Does Size Matter? The Moderating Effects of Firm Size on the Employment of Non-Family Managers in Privately-Held Family SMEs

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Abstract:

Family firms' decisions to hire nonfamily managers are influenced by agency costs, socioemotional wealth concerns, and the availability of high-quality nonfamily managers in the labor pool. We hypothesize that owing to these factors, family ownership and intrafamily succession intentions will be negatively associated with the proportion of nonfamily managers in private small- and medium-sized (SME) family firms. However, firm size is hypothesized to positively moderate those relationships because as family firm size increases, the benefits of hiring nonfamily managers rise faster than the costs. Tobit regression analyses of 7,299 private SMEs support our hypotheses.

Keywords: family firm | nonfamily managers | SME | analysis

Article:

Introduction:

The extent of family ownership and the intention for intrafamily succession can lead to strategic decisions and behaviors that differentiate family firms from nonfamily firms (Chua, Chrisman, & Sharma, 1999) and create heterogeneity among family firms (Chua, Chrisman, Steier, & Rau, 2012; De Massis, Kotlar, Chua, & Chrisman, 2014; Melin & Nordqvist, 2007). One factor of importance is the extent to which nonfamily members are included in the management team, since their presence can affect the short- and long-term achievement of a family firm's economic and noneconomic goals (Chrisman, Memili, & Misra, 2014).

The role of nonfamily managers in family firms has been explored in the literature (e.g., Blumentritt, Keyt, & Astrachan, 2007; Chrisman, Chua, & Litz, 2004), but numerous gaps remain. Most notably, although the economic and noneconomic rationales of family owners for employing nonfamily managers have been discussed (Carney, 2005; Verbeke & Kano, 2012), there is a paucity of empirical studies on how family ownership and transgenerational succession intentions influence the employment of nonfamily managers. The family's control of the firm through ownership is critical, as it provides the family the autonomy to pursue its interests through the firm. Therefore, family control is recognized as having both economic and socioemotional consequences. Likewise, the intentions to transfer control of a firm to future generations of family owners is not only ostensibly a socioemotional concern, but also both influences rely upon the underlying economic feasibility of the firm. Furthermore, because family ownership is a necessary, but not sufficient, condition for intrafamily succession to occur, the two are related, yet have distinct influences on the extent to which nonfamily managers are employed in the firm. Thus, these two concerns are "complementary rather than alternative explanations for variations among family firms and, by implication, differences between family and non-family firms" (Zellweger, Kellermanns, Chrisman, & Chua, 2012, p. 852).

Although the temporal dynamics of the family have been recognized (Sharma, Salvato, & Reay, 2014), other equally important factors—such as firm size—that do not vary uniformly over time have been under-researched in a family firm setting. Although firm size has been recognized as an important contingency factor (Gómez-Mejía, Cruz, Berrone, & De Castro, 2011), studies usually treat firm size as a control variable, assuming that its only effect on firm behavior and performance is direct. However, examining only the direct impact of firm characteristics such as size fails to recognize that as firms change, so might family and firm goals (Kotlar, Fang, De Massis, & Frattini, 2014). This may alter how other characteristics, such as family ownership and succession intentions, influence important decisions regarding firm strategy and governance, including those pertaining to hiring nonfamily managers (Kotey & Folker, 2007). As nonfamily managers often play a key role in family firms, theory seeking to increase our understanding of family firms needs to take the influence of variables such as size more fully into account. Indeed, previous research suggests that family firms often follow an idiosyncratic pattern of growth and that traditional wisdom coming from the study of nonfamily firms cannot always be directly applied to family firms (Colombo, De Massis, Piva, Rossi-Lamastra, & Wright, 2014).

This study intends to address this issue by investigating how the extent of family ownership and intentions for transgenerational family control of the firm influences decisions to hire nonfamily managers and how those relationships are moderated by firm size. We use Tobit regression to analyze these relationships among a sample of 7,299 privately held, small- and medium-sized (SME) firms with family involvement in ownership. We focus on SMEs (those with 5–500 employees) so that our results are not confounded by the fact that firm size can influence decisions to hire nonfamily managers simply because there are limits to the number of family members available to meet the demand for managers as a family firm grows. We also wanted to ensure that our sample was composed of firms where the family has substantial ownership and significant discretionary power to make important decisions, such as whether to hire nonfamily managers (Cromie, Stephenson, & Monteith, 1995).

Theoretically, we posit that hiring nonfamily managers creates a separation between ownership and control, which can increase agency costs (e.g., Chua, Chrisman, & Bergiel, 2009) and reduce economic performance. Furthermore, hiring nonfamily managers decreases socioemotional wealth, a key concern for family firms (Berrone, Cruz, & Gómez-Mejía, 2012). Finally, family ownership and intrafamily succession intentions can have a deleterious effect on the perceptions of prospective nonfamily managers with respect to career opportunities and just treatment (Verbeke & Kano, 2012), which can reduce the quality of the available labor pool and the perceived benefits to family owners of hiring nonfamily managers (Chrisman et al., 2014). Taken together, these factors suggest that both ownership and intrafamily succession intentions will be negatively related to the proportion of nonfamily managers employed in family firms.

On the other hand, as size increases, family firms are more likely to professionalize, institute formal agency cost control mechanisms (Chittoor & Das, 2007), and appreciate high performance as a means of achieving both economic and noneconomic goals. These factors may increase career opportunities, decrease favoritism in performance evaluations, and diminish information asymmetries, giving family firms access to a higher quality managerial labor pool. Thus, size decreases the costs and increases the benefits of using nonfamily managers in family firms. As such, we expect size to moderate the relationship between family ownership and intrafamily succession intentions and the employment of nonfamily managers. [1]

We contribute to the literature by testing relationships that have previously only been conjectured but are of fundamental importance to family firms (Chua, Chrisman, & Sharma, 2003). The results of our study indicate that both family ownership and intentions for transgenerational succession are negatively related to the proportion of nonfamily managers in family firms. More importantly, we address whether size, a variable typically used as a control, might have greater theoretical and empirical significance in a family business setting. We find that size moderates the impact of family ownership and succession intentions on the employment of nonfamily managers by reducing their negative influence. More generally, our findings suggest that size changes the perceptions of family owners–managers about how nonfamily managers impact firm governance and goal achievement. In our study, we show that the direct effect of size may be less important than its moderating effect. In other words, it is not just supply–demand issues associated with size that influences the employment of nonfamily managers. Rather, it is that the agency and socioemotional wealth issues associated with the employment of nonfamily managers fade in importance as a firm grows, owing to an increase in the benefits associated with the separation of ownership and control (Cruz, Gómez-Mejía, & Becerra, 2010; Fama & Jensen, 1983). This suggests that variables such as size may lead to differences in both the type and degree of unique behaviors exhibited by family firms.

Theory and Hypothesis

To describe how family ownership, intrafamily succession, and size impact the proportion of nonfamily managers in family firms, we rely on agency theory, socioemotional wealth considerations, and the employment preferences of nonfamily managers.

Family Ownership and the Employment of Nonfamily Managers

Within the domain of agency theory, a principal–agent relationship emerges when an owner hires and delegates authority to a manager with the expectation that the manager will act in the best interest of the owner (Jensen & Meckling, 1976). According to Jensen and Meckling (1994), agency problems arise from interest divergence, which motivates managers to engage in opportunistic behaviors, and information asymmetries, which make such behaviors difficult to detect. In response, owners may invest resources to monitor and provide incentives to managers (Eisenhardt, 1989). Hence, agency costs consist of the costs of controlling agent behavior and the residual loss that occurs from opportunistic behavior that is not or cannot be controlled. Owners bear the brunt of these costs, which, unlike the private benefits of control, are shared proportionally. So, as an owner's stake increases, so does the incentive to minimize agency costs.

In general, research has indicated that agency costs are lower in family firms (Chrisman et al., 2004; Le Breton-Miller, Miller, & Lester, 2011). Theoretically, this is assumed to be the case because agency conflicts and costs occur in different ways when there is a familial association between owners and managers. Although distinct agency conflicts based on altruism may arise (Schulze, Lubatkin, Dino, & Buchholtz, 2001), agency theorists have suggested that when owners and managers share family ties, conflicts of interest are minimized because family involvement facilitates the alignment of interests among owners and managers (Fama & Jensen, 1983; Jensen & Meckling, 1976). However, because by definition nonfamily managers do not share familial ties with family firm owners, they are less likely to be privy to the familial dynamics that allow family managers to function with reduced agency conflict. As such, nonfamily managers may be more prone to act opportunistically (Ilias, 2006; Wu, James, Wang, & Jung, 2012).

Additionally, family social ties and shared history reduces information asymmetries between family principals and family agents. Family principals therefore have the ability to use both informal monitoring mechanisms and familial sanctions to control the behavior of the latter, which limits the emergence of opportunism among family agents and reduces the need to invest in costly formal control mechanisms (Pollak, 1985). Unfortunately, the misalignments that can occur between nonfamily managers and family owners are exacerbated by the tendency of the family owners to rely on informal control mechanisms better suited for monitoring family rather than nonfamily agents (Chua et al., 2009). As a result, it is not surprising that family owners are often reluctant to hire nonfamily managers (Ilias, 2006) who often require different and more expensive methods of control.

Nevertheless, nonfamily managers may provide family firms with access to skill sets not available from family members (Bennedsen, Nielsen, Pérez-González, & Wolfenzon, 2007; Carney, 2005). The managerial labor market is likely to contain individuals more qualified than the limited number of family members available for employment in the firm (Chrisman et al., 2014). Assuming that the family firm can draw from the entire labor market pool, family owners may be faced with a choice between family managers who are presumed to have lower ability but put forth greater effort, and nonfamily managers who are presumed to put forth less effort but have greater ability (Verbeke & Kano, 2012).

In addition, the literature also acknowledges the importance of noneconomic goals (Chrisman, Chua, Pearson, & Barnett, 2012) and socioemotional wealth within family firms, which emanate

from family ownership (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Monyano-Fuentes, 2007; Gómez-Mejía et al., 2011). Almost by definition, nonfamily managers are less likely to contribute to or benefit from noneconomic goals that lead to socioemotional wealth. Furthermore, the presence of nonfamily managers may restrict the family's discretion to act altruistically and otherwise divert resources and pass control to family members (Chua et al., 2009; De Massis, Chua, & Chrisman, 2008). This may decrease the willingness of family owners to hire nonfamily managers as they perceive them as unable to contribute to the achievement of family-oriented noneconomic goals that create socioemotional wealth.

Conversely, family ownership in firms may also discourage some nonfamily managers from pursuing employment in family firms. For instance, nonfamily managers may worry about procedural and distributive justice in family firms (Barnett & Kellermanns, 2006; Colombo et al., 2014). Nonfamily managers may perceive active family owners as a factor restricting their potential for career advancement, and instead prefer employment with high-performing nonfamily firms (Block, 2011). Finally, high family ownership may signal relatively poor human resource practices (Carlson, Upton, & Seaman, 2006) and limited opportunities for training (De Massis, 2012; Kotey & Folker, 2007).

Noneconomic goals are more difficult to communicate than economic goals (Mitchell, Morse, & Sharma, 2003), in part because noneconomic performance, being subjective in nature, is harder to measure than economic performance. The pursuit of noneconomic goals that create socioemotional wealth in family firms is also likely to lead to idiosyncratic strategies and behaviors (Carney, 2005; Gómez-Mejía et al., 2011). Since the effectiveness of managers is dependent upon their ability to understand and facilitate the achievement of goals, nonfamily managers, who are not part of the family, may be at a disadvantage in situations where family-centered noneconomic goals and socioemotional wealth are important (Chrisman et al., 2014; Chua et al., 2009). These information asymmetries may create further barriers for the career advancement and self-development of nonfamily managers (Colombo et al., 2014). In addition, nonfamily managers may not be completely compensated for their performance (Block, 2011), because family owners may be biased in their evaluations and expectations (Chrisman et al.; Chua et al.) or place a higher priority on contributions to the family's socioemotional wealth than on the firm's economic performance (Berrone et al., 2012).

It may also be the case that nonfamily managers possess certain personal traits that are incompatible with the organizational culture in family firms (Barnett, Long, & Marler, 2012; Chirico & Nordqvist, 2010). Owning families often build complex yet conflicted sets of identities in family firms (Shepherd & Haynie, 2009), and nonfamily managers may have difficulties in dealing with these organizational identities. Overall, working in family firms often requires a high degree of socialization before nonfamily managers are able to acquire even a moderate understanding of the goals, values, and norms of the family (Blumentritt et al., 2007), some of which may be in conflict with their own agendas (Hall & Nordqvist, 2008).

Attenuated career opportunities, noneconomic goals, favoritism, and lack of justice serve to reduce the pool of nonfamily candidates for managerial positions in family firms (Chrisman et al., 2014). However, owing to the ubiquity of family firms, the pool of potential nonfamily managers will be reduced, but not eliminated. Labor market sorting will lead to the most

qualified candidates eschewing employment in family firms, turning instead to more attractive options in nonfamily firms, because they can (Schulze et al., 2001). Less qualified candidates will not be able to be as selective.

What this means for our theory is that family owners must necessarily draw from a lower quality labor pool, which will reduce the benefits of hiring nonfamily managers and thus reduce their willingness to do so. However, potential agency problems still remain, just with fewer offsetting benefits owing to the lower probability of obtaining higher quality personnel (*vis-à-vis* family managers). In fact, the potential for agency problems may actually increase, because if less qualified employees are utility maximizers, they will gain greater utility by expending less effort; owing to their lower abilities, greater effort is less likely to pay off (Chua et al., 2009).

In summary, the agency risks combined with the potential loss of socioemotional wealth associated with the hiring of nonfamily managers may be perceived to exceed the potential economic benefits that those managers are able to provide to the firm. Since ownership confers the discretion and power to use the firm as the owner(s) sees fit (Carney, 2005), we argue that the incentive and motivation to hire nonfamily managers will be directly proportional to the level of family ownership and control. Thus, as expressed below, an increase in family ownership should be associated with a decrease in the proportion of nonfamily managers.

- **Hypothesis 1:** Family ownership is negatively associated with the proportion of nonfamily managers in family firms.

Intrafamily Succession and the Employment of Nonfamily Managers

Although family ownership is a necessary ingredient for the pursuit and preservation of socioemotional wealth, transgenerational succession intentions have specifically been highlighted as a primary component of family governance that reflects underlying goals of socioemotional wealth preservation (Berrone et al., 2012; Chrisman et al., 2012; Chua et al., 1999; Gómez-Mejía et al., 2011). Indeed, transgenerational succession intentions have been shown to increase owners' perceptions of the monetary value of the firm, thus serving to illustrate a fundamental and significant differentiating factor of family firms (Zellweger et al., 2012). By contrast, risks to transgenerational succession often come from intrafamily conflict that threatens socioemotional wealth, making the continuation of the firm as a family institution of dubious value (De Massis et al., 2008; Eddleston, Otondo, & Kellermanns, 2008). Together, these arguments and this evidence suggest a series of implications for the role of nonfamily managers in family firms.

Specifically, the employment of nonfamily managers and resulting potential for diluted family control can frustrate intentions and plans for intrafamily succession (Sonfield & Lussier, 2009). Likewise, conflicts between potential successors and nonfamily managers is a major factor that can prevent intrafamily succession from occurring (De Massis et al., 2008). Furthermore, family firms that are reliant on nonfamily managers may be less capable in transferring firm-specific tacit knowledge to potential family successors (Chirico & Nordqvist, 2010). Finally, since the satisfaction of the successor is heavily dependent upon perceptions of the incumbent's willingness to transfer leadership control (Sharma, Chrisman, & Chua, 2003), even well-meaning “seat-warmer” strategies involving the temporary appointment of a nonfamily chief executive

officer (CEO) can backfire (Lee, Lim, & Lim, 2003). Thus, family firms with transgenerational succession intentions may prefer to reserve managerial positions for family members.

On the other side of the coin, competent professional agents may not be attracted to family firms that are committed to intrafamily succession, as such intentions signal the presence of a family-centered culture or identity with which, as discussed above, nonfamily managers may not feel compatible (Blumentritt et al., 2007). In addition, successful transgenerational succession often requires strong interactions between key family and nonfamily employees, and nonfamily managers may perceive this to conflict with their professional development and self-interest (Hall & Nordqvist, 2008). Finally, intentions for intrafamily succession among family owners effectively eliminate the opportunity for nonfamily managers to become CEO, which may be enough to discourage ambitious candidates from applying for a position with a family firm. Again, since it is the most qualified candidates who have the most employment options, the negative sorting that occurs diminishes the likelihood of a family firm being able to hire top-quality management talent, which reinforces the proclivity of family firms to stick with family managers whenever possible. Thus:

- **Hypothesis 2:** Transgenerational succession intention is negatively associated with the proportion of nonfamily managers in family firms.

Although these initial hypotheses should be generally relevant in family firms, we posit that these relationships can significantly vary depending on firm size. In the following sections, we argue that when family firms grow larger, the hypothesized negative effects of both family ownership and transgenerational succession intention become weaker.

Firm Size, Family Ownership, and the Employment of Nonfamily Managers

Theory and research suggest that an overreliance on family management may negatively impact performance owing to the restricted skill sets of family members that take managerial positions (Gubitta & Gianecchini, 2002; Karra, Tracey, & Phillips, 2006; Stewart & Hitt, 2012). This concern becomes more pivotal in large family firms (Barber, Wesson, Roberson, & Taylor, 1999; Heneman, Tansky, & Camp, 2000). Managerial tasks in larger firms are more complex, and hence, the capabilities of firm managers become more important (Deshpande & Golhar, 1994). Consequently, professionalization becomes imperative, and hiring and promoting managers based on family-centered criteria rather than business qualifications are less acceptable (Chrisman et al., 2004; Jensen & Meckling, 1994; Schulze et al., 2001). As this suggests, recruiting nonfamily managers may help family firms overcome the inherent limitations of family management and improve effectiveness (Astrachan & Kolenko, 1994; Bennedsen et al., 2007; Ensley, 2006; Lester & Cannella, 2006; Martínez, Stöhr, & Quiroga, 2007), which is particularly important as the family firm gets bigger (Chittoor & Das, 2007; Sonfield & Lussier, 2009).

Furthermore, larger family firms have more resources with which to devise formal monitoring systems to ensure that managers comply with the mandates of owners, and to provide incentive compensation systems to align the interests of managers with owners; potentially reducing the risk of agency conflict and costs in hiring nonfamily managers (Carlson et al., 2006). Larger size

could also lead to economies of scale in the design and implementation of such systems, making the control of nonfamily agents relatively less expensive and more effective than would be the case in smaller firms (Grandori, 2004). Such tactics serve to both protect the family firm against the agency conflicts commonly associated with the hiring of nonfamily managers as well as serve to increase the attractiveness of working in family firms to competent managers.

Overall, as firms get larger, hiring nonfamily managers should be more attractive to family owners. This is partially because specialized managerial ability becomes relatively more important than agency costs (Fama & Jensen, 1983), which may be proportionally lower as firms get larger. Another reason is that the prominence of socioemotional wealth as a driver of decision making tends to wane as size increases (Gómez-Mejía et al., 2007, 2011).

Since owners share the economic benefits accruing from firm performance, and discretion and power are proportional to the family's ownership stake, the hypothesized negative relationship between family ownership and nonfamily management is expected to be attenuated as the firm grows larger. However, the moderating effect of size is also influenced by the preferences of managers and hence the characteristics of the labor pool from which family firms can draw. From the perspective of nonfamily managers, size may mitigate some of the negative effects of family ownership. Larger firms have higher social visibility. In the case of family businesses, increased firm size brings more attention from nonfamily stakeholders (King & Lenox, 2000; Lepoutre & Heene, 2006), who may press for conformance to prevailing industry norms and best practices in areas such as human resource management (Carlson et al., 2006; Parada, Nordqvist, & Gimeno, 2010).

Furthermore, larger family firms should provide greater career opportunities (Sonfield & Lussier, 2009) and are more likely to be professionalized, reducing to some extent the likelihood of favoritism. Since the relative salience of economic goals in larger family firms is likely to be greater, the information asymmetries that exist between family owners and nonfamily managers are likely to be lower (Chrisman et al., 2014). For these reasons, employment in larger family firms is more attractive to nonfamily managers. Therefore, the managerial labor pool will be larger, giving family owners the possibility of hiring higher quality personnel. This means that the ability of the agents they hire is more likely to offset agency concerns about effort. But again, effort tends to follow ability, so family owners will doubly benefit. Together, as better candidates are available as the family firm gets larger, and their threat to socioemotional wealth becomes less important, the reluctance of family owners to hire nonfamily managers is reduced.

- **Hypothesis 3:** Firm size moderates the relationship between family ownership and nonfamily management such that the hypothesized negative relationship becomes weaker in larger firms.

Firm Size, Succession Intentions, and the Employment of Nonfamily Managers

Besides the altruistic tendency of the owning family to maintain family control mentioned above, transgenerational succession intentions can also indicate a long-term strategic orientation designed to sustain firm prosperity and family ownership across generations (James, 1999; Le Breton-Miller & Miller, 2006). This strategic idiosyncrasy of family firms has implications with

regard to the role of nonfamily managers as the firm gets larger. To the extent transgenerational succession is valued by family owners, the economic and noneconomic interests of the family converge in the long term, because firm survival and prosperity usually requires reinvestment and innovation (Lumpkin & Brigham, 2011). Furthermore, transgenerational succession requires family members who are willing and able to assume leadership and ownership positions in the future. As noted by Sharma et al. (2003) and De Massis et al. (2008), this at least in part depends on the financial prospects of the firm. Thus, the short-term socioemotional sacrifice of hiring nonfamily managers may diminish as firm size and complexity increase, owing to the socioemotional benefits associated with favorable long-term performance expectations.

Although hiring nonfamily managers may arguably reduce the possibility that the owning family altruistically satisfies individual family members' short-term needs, the long-term needs of the firm and family are often better fulfilled by hiring more capable nonfamily managers rather than solely relying on family managers with limited capabilities (Bennedsen et al., 2007; Sonfield & Lussier, 2009; Vandekerkhof, Steijvers, Hendriks, & Voordeckers, 2014). Hence, for the purpose of sustaining the potential for the transgenerational prosperity of the business, the owning family may be more willing to hire nonfamily managers as the firm gets larger. To conclude, the socioemotional risks in hiring nonfamily managers as discussed in Hypothesis 2 are less salient in larger firms where the short-term risks to family control do not loom as large and the value of nonfamily managers' contributions to the long-term probability of survival of the firm increase.

In addition, firm size may also change the effect of transgenerational succession intention on the preferences of nonfamily managers. For instance, Roberts, Sawbridge, and Bamber (1992) suggested that informal styles of management become less prevalent when firms grow larger. In this regard, family-centered culture and identity conflicts may be reduced (Shepherd & Haynie, 2009), and their effect on employment of nonfamily managers may diminish as family firms get larger. Similarly, a long-term orientation that values economic performance may be more suited to nonfamily managers, attenuating the negative labor market sorting typically associated with family firms. Hence, when transgenerational succession intentions remain salient as the firm gets larger, high-quality nonfamily managers may be more willing to work in a family firm, thereby increasing the benefits of employing nonfamily managers. Taken together, we expect that the negative effect of transgenerational succession intentions will be less salient in larger family firms.

- Hypothesis 4: Firm size moderates the relationship between transgenerational succession intentions and nonfamily management, such that the hypothesized negative relationship becomes weaker.

Methodology:

To test our hypotheses, we used an existing database drawing from annual surveys of clients of the Small Business Development Center (SBDC) program. Overall, the SBDC received 67,976 responses to its surveys between 2004 and 2010 from throughout the United States. The effective response rate was approximately 18%. The main informant of the survey was the principal manager of each firm who in most cases was also the primary owner. *T*-tests comparing early and late respondents to the survey along the variables of interest indicate that nonresponse bias is

not a problem (Kanuk & Berenson, 1975; Oppenheim, 1966). Additionally, an *ex-ante* cluster analysis illustrates that the firms in our sample conform to the findings of prior research, namely that firms with greater family ownership also exhibit greater intentions for transgenerational succession (e.g., Chrisman et al., 2004; Zellweger et al., 2012).

In order to effectively test our hypotheses, we applied a series of restrictions. We exclude firms without family involvement in ownership, since such firms would by definition have no family managers, reducing our sample to 40,793. Since our purpose is to study firms with management teams, we also exclude respondents with less than two managers, further decreasing our sample to 19,862. Additionally, we exclude preventures that did not go into business and responses with missing data resulting in a cleaned dataset of 10,317 firms. Finally, we restricted the sample to firms with a minimum of five and maximum of 500 employees in order to ensure that firms in the sample possess both an adequate employee-to-manager ratio, can be accurately defined as a small business following accepted measures (Small Business Administration, 2014), and the direct effect of size on nonfamily management is minimized. After implementing these controls, the final sample size of our analysis was 7,299 privately held SMEs.

Dependent Variable

The absolute number of nonfamily managers in a family firm does not necessarily capture the level of nonfamily management, because the size of the management team can also vary. Therefore, in order to encapsulate the presence of nonfamily managers relative to family managers, we divided the number of nonfamily managers by the total number of managers in each firm to obtain the measure of *nonfamily management*. On average, approximately 42.7% (standard deviation [SD] = 33.2%) of the managers of the firms in our sample were from outside the family.

Independent Variable

Family ownership is measured via the percentage of firm ownership by members of the same family. The mean family ownership was 90.6% (SD = 21.0%). *Succession intentions* are measured by the question, "Do you wish/expect that the future successor as president of your business will be a family member?" We create a dummy in which one (1) denotes an answer of "yes," whereas zero (0) means "no." On average, about 53.6% of the respondents indicated an intention to pass the leadership of the firm onto family members.

Moderator

The mean number of employees of firms in our sample was 21.83, with a minimum of five and maximum of 500 employees. Due to the asymmetrical distribution, *firm size* is measured by the logarithm of the number of employees in the current fiscal year. In our robustness tests, we use the log of sales revenues as an alternative measure of firm size.

Control Variables

Consistent with previous studies (e.g., Chrisman et al., 2004; Schulze et al., 2001), we controlled for past performance, firm age, and industry. Past performance (mean = 10.6; SD = 2.0) is measured by firm productivity, operationalized by the log of firm sales divided by the number of employees in the previous year (for firms with no sales or employees in the previous year, the value of the variable was set to zero). Firm age (mean = 14.1; SD = 17.2) is measured by the number of years since the firm was established. Even though the regression analyses do not appear to be affected by multicollinearity, since firm age is significantly correlated with firm size (r = .25), we conducted a *post hoc* interquartile analysis to ensure that the relationship between size and age does not affect the validity of our results.

We controlled for industry using three dummies representing retail, service, and manufacturing sectors, respectively. Firms in other industries were coded as zero for each variable. In addition, we use a series of dummy variables to measure both the *period* in which the survey was conducted (2004–2010) to control for the possibility of periodic fluctuations, and the *state* where the firms were located to account for possible differences in geographic regions (Chang, Chrisman, Chua, & Kellermanns, 2008).

Analysis

The descriptive analysis and correlation matrix of all variables, including dependent, independent, control, and instrumental variables are listed in Table 1. The variance inflation factor (VIF) for all of the variables are lower than 10. Combing the correlations among the independent variables, moderators, control, and instrumental variables, there does not appear to be a significant multicollinearity problem in this study.

Table 1. Descriptive and Correlation Analysis

	Mean	SD	1	2	3	4	5	6	7	8	9	10	11
1. Nonfamily management %	42.72	33.16	—										
2. Family ownership %	90.55	21.04	−.29	—									
3. Succession intention	0.53	0.50	−.30	.24	—								
4. Firm size	2.61	0.83	.30	−.06	.01	—							
5. Past performance	10.64	2.00	.06	.00	−.02	.03	—						
6. Firm age	14.11	17.20	.04	.06	.06	.25	.20	—					
7. Retail	0.23	0.42	−.07	.11	.05	−.07	−.04	−.06	—				
8. Service	0.21	0.41	.00	−.01	−.06	−.02	−.10	−.10	−.28	—			
9. Manufacturing	0.20	0.40	.10	−.08	−.04	.16	.20	.12	−.27	−.26	—		
10. Founder control	0.76	0.43	−.01	.35	−.02	−.09	−.13	−.05	.06	.04	−.11	—	
11. SBA loan	2.51	4.88	−.02	.02	.05	.02	−.12	−.07	.10	−.01	−.05	.06	—
12. Equity financing	1.78	4.18	.06	−.15	−.03	.01	−.13	−.10	.03	−.02	.01	−.08	.14

Note: All correlations above |.02| are significant at .05 or better for a two-tailed test.
SBA, Small Business Association; SD, standard deviation.

Instrumental Variables: Controlling for Endogeneity

We also controlled for the endogeneity of family ownership, because the results could be affected by reverse causality or latent factors that were not included in the model. Following Hamilton and Nickerson (2003), we used a two-stage regression approach with instrumental variables. The key to controlling for endogeneity is to find instrumental variables that are strongly related to the focal variables, but unrelated to the dependent variable. The instrumental variables used were founder control, equity financing, and Small Business Administration (SBA)-guaranteed loans. Founder control is measured as a categorical variable in which one (1) denotes situations where the founder has at least a 50% share in firm ownership and zero (0) denotes situations where the founder does not. Equity financing and SBA loans were measured by the logarithm of the reported amount of equity capital and SBA-guaranteed debt financing raised by clients during the period of analysis, respectively. These variables were coded as zero for firms that did not obtain any equity financing and/or SBA loans during the period in question.

These three instrumental variables were expected to be strongly related to family ownership. The firm's founder is an integral family stakeholder (Gersick, Davis, Hampton, & Lansberg, 1997), and his/her influence may persist even when he/she is no longer in control of the firm (Eddleston, 2008). In addition, the owning family may favor loans that reduce control the least, i.e., debt is preferred to outside equity (Chua, Chrisman, Kellermanns, & Wu, 2011). On the other hand, the instruments were not expected to be as strongly related to nonfamily management as they are to family ownership or firm growth. Indeed, as seen in Table 1, the correlations between the instrumental variables and the independent variables were consistently higher than the correlations between the instrumental variables and the dependent variable, suggesting that our selection of instrumental variables is reasonable.

Endogeneity Tests

In Model 1 (first stage), the three instruments, moderator, and controls were used to estimate family ownership (Table 2, Model 1). As expected, we found that the coefficients of both founder's control (B = 16.58, $p < .001$) and SBA loans (B = 0.08, $p < .10$) were significantly positive, whereas equity financing is significantly negative (B = −0.59, $p < .001$). In addition, these three estimators were found to be jointly significant (F-statistics = 466.15, $p < .001$). As will be further discussed, the *predicted* family ownership obtained in Model 1 is used in the second-stage regressions concerning the employment of nonfamily managers (Table 2, Models 2–5). However, the actual values of family ownership were later used in robustness tests.[2]

Table 2. Regression Analysis

	Family ownership (first stage)	Employment of nonfamily managers (second stage)			
	OLS		Tobit		
	Model 1	Model 2	Model 3	Model 4	Model 5
Constant	78.82***	27.25***	71.73***	17.90**	50.44***
Independent variables					
Family ownership‡			−.29***	−.75***	−.49**
Succession intention			−26.08***	−26.45***	−34.74***
Moderator					
Firm size‡	−1.24***			14.35***	−2.57
Interaction					
Family ownership × firm size					.19***
Succession intention × firm size					3.35***
Controls					
Past performance	−.09	1.04***	.89**	1.06***	1.07**
Age	.15***	−.03**	−.12***	−.09***	−.09***
Retail	4.36***	−2.96	−.91	−.86	−.75
Service	.04	2.44	−.67	−1.82	−.58
Manufacturing	−1.24†	8.92***	6.34***	3.27**	3.27**
Year dummies§	Yes***	Yes***	Yes***	Yes***	Yes***
State dummies§	Yes***	Yes***	Yes***	Yes***	Yes***
Instrumental variables					
Founder's control	16.58***				
SBA loan	.08†				
Equity financing	−.59***				
Sample size	7,299	7,299	7,299	7,299	7,299
R^2	.169				
F-statistics	18.890***				
Log likelihood		−29,205.60	−28,885.20	−28,554.08	−28,553.09

*** $p < .001$; ** $p < .01$; * $p < .05$; † $p < .10$.
‡ Predicted value from the first-stage regression.
§ Year and state dummies are tested for their joint significances.
Note: Unstandardized estimation coefficients are reported.
OLS, ordinary least squares; SBA, Small Business Administration; SD, standard deviation.

Regression Results

Because family-owned firms often favor family management, the dependent variable is 0 in a significant portion of the observations in the second stage. Thus, ordinary least square regression may yield biased results. To guard against this possibility, we used Tobit regression for our primary analysis in the second stage to generate more precise estimations. White's (1980) method for variance correction of the error terms was applied to adjust for the potential impacts of serial correlation and heteroscedasticity in both first- and second-stage analyses.

We follow the hierarchical approach in reporting the regression results. In the first step, control variables were entered (Table 2, Model 2). We found that past performance (B = 1.04, $p < .001$), age (B = −0.03, $p < .01$), and manufacturing industry (B = 8.92, $p < .001$) were significantly related to employment of nonfamily managers. The independent variables are entered in the second step (Table 2, Model 3). In support of hypotheses 1 and 2, the coefficients for both the family ownership (B = −0.29, $p < .001$) and succession intentions variables (B = −26.08, $p < .001$) were significantly negative. The moderator (firm size) is entered in step three (Table 2, Model 4); as expected, the coefficient of firm size was positive and significant. The interactions between the independent variables and moderator were entered in step four (Table 2, Model 5). Here, the coefficient of firm size becomes negative and nonsignificant. In support of hypotheses 3 and 4, both the interaction of family ownership and firm size (B = 0.19, $p < .001$) and the interaction of succession intentions and firm size (B = 3.354, $p < .001$) were positive and significant. These findings suggest that the effect of firm size on the employment of nonfamily managers is largely dependent upon the trade-offs between their benefits and costs to the firm rather than just an imbalance between the supply of family managers and the demand for managers of the firm.

To illustrate the significant interactions regarding hypotheses 3 and 4, we plot the moderation effects of firm size from Model 5 of the Tobit regressions. As shown in Figure 1, the larger firms in our sample generally have higher levels of nonfamily management than smaller firms. Consistent with hypothesis 3, the downward slope of the nonfamily management variable for larger family firms becomes gentler as family ownership increases, meaning that the demand for nonfamily managers does not vary as much according to family ownership for larger family firms as it does for smaller family firms. In support of hypothesis 4 (Figure 2), a similar moderation effect was found regarding the negative impact of succession intention on nonfamily management; the reduction in the use of nonfamily managers among firms with transgenerational succession intentions is lower in larger firms than that in smaller ones.

Figure 1

Family Ownership, Firm Size, and Nonfamily Management

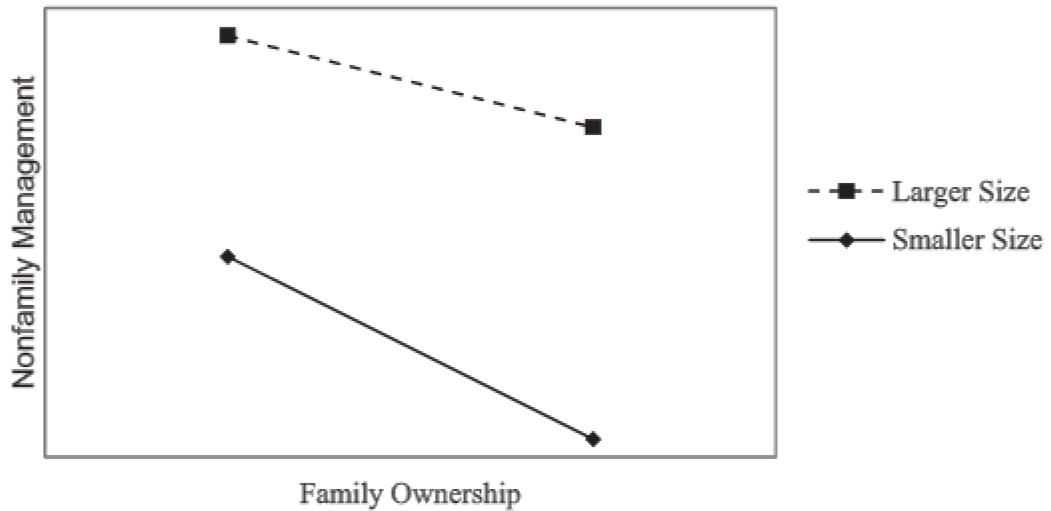
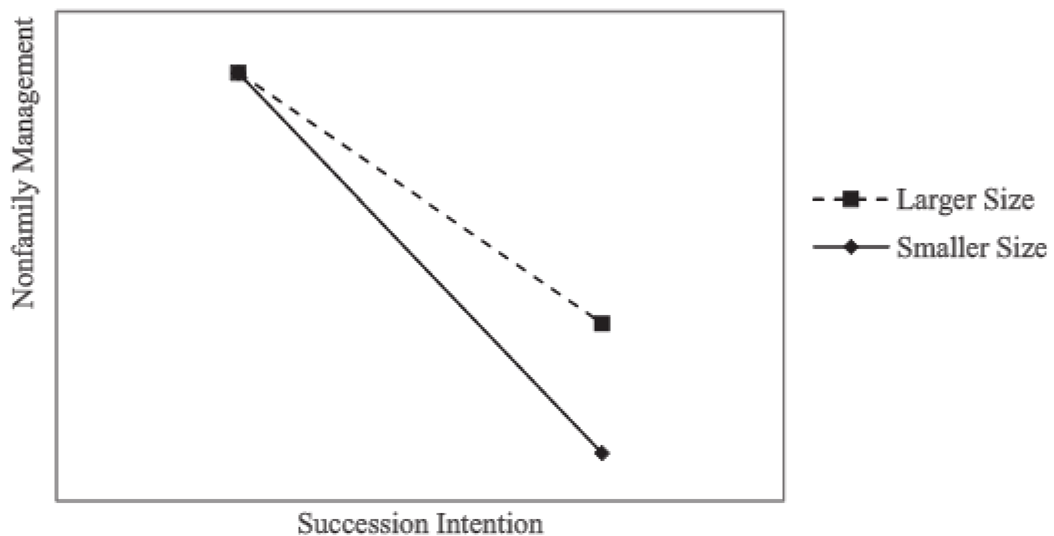


Figure 2

Succession Intention, Firm Size, and Nonfamily Management



Robustness Tests

In order to ensure the robustness of the results presented in the previous section, we performed several additional tests. [3] First, we ran the analysis using the actual rather than the predicted values for the family ownership variable. Second, we changed our measure of firm size from the

log of total employment to the log of total sales. Third, we changed the size threshold from 500 to 250 employees to meet alternative boundary conditions for the classification of SMEs (European Commission, 2003). In all cases, we obtained results that were consistent with the main analyses reported above.

Finally, we ran an interquartile analysis based on the distribution of firm age. This analysis indicated that our findings are robust across all age ranges, with the exception of newly founded firms. Interestingly, and related to the counterintuitive correlation between age and family ownership discussed in footnote 2, the positive relationship one might anticipate between firm age and the prevalence of nonfamily managers occurred only for firms less than 5 years old. However, this relationship deteriorated and eventually reversed, as older and older firms were included in the analysis. We believe that the results pertaining to firm age in our study are likely a function of (1) firms with owners that are only partially committed to transgenerational family control selling out over time, and (2) firms with owners with strong family commitments maintaining or increasing their control as they evolve. Further research is needed, however, to determine if this conjecture is valid.

Discussion and Conclusions

In this study, we develop and test a model of the impact of family ownership and transgenerational succession intentions on decisions regarding the employment of nonfamily managers, and how firm size moderates those relationships. Results from Tobit regression analyses lend support to our hypotheses, which have both theoretical and practical implications. The current study contributes to the literature in at least three ways. First, we present empirical evidence that the employment of nonfamily managers by family firms is influenced by family ownership and transgenerational succession intentions. Although these forces have long been discussed in the family business literature (e.g., Schulze et al., 2001; Zellweger et al., 2012), we provide a comprehensive model for their study by simultaneously considering the influence of agency theory and socioemotional wealth. Furthermore, we enrich the model by considering how the preferences of nonfamily managers and the resulting quality of the managerial labor pool can uniquely influence these relationships. Overall, consistent with Chrisman et al.'s (2014) conceptual work, our findings suggest that both the economic and noneconomic goals of family owners and the supply and demand considerations of the market need to be taken more fully into account when studying the role of nonfamily managers in family firms.

Second, our findings suggest that firm size may influence the way family firms respond to trade-offs in the potential for nonfamily managers to contribute to economic and noneconomic goals (Kotlar, De Massis, Fang, & Frattini, 2013). Size has long been considered an important control variable in family business research, and Gómez-Mejía et al. (2011) have argued that size is an important contingency variable that might influence the relationship between socioemotional wealth and family firm decision making. Indeed, it is reasonable to assume that the concerns of family owners change as firms grow larger and/or the stakes of family involvement become greater. However, few studies have examined the nuances of how traditional control variables such as size affect family firm behavior. Family business research is still in its early stages of development, and as our understanding of family business relationships and theory becomes more refined, there is a greater need to test the applicability, or the extent, to which assumptions

found in general management studies apply to family firms. Namely, although the separation between ownership and control becomes more useful as firms grow (Fama & Jensen, 1983), the process through which this occurs in family firms, and its unique outcomes, have yet to be studied. Size itself can have important implications regarding the strategic decisions and performance outcomes in family firms (Kotey, 2005; Stewart & Hitt, 2012; Vandekerkhof et al., 2014), because it is both a cause and a consequence of rising levels of aspirations and achievements. Therefore, in family firms in particular, increased size is likely to change the nature of the underlying goals, governance, and resources (Chua et al., 2012). For research using econometric analyses, this means that the slopes instead of the intercept are likely to be affected. Our findings contribute to a better understanding of these relationships.

The results of our full model show that in terms of nonfamily management, the direct effect of firm size is insignificant, whereas the interactive effects with family ownership and succession intentions are significant. This suggests that firm size may impact family firms in unique ways through its interaction with other important variables such as family ownership and succession intentions, not currently explored in general management research. Indeed, a fuller investigation of the impact of firm size and other variables, typically treated merely as controls, may aid our understanding of the strategies of family firms in different competitive situations.

Third, the current study is embedded in the ongoing discussion of the heterogeneity of family firms (Corbetta & Salvato, 2004; Sharma, 2004; Stewart & Hitt, 2012; Westhead & Howorth, 2007). Although extensive evidence has been found to suggest that family firms are strategically and behaviorally distinct from nonfamily firms, their unique characteristics may manifest in various ways (Chua et al., 2012), and in various contexts (Wright, Chrisman, Chua, & Steier, 2014), making family firms a vastly heterogeneous group (Melin & Nordqvist, 2007). Our findings suggest that family ownership and transgenerational succession are two distinctive yet complementary aspects that stimulate the nature of family firms' decision making. Furthering this claim, we posit that the size of family firms alters their propensity to hire nonfamily managers, because the threats posed by nonfamily managers diminish as firms grow while their abilities to benefit the firm increase. Thus, by exposing a factor that affects and is affected by a firm's goals, governance, and resources, firm size may help explain the heterogeneity among the family business population, and further study may help explain how family firms of different sizes strategically pursue and balance economic and noneconomic goals, particularly when a long-term perspective is taken.

Limitations

Although we endeavored to ensure the theoretical and empirical integrity of our research, there are several limitations of our study that must be recognized. First, although our focus on SME family firms minimizes the probability that the larger firms in our sample had no choice but to hire nonfamily managers owing to an insufficient number of available family members, it does not eliminate that possibility. Even if the effect of firm size appears to be insignificant when interactive terms are added, supporting our underlying theory, we recognize that there may be additional dynamics regarding the authority and power of family principals to control managerial hiring as the firm grows, which have not been taken into account in our study.

Second, our examination of the possibility of endogeneity among our variables was constrained by data limitations. Therefore, reverse causality and omitted variable bias cannot be entirely

ruled out. Indeed, not unlike other studies of family firms, our multidimensional arguments emerge at the apex of economic and noneconomic goals, family and nonfamily managers, and principal and agent perspectives, each of which presents multiple avenues for endogeneity threats. Even though we endeavored to ensure the validity of our results through a battery of endogeneity and robustness tests, we wholly recognize the nascent stage of this line of inquiry and the need for its further development.

Third, our sample came from the clients of a public provider of consulting services to privately held SMEs in the United States. Thus, only firms who sought consulting services were included in our population. Although we see no reason that the nature of our sample would have affected the results, we cannot rule out the possibility of selection bias and other limits to the generalizability of the results.

Fourth, although it is arguable that family control and succession intentions are primary concerns in family-owned businesses (Gersick et al., 1997), and have been studied extensively in the literature (Zellweger et al., 2012), more comprehensive measures of the components, essence, and socioemotional wealth of family firms should be developed and tested (Berrone et al., 2012; Chua et al., 1999). Furthermore, although our categorical measure of transgenerational succession intentions has precedence (Chrisman et al., 2012), it does not possess the same level of internal validity as would a multi-item scale.

Finally, although our theory acknowledges the importance of the willingness of nonfamily managers to work in family firms and the ability of family firms to effectively attract nonfamily managers, we do not directly measure such variables. Even though we ground our arguments in recent theory and research, further research that more directly measures the willingness of both family firm principals and nonfamily agents concerning employment in family firms may greatly strengthen this aspect of our model.

Future Research Directions

Future research should address the limitations of this study. However, there are other research avenues that tie into the theoretical and practical implications of our findings. First, although we focus on the employment of nonfamily managers, as they represent one of the most important strategic issues in family firms (Chua et al., 2003), the difference between smaller and larger family firms in terms of innovation and internationalization, the employment of in-laws or members of the extended family, supply chain management, the management of collaborative networks, and other topics are also worthy of study.

Second, we attempt to capture the difference between smaller and larger family firms. However, firm growth involves a temporal dimension. Although this study is cross-sectional in nature and did take firm age into account, there are likely to be other aspects of family firm behavior that require longitudinal study. Indeed, we found that age is positively related to family ownership and negatively related to the proportion of nonfamily managers among the firms included in our study. These findings are not inconsistent with prior work (Chua, Chrisman, & Chang, 2004), but since they are based on cross-sectional rather than longitudinal analyses, further work is needed to fully comprehend the implications. Similarly, further research on the determinants and

consequences of economic and noneconomic goals in SME family firms as they age or pass from generation to generation would be useful.

Third, the theory underlying our study suggests a variety of other factors that may influence managerial employment decisions in family firms, such as the number and degree of involvement of family owners, strategic initiatives, and the industry environment (e.g., Fang, Memili, Chrisman, & Penney, Forthcoming). The influence of these factors may have independent, interactive, or complementary effects that need to be understood.

Finally, there is a need for research conducted from the perspective of nonfamily managerial applicants before and after they are hired to understand how they view the opportunities and challenges for career advancement in family firms. Studies that explore the methods through which nonfamily managers are hired, trained, evaluated, and compensated would also be valued (Chrisman et al., 2014; Memili, Misra, Chang, & Chrisman, 2013). The consequences of these decisions in terms of firm performance and employee turnover are also important to better understand how family owners expect nonfamily managers to contribute to the firm. Thus, interdisciplinary research regarding the human resource management practices and strategies employed by family firms may provide invaluable additional perspectives.

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Conclusion

In conclusion, our study shows that family ownership and transgenerational succession intentions significantly influence the employment of nonfamily managers in family firms and that firm size moderates these relationships. Although firm size is often used as a control variable, its importance as a moderator has generally been overlooked. We hope that these findings will inspire researchers to more closely investigate other fundamental relationships rather than take for granted that such relationships pertaining to nonfamily firms also apply to family firms.

Footnotes

1. We recognize that these relationships are further accentuated among large firms with more than 500 employees.

2. An interesting and somewhat counterintuitive result in Model 1 is the positive relationship between age and family ownership. However, the work of Chua et al. (2004) suggest that even though most family firms are founded as such, over time, the proportion of family firms in the population of firms tends to increase. Furthermore, in SMEs, it is unusual for the family to relinquish control of their firm (e.g., Gómez-Mejía et al., 2007). Therefore, it is plausible that family ownership increases as firms get older.

3. The detailed results of the robustness tests are available from the corresponding author upon request.

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