Cialdini, 1996). For instance, many researchers argue that nepotism may in fact harm the durability and economic viability of family businesses (Dyer, 2006; Schulze, Lubatkin, Dino, & Buchholtz, 2001).

In addition to analyzing the impact of nepotism on firm financial outcomes, family business studies suggest that the practice of nepotism may also affect the family's socioemotional wealth (SEW) (Cruz et al., 2011; Naldi, Cennamo, Corbetta, & Gomez-Mejia, 2013). SEW refers to the collective set of non-economic utilities that family owners derive from firm ownership (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007), including aspects such as family control, a sense of identity, emotional ties and the ability to transfer a healthy business to the next generation (Berrone, Cruz, & Gómez-Mejía, 2012). Extant research provides compelling evidence that for family owners the pursuit of socioemotional utilities often takes place at the expense of financial gains (Cruz, Larraza-Kintana, Garcés-Galdeano, & Berrone, 2014; Naldi et al., 2013).

As in the case of financial outcomes, the impact of nepotism on SEW is unclear. While some suggest that the practice of nepotism may enhance SEW by strengthening family influence (Gómez-Mejía, Patel, & Zellweger, 2015) and/or facilitating the transition of firm leadership on to the next generation (Le Breton-Miller & Miller, 2006), others highlight the potential negative effects of nepotism on family SEW. Among these, nepotism may bring conflicts of interest between family members (Zellweger & Astrachan, 2008) or between family members and other stakeholders (Fan & Wong, 2002), as well as identity conflicts (Schulze et al., 2001) and reputational concerns (Dyer & Whetten, 2006).

The aforementioned discussion suggests that in deciding whether or not to practice nepotism, family owners would assess the potential gains and losses of nepotism both in the firm's financial performance and in the family's stock of SEW. Hence, a theoretical framework that predicts variations in nepotistic practices among family firms as well as its performance implications should be able to explain how socioemotional and financial motives interact when family owners face the nepotism decision. In this paper, we develop a refinement of the SEW framework which builds on the recent concept of "mixed gambles" (Bromiley, 2009) to explain the choices family owners face when making strategic decisions (Gómez-Mejía, Cruz, & Imperatore, 2014; Gómez-Mejía et al., 2015).

Specifically, we argue that given the potential for both positive and negative outcomes associated with nepotism, family owners are likely to view it as a "mixed gamble" in which they would have to weigh the likely gains and losses of nepotism in financial and socioemotional terms in tandem (Gómez-Mejía et al., 2015). Consequently, we analyze how financial and socioemotional goals of family firms inter-relate to predict the prevalence of nepotism among family firms. Moreover, consistent with research highlighting SEW as a multi-dimensional as opposed to a monolithic construct (Berrone et al., 2012), we examine which family firms would be more likely to take the "nepotism gamble", depending on how family owners prioritize among the different family SEW dimensions.

Our proposed theoretical framework also attempts to contribute to the debate on the impact of nepotism on firm performance. Building on contemporary research portraying SEW as a "situational" framework (Cruz et al., 2014), we reexamine the nepotism-performance relationship using a contingency approach based on environmental characteristics. According to this perspective, some environmental and organizational variables should be aligned together in order to attain a fit that leads to better organizational performance (Lawrence & Lorsch, 1967; Powell, 1992). Our theoretical framework aims at identifying such variables that make some family businesses engaging in nepotism highly successful while leaving others at a disadvantage, depending on the specific contingencies that the family firm confronts. Lastly, following the contingency logic, we examine how specific human resource (HR) practices interact with environmental contingencies to influence the relationship between nepotism and performance.

The paper is organized as follows. First, it elucidates which specific characteristics of family firms as embodied in the SEW concept will influence the practice of nepotism when it comes to hiring family members to executive positions within family firms. Whereas previous research has revealed mixed findings on the relationship between nepotistic hiring at the top and firm performance, with a few exceptions it has not provided theoretical explanations about the contextual conditions that influence the relationship between nepotism and firm performance (Jaskiewicz & Luchak, 2013; Naldi et al., 2013). Specifically, we examine the influence of two contingencies (environmental uncertainty and institutional environment) on the relationship between nepotism and firm performance. Finally, we explain how the use of certain HR practices might impact the relationships between nepotism, environmental contingencies, and firm performance. Fig. 1 summarizes our proposed framework.

2. Nepotism as a mixed gamble: a socioemotional wealth perspective

2.1. Nepotistic practices in family firms

Despite the dearth of studies focusing explicitly on nepotism in family firms, the literature on family business is full of anecdotal evidence showing how family presence allows kinship ties to conflict with business values of profitability and efficiency when it comes to human resource practices for relatives (Dyer, 1988). Among others, studies highlight family firms' difficulty in dealing objectively with a family member's performance and qualifications (Crane, 1985), a lack of rational systems based on merit (Kanter, 1989), incompetent family members on the payroll (Claessens, Djankov, Fan, & Lang, 2002; Volpin, 2002), pay decoupled from firm performance for family CEOs (Gómez-Mejía, Nunez-Nickel, & Gutierrez, 2001), and the design of "caring" contracts for family