The propensity to use incentive compensation for non-family managers in SME family firms

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Abstract:

Purpose
– The purpose of this paper is to use the socio-emotional wealth perspective to examine how the level of family involvement reduces the propensity to use incentives to non-family managers in small to medium-sized enterprises (SME) family firms. **Design/methodology/approach** – Primary data were collected from US firms. To evaluate the hypotheses, a logit model was employed on a final sample of 2,019 small family firms.

Findings
– Results suggest that family influence and control and intra-family transgenerational succession intentions are negatively related to the propensity to use incentives. Also, the interaction effects of family management and ownership reduce the propensity to use incentives.

Originality/value
– The paper's empirical findings imply that despite their potential economic benefits, family involvement reduces the probability that incentives will be offered to non-family managers because such incentives are perceived to be inconsistent with the preservation of the family's socioemotional wealth. Also, choices that reflect a preference for socioemotional wealth may not only be a function of decision framing and loss aversion but also by the size of the economic pay-offs that might be available. The findings suggest that non-family managers in SME family firms may be affected by a family's preoccupation with its socioemotional endowments. Thus, the authors expect that this paper provides further avenues to explore the decisions about attaining non-economic and economic goals and other strategic issues in family firms.

Keywords: Small to medium-sized enterprises | Family firms | Family business management | Family involvement | Nonfamily managers | Incentive compensation | United States of America

Article:

1. Introduction

In the family and business interface (Litz, 2008), an important issue faced by many small- and medium-size privately held family firms (hereafter SME family firms) is the limited ability to compete in the market for managerial labor and provide competitive compensation (Block, 2011; Carney, 2005; Ensley *et al.*, 2007). Indeed, incentive compensation decisions are critical in all organizations since they influence how individuals behave (Baker *et al.*, 1988). Gibbons and Murphy (1992) show that to maximize managerial effort, compensation contracts should be designed to optimize total incentives (i.e. the combination of the implicit incentives from career opportunities and explicit incentives from the compensation contract).

Incentive compensation packages that are beyond regular wages tend to include profit sharing, bonuses, and company stock options (Baker *et al.*, 1988). Non-family firms (publicly traded and/or privately held) utilize incentive compensation when managerial retention is a concern, owing to the criticality of the manager's expertise, and the ease of managerial mobility (Dutta, 2003). In the case of SME family firms, the level of family involvement may have distinctive consequences for the implementation of these schemes for managers (family or non-family related). For example, because of the pursuit of non-economic goals designed to create and preserve socioemotional wealth, SME family firms are often reluctant to offer stock options to non-family managers (Berrone *et al.*, 2012; Gomez-Mejia *et al.*, 2007, 2011; McConaughy, 2000)[1]. Unfortunately, although recent studies have addressed intra-firm determinants of managerial compensation in family firms (e.g. Block, 2011; Ensley *et al.*, 2007), our knowledge about the incentive compensation paid to non-family managers in SME family firms is largely limited to conceptual treatises (e.g. Chrisman *et al.*, 2014;Chua *et al.*, 2009; Lee *et al.*, 2003).

Building from a socioemotional wealth perspective, our paper focusses on testing how the level of family involvement reduces the propensity to use incentives to non-family managers in SME family firms. We focus on SME family firms because they tend to experience substantial trade-offs in their preferences for economic and non-economic goals and this influences their decisions on whether to use incentive compensation. In addition, the family's ownership and control are key elements of their socioemotional wealth and also allow the family the power to pursue its agenda throughout the firm (Zellweger *et al.*, 2012). Although socioemotional wealth concerns tend to dominate decision making, family firms can be expected to attempt to maximize their utility from achieving both economic and non-economic goals (Chrisman *et al.*, 2003c, 2014), whereas non-family firms will primarily focus on achieving only economic goals. As a consequence, it is expected that the SME family firm will compensate non-family managers less for two reasons. First, those managers are unlikely to be entirely willing or able to contribute to the achievement of non-economic goals and preservation of socioemotional wealth. Second, offering higher levels of compensation to non-family managers negatively affects the overall

utility of family owners since such compensation reduces their ability, dollar for dollar, to provide altruistic-inducted benefits to family managers.

Our empirical analysis is based on the study of 2,019 SME family firms. Our findings are consistent with the extant research suggesting that the values and aspirations of the family business owner(s) and/or manager(s) (e.g. Chrisman *et al.*, 2003b) and their intentions for transgenerational succession (Ward, 1997; Habbershon and Williams, 1999; James, 1999; Anderson and Reeb, 2003;Zahra *et al.*, 2008) play a key role in formulation and implementation of strategies, including managerial compensation decisions.

We contribute to the family firm literature by providing further insights into the family and business interface. Our empirical findings imply that despite their potential economic benefits, family ownership, management, and intra-family succession expectations reduce the probability that incentives will be offered to non-family managers because such incentives are perceived to be inconsistent with the preservation of the family's socioemotional wealth. This is an important theoretical contribution because unlike diversification and R&D (Chrisman and Patel, 2012; Gomez-Mejia *et al.*, 2010), incentive compensation schemes need only be paid when warranted by performance and therefore have low to no downside economic risk for the firm. Thus, we suggest that choices that reflect a preference for socioemotional wealth may not only be a function of decision framing and loss aversion as implied by previous research (e.g. Gomez-Mejia *et al.*, 2007, 2010) but also by the size of the economic pay-offs that might be available. Apparently, even relatively certain economic benefits are discounted if the possibility of a loss of socioemotional wealth is present. Consequently, our theoretical arguments and findings confirm previous research and theory and draw attention to new avenues for future work on the non-economic and economic goals that underlying decisions regarding managerial compensation and other strategic issues in family firms.

We proceed in the following manner. First, we outline the theoretical model and hypotheses. Second, we present our methodology, empirical model, and results. Third, we conclude with our research directions for theory and practice.

2. Goal pursuance in SME family vs non-family firms

Firm decisions are driven by the goals of owners and managers, which sometimes come into conflict. Incentive compensation is intended to align the interests of owners and managers and thereby reduce or eliminate goal conflict as well as improve firm performance. However, because SME family firms seek economic and non-economic goals while non-family firms are driven primarily by economic goals (Chrisman *et al.*, 2003c); the value of incentive compensation may vary. For example, Chrisman *et al.*(2014) suggest that family-centered goals lower the willingness and ability of SME family firms to provide competitive compensation to non-family managers even when those managers behave as stewards rather than agents.

Similarly, it has been argued that family firms are a unique organizational form because the attainment of family-centered goals leads to the creation of socioemotional wealth involving, the preservation of family values, harmony, social capital, reputation, and the ability to behave altruistically toward family members (Chrisman *et al.*, 2012; Gomez-Mejia *et al.*,

2007; Pearson *et al.*, 2008).Berrone *et al.* (2012, p. 259) recently proposed that socioemotional wealth encompasses five dimensions that can be summarized by the acronym of "FIBER (Family control and influence, Identification of family members with the firm, Binding social ties, Emotional attachment of family members, and Renewal of family bonds to the firm through dynastic succession)." Although these dimensions resemble the main characteristics of family involvement in the business (e.g. Chrisman *et al.*, 2005), family owners' ability to maximize their utility through the firm will depend upon how the interactions between the business and the family are managed.

SME family firms often face a dilemma between offering compensation packages to non-family managers that are comparable to those offered to family managers (Barnett and Kellermanns, 2006) and their pursuit of family-centered non-economic goals, which oblige them to provide altruistically induced benefits to family managers but not others (Chrisman *et al.*, forthcoming). Family owners must thus consider whether the possibility of improving the performance of the firm by offering incentives to non-family managers is worth the potential loss of socioemotional wealth (Chua *et al.*, 2009). Research has shown that family owners are loss averse with regard to their socioemotional wealth (Gomez-Mejia *et al.*, 2011). This implies that when performance is at or above aspiration levels, family owners are risk averse toward opportunities to improve economic performance if there is a possibility of reducing socioemotional wealth, yet socioemotional wealth will sometimes be sacrificed when financial performance is below the aspiration levels of family owners (Chrisman and Patel, 2012; Gomez-Mejia *et al.*, 2010). As a result, family firms are concerned with the trade-offs between economic and non-economic goals when making risky choices among alternatives. However, incentives *per se* are not risky in a similar sense because the costs of the incentives are contingent upon results; therefore, economic performance must rise before incentives are paid, suggesting that the decision is less about risk than about the utility attached to more certain economic and non-economic pay-offs.

In sum, efforts to hire and retain a non-family manager may have non-economic costs to SME family firms that decrease the socioemotional wealth of the family controlling the business. However, providing incentives to attract, retaining, and align the interests of qualified non-family managers is desirable for improving firm growth, professionalizing management practices (Klein and Bell, 2007; Sirmon and Hitt, 2003), avoid inertia (Ensley, 2006; Lester and Cannella, 2006; Mitchell *et al.*, 2003; Schulze *et al.*, 2002;Zahra *et al.*, 2004), grow their knowledge base (Block, 2011), prevent managerial entrenchment (Gomez-Mejia *et al.*, 2001), and relax the constraints to growth when there are not enough family members who are capable to manage the firm (Chua *et al.*, 2009;De Massis *et al.*, 2008; Dunn, 1995). Again, unlike investments in R&D and diversification, the economic risks of providing incentives to non-family managers in the firm are minimal, meaning that such decisions are based more on the marginal utility of the options to family owners rather than loss or risk aversion.

2.1 Hypotheses

Following the arguments of Litz (2008) and recent suggestions from the socioemotional wealth perspective (e.g. Berrone *et al.*, 2012), we develop hypotheses about the impact of family ownership, management, and transgenerational succession intentions on the propensity to use incentives for non-family managers. We base our arguments on the notion that the decisions of

family owners and managers will tend to consider both the pay-offs as well as the risks of their actions and will therefore weigh the trade-offs between economic and non-economic benefits. However, we also argue that their decisions but will generally exhibit a preference for the preservation socioemotional wealth. In that regard, Chrisman *et al.* (2005) suggest that the family's ability to act in its own interests is given by its level of control and influence – the first of Berrone *et al.* (2012) FIBER dimensions – over the firm through ownership and management whereas its willingness to act idiosyncratically is influenced by its succession intentions – the last of Berrone *et al.* (2012) FIBER dimensions.

2.1.1 Family ownership and management

Family ownership is significant "when a family owns all or a controlling portion of the business and plays an active role in setting strategy and in operating the business on a day-to-day basis" (Kelly *et al.*, 2000, p. 27). Both family owners and managers are prone to consider how their decisions will affect socioemotional wealth (Berrone *et al.*, 2012). Hence, ownership and management can be important in determining strategic choices on a business such as providing incentives to non-family managers.

Family ownership allows family members to have control rights over the use of a firm's assets and use these rights to instill a vision and dominate decision making in family firms (Carney, 2005; Zahra, 2003). When decision making is centralized among top family members, the ability and willingness to make idiosyncratic decisions increase, while the cost of making and implementing decisions decreases (Habbershon and Williams, 1999; Naldi *et al.*, 2007; Zahra *et al.*, 2008). In addition, ownership gives the family the discretion power for the timely generation and implementation of strategic ideas (Zahra, 2005; Zellweger *et al.*, 2012). Hence, decisions related to compensating managers (family and non-family) will be shaped by the family owner(s)'s primary desires or wishes.

Family owners may wish to pursue family-centered non-economic goals even at the expense of economic goals in order to maximize family firm utility and preserve socioemotional wealth. When family welfare is closely tied to the family firm's welfare (Anderson and Reeb, 2003), the propensity to hold non-economic goals increases as family ownership in the business increases (Chrisman *et al.*, 2012). Such behavior provides room for lavish rewards for family managers, but it reduces the desirability of offering similar rewards to non-family managers. Indeed, the benefits of achieving non-economic goals are not transferable to non-family managers and indeed those managers may be largely unaware of the nature of the family's non-economic goals. Since non-family managers are unlikely to be able or willing to add to the family's socioemotional wealth, there is little motivation for family owners to set up incentive compensation schemes for them (Chrisman *et al.*, 2014). Thus, when the proportion of family ownership is at higher levels, the likelihood for offering additional compensation packages to non-family managers will be reduced.

Aside from family ownership, the influence of the family increases when governance and management responsibilities are given to family members. Particularly, in SME family firms, strategic decisions involving employment and compensation of non-family managers are shaped by the values and aspirations of family owners and managers and the level of professionalized

management may be low or inexistent (e.g. Carney, 2005; Chua *et al.*, 2009). Indeed, when family managers have the power and the legitimacy to dominate decision making, the probability that non-family managers will be given incentive compensation decreases because these packages may empower non-family managers and consequently decrease the family's discretion to act unilaterally and idiosyncratically. For example, if job creation for family members is a primary non-economic goal (Chrisman *et al.*, 2003a), policies that shift the criteria for promotion and/or compensation to competence rather than kinship ties, as is the usual and preferred situation, could threaten socioemotional wealth (Dyer, 2006; Perrow, 1972). Furthermore, the absence of willingness to retain non-family manager(s) in the long run (cf. Lee *et al.*, 2003) may reduce the likelihood they will be provided incentive compensation.

Furthermore, the compensation of family managers may set an upper limit on the compensation paid to non-family managers even if the latter displays greater ability and the higher paid family manager does not expend sufficient additional effort in return for the “altruism-induced extra pay” received (Chua *et al.*, 2009, p. 363). On one side, the viability of the firm and the socioemotional wealth of the family may be strengthened when family managers sacrifice their economic well-being by receiving lower compensation because of affective commitment to the firm and higher levels of job security compared to non-family managers (Combs *et al.*, 2010;Cruz *et al.*, 2010; Gomez-Mejia *et al.*, 2011). The willingness of family managers to accept lower pay owing to the “family handcuff,” altruism, and current or future ownership provide the family firm with survivability capital (Gomez-Mejia *et al.*, 2011; Sirmon and Hitt, 2003). Offering non-family managers incentive compensation might upset this delicate balance. Furthermore, in comparison to the abilities of family managers which, owing to their life-long relationships with family owners are well-understood, it will be difficult for family firms to gauge the extent to which non-family managers will be able to contribute to firm value. Finally, since providing incentive compensation to non-family managers may reduce socioemotional wealth, the utility associated with the improvement of economic performance will need to be higher in order to offset that loss. However, family firm-specific idiosyncrasies, which make it more difficult for non-family managers to effectively apply their experience to the family firms, will limit the possibility of this occurring (Chrisman *et al.*, 2014).

In sum, when considering the effects of family influence and control in terms of ownership and management, it may be expected that preserving the socioemotional wealth of the SME family firm will decrease the likelihood of offering incentive compensation to non-family managers. Thus:

H1a. Family ownership is negatively associated with the propensity to use non-family managers’ incentive compensation in family firms.

H1b. Family management is negatively associated with the propensity to use non-family managers’ incentive compensation in family firms.

2.2.2 Intra-family succession intentions

Chua *et al.* (2004) suggest that most family firms start with a high degree of family involvement and an emphasis on intra-family transgenerational succession. Berrone *et al.* (2012) suggest that

succession expectations inside the family renew the commitment of the family to the business and this is a key dimension for determining the level of socioemotional wealth.
Family firms with succession expectations tend to be more long-term oriented in business activities (Ward, 1997; Habbershon and Williams, 1999; James, 1999; Anderson and Reeb, 2003; Zellweger, 2007) and more concerned with the achievement of non-economic goals (Chrisman *et al.*, 2012). The longer time horizon is rooted in the primary desire for the family's continuity, stability, unity, and legacy (Upton *et al.*, 2001; Anderson and Reeb, 2003; Miller and Le Breton-Miller, 2006), which can facilitate the maximization of the family's economic and non-economic goals for the firm and lower the value of hiring and retaining non-family managers, which consequently impacts the willingness to provide them with incentive compensation.

Furthermore, since family firm leaders wish to pass on a sustainable legacy to subsequent generations (Dyer and Whetten, 2006), they tend to exhibit careful resource conservation and allocation (Carney, 2005), which may lead to parsimony in determining non-family managers' compensation. According to Miller and Le Breton-Miller (2005a, b), nurturing the business to support future generations can even result in family business members' accepting lower dividends and pay, which extends the financial sacrifice to include both family and non-family managers. Even though incentives packages such as stock options can be used to align interests and transfer risk between owners and managers (Nalebuff and Stiglitz, 1983; Ross, 2004) and increase managerial productivity (Baker *et al.*, 1988; Dutta, 2003); those decisions may conflict with the expectation that the next business leader will come from the family because they can reduce family control. In other words, decisions about the alignment of interests between owners and managers are more about developing commitment among the next generation of family members than providing non-family managers with stock options or other incentives.

Moreover, the primary focus on promoting and retaining family business members owing to the intentions to transfer the business to the next generation can result in relatively higher dependence on family members than on non-family managers, particularly when there are family members who are able and willing to take over the business (Block, 2011; Sharma *et al.*, 2003). When this occurs, the motivation to retain non-family managers in the long run is reduced, which makes providing incentive compensation of lower value. Indeed, family firms with intra-family succession plans may be preoccupied with grooming and preparing the potential successor(s), rather than concerns about non-family managers (Handler, 1994; Mitchell *et al.*, 2003). Hence, intentions for transgenerational succession are expected to result in lower incentive compensation of non-family managers:

H2. Intra-family succession intentions are negatively associated with the propensity to use non-family managers' incentive compensation in family firms.

3. Methods

For testing our hypotheses, we needed to find a sizable sample of SME family firms. As family firms are heterogeneous (Berrone *et al.*, 2012; Chrisman and Patel, 2012; Melin and Nordqvist, 2007), it is not easy to obtain primary data that could cover and address the methodological requirements outlined by prior researchers (e.g. Berrone *et al.*, 2012). In that regard, we collected

cross-sectional data from a survey conducted by the Small Business Development Center (SBDC) Program in the USA in 2005. Since the SBDC conducts programs in each state, serving large numbers of small and new firms each year, it is a useful source of data for studying small family firms in the US questionnaires were sent twice by mail to the entire population of 30,416 operating businesses that received counseling assistance from an SBDC in 2003. A total of 4,950 firms responded (16.3 percent).

As our unit of analysis is the SME family firm, we limited our analysis to those firms with five or more employees, and with at least one of the following: family ownership, family managers, and succession intentions as prior research have used these variables to classify family firms (e.g. Chua *et al.*, 1999, 2004). By applying these restrictions, along with missing data, the final sample size was reduced to 2,019 firms that ranged from low to high levels of family involvement. In order to test for potential non-response bias, responses were divided into early and late respondents based on the time they returned the questionnaire. There were no statistically significant differences between the responses to the first and second mailings on the variables of interest to this study. Since relative to early respondents late respondents are likely to be more similar to non-respondents (Kanuk and Berenson, 1975;Oppenheim, 1966), the tests suggest that non-response bias is not a significant concern in this study. Furthermore, subsequent analysis of the data and the results indicated that neither common method variance (Podsakoff and Organ, 1986) nor multicollinearity was a problem.

3.1 Dependent variable

Respondents were asked if they provide non-family managers compensation packages that include bonus, profit sharing, and/or ownership stakes in the business. We created a categorical variable: *propensity to use incentives to non-family managers* where values of 1 were given if the firm offers bonuses, profit sharing, or both to compensate non-family managers while values of 0 were given if the firm does not offer such incentives to non-family managers. Research has indicated that family firms rarely offer ownership shares or stock options to non-family members (McConaughy, 2000) so it is reasonable to exclude this form of incentive compensation. Indeed, <5 percent of the firms in the sample offered stock options to non-family managers. The dependent variable has a mean of 0.38 (SD=0.49) which indicates that over one-third of the firms in the sample offer incentive compensation to non-family managers in addition to their salaries.

3.2 Independent variables

Family influence and control were measured by the proportion of family ownership in the firm and by the proportion of family managers over the total management team of the firm. In the sample, 91 percent of the firms are majority owned by family members and 72 percent of the managers are family members.

Intra-family transgenerational succession intentions is a categorical variable where values of 1 were given when respondents expressed intentions for transgenerational succession and values of 0 were given if they did not. In the sample, 52 percent of the respondents have intentions for transgenerational succession.

3.3 Control variables

We controlled for *industry*, *firm's age*, *firm size*, and *perceived performance* owing to their possible influence on the managerial compensation of non-family managers. Three categorical variables are used to account for firms in retail, service, and manufacturing industries. In the sample, 20 percent of the firms are in retailing, 50 percent are in services, and 16 percent are in manufacturing with the remainder operating in other industries. *Firm age* was measured by the number of years the firms had been in business. The average firm age is about 13 years. *Firm size* is measured by the number of employees in a firm. The average firm size is about 11 employees. *Perceived performance* is a self-reported subjective measure where respondents were asked to compare, on a five-point Likert-type scale, their profitability (return on sales) relative to their expectations over a three-year period. Research indicates that subjective and objective performance data are correlated (Dess and Robinson, 1984). Furthermore, these measures of performance have been successfully utilized in prior family firm research (e.g. Eddleston and Kellermanns, 2007; Eddleston *et al.*, 2008).

3.4 Empirical model

To test our hypotheses, we develop a logit model of the relationship between the propensity to use incentive compensation to non-family managers and family involvement. Thus, the model implies that:

$$Y_i = L(\beta_0 + \beta_j X_{ik} + \beta R_{ij}) + \varepsilon_i$$

where Y_i=1 if family firms use incentives such as bonus, profit sharing, or both to compensate non-family managers and otherwise Y_i=0. X_{ik} represent a set of control variables, such as industry, firm age, and firm size, R_{ij} is the vector of independent variables (family ownership, family management, and intra-family transgenerational succession), and ε_i is random error term in this model.

4. Results

Table I provides the means, standard deviations, and correlations of the variables used in the study. Table II presents the results of six logit regression models. We used the χ^2-statistic to indicate the overall explanatory power and found that all six of the logit models were significant at the 0.001 level.

Table I Descriptive statistics and correlations

	Mean	SD	1	2	3	4	5	6	7	8	9
1. Propensity to use incentives to non-family managers	0.38	0.49	1								
2. Proportion of family ownership	0.91	0.23	−0.27***	1							
3. Intra-family transgenerational succession intentions	0.52	0.50	−0.14***	0.25***	1						
4. Proportion of family management	0.72	0.36	−0.24***	0.39***	0.21***	1					
5. Retail	0.20	0.42	−0.03	0.10***	−0.01	0.042****	1				
6. Service	0.50	0.50	0.03	0.04****	−0.05*	0.09***	−0.50***	1			
7. Manufacturing	0.16	0.37	0.00	−0.16***	−0.01	−0.17***	−0.22***	−0.44***	1		
8. Firm age	13.15	16.73	−0.06*	−0.03	0.04	−0.10***	−0.01	−0.16***	0.23***	1	
9. Firm size (employees 2003)	11.32	26.42	0.02	−0.16***	0.02	−0.28***	−0.05*	−0.09***	0.20***	0.25***	1
10. Perceived performance	2.99	1.02	0.00	0.01	0.03	−0.06**	−0.01	0.05*	−0.03	−0.04****	0.06**

Notes: $n = 2{,}019$. $^{*}p < 0.05$; $^{**}p < 0.01$; $^{***}p < 0.001$; $^{****}p < 0.10$

Table II Results of logit model

Dependent variable: propensity to use incentives to non-family managers	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Constant	−2.93***	−0.48	−1.04	−2.27***	−0.55*	−0.26
	(0.45)	(0.51)	(0.49)	(0.47)	(0.28)	(0.34)
Controls						
Retail	−0.06	0.31	0.03	−0.26	−0.02	0.01
	(0.42)	(0.44)	(0.43)	(0.43)	(0.17)	(0.18)
Service	0.35	0.53	0.37	0.14	−0.02	−0.03
	(0.35)	(0.37)	(0.36)	(0.36)	(0.15)	(0.15)
Manufacturing	0.42	0.06	0.06	0.17	−0.01	0.01
	(0.42)	(0.44)	(0.43)	(0.42)	(0.18)	(0.19)
Firm size (employees 2003)	0.00*	0.01	−0.00	0.01**	0.01***	0.01**
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Firm age	−0.03***	−0.03***	−0.03***	−0.03***	0.00***	0.01*
	(0.01)	(0.01)	(0.01)	(0.01)	(0.00)	(0.00)
Perceived performance	−0.02	−0.01	−0.08	−0.01	0.32***	0.30***
	(0.11)	(0.11)	(0.11)	(0.11)	(0.05)	(0.05)
Independent variables						
Proportion of family ownership		−0.03***			0.00	0.00
		(0.00)			(0.11)	(0.00)
Proportion of family management			−2.93***		−1.79***	−0.85****
			(0.30)		(0.00)	(0.49)
Intra-family transgenerational succession intentions				−1.55***	−0.30***	−0.32**
				(0.27)	(0.15)	(0.10)
Family ownership × family management						−0.01*
						(0.01)
χ^2	14.26***	107.42***	120.25***	55.85***	315.36***	350.78***
Log-likelihood	−369.93	−323.34	−316.93	−349.13	−1,170.05	−1,173.28
Pseudo R^2	0.02	0.14	0.15	0.07	0.11	0.13

Notes: $n = 2{,}019$. $^{*}p < 0.05$; $^{**}p < 0.01$; $^{***}p < 0.001$

Model 1 regresses the control variables against the dependent variable. The pseudo R^2 is 0.02. Firm age is negatively related and firm size positively related to incentive compensation, testing at the 0.05 level. Model 2 is used to test *H1a* as the family ownership variable is added to the model. The pseudo R^2 increases to 0.14. Firm age continues to be significant. More importantly, family ownership is negatively related to the dependent variable at the 0.001 level. Thus, *H1a* is supported. Model 3 is used to test *H1b* as the family management variable is added to the model. The pseudo R^2 increases to 0.15. The firm age variable is once again negative and significant. Supporting *H1b*, family management is negatively related to the dependent variable at the 0.001 level. Model 4 adds the transgenerational succession intentions variable to test *H2*. The pseudo R^2 increases to 0.07 with firm age negatively related and firm size positively related to

the dependent variable. *H2* is also supported by the significant, negative relationship between succession intentions and the incentive compensation variable ($p<0.001$).

Models 5 and 6 provide further support for our theory and hypotheses. Model 5 includes the three independent variables together. The pseudo R^2 is 0.11. *H1b* and *H2* are supported as family management and succession intentions are negative and significant ($p<0.001$) but *H1a* is not supported as family ownership is not significant. In addition, it is important to notice that perceived performance is positive and significant and in this model firm age and size are also positive and significant ($p<0.001$). Due to the results of Model 5, we included Model 6 where the interaction effect of family management and ownership is added to the model. The pseudo R^2 increases to 0.13 as the interaction is significant ($p<0.05$) and family management becomes marginally significant ($p<0.10$).

This finding suggests that the combined effects of family influence via ownership and management tends to decrease the propensity to offer incentives to non-family managers. It also helps explain the discrepancy in the findings of Models 2 and 5 with regard to *H1a*. Thus, although family ownership provides the power to determine whether incentive compensation is offered to non-family managers or not, the lack of family managers eliminates one of the major obstacles to doing so since there are no or fewer non-economic considerations that make such decisions unattractive. In other words, without family managers the threat to the socioemotional wealth of family owners of providing incentive compensation to non-family managers is greatly diminished, allowing them to focus on the potential economic benefits of a stronger alignment of their interests with those of non-family managers.

4.1 Robustness tests

To provide additional support for our findings, we conducted several robustness tests by exploring other specifications in the dependent variable. First, we reran the analysis using only the presence or absence of profit sharing packages to compensate non-family managers as the dependent variable. The results were very similar to the Model 5. Second, we next considered the results of using bonuses as the dependent variable. In this case the results were consistent but even stronger than those presented in the Model 5; family ownership was negative and significant ($p<0.05$) to attain further support for *H1a*. Third, we converted the binomial dependent variable into a multinomial dependent variable ranging from 0 to 2 depending upon if the firm offered no incentives (0), bonus or profit sharing (1), or both bonus and profit sharing (2). Multi-nominal and ordinary least square regressions again confirmed the findings discussed above.

In sum, our findings provide empirical support that as family ownership, management, and intentions for transgenerational succession intentions increase, SME family firms are less likely to offer incentive compensation to non-family managers. The results therefore provide further evidence to support the notion of that preserving socioemotional wealth may be a priority for firms showing higher levels of family influence and control as well as intentions for intra-family succession. Our results suggest as family domination increases, employment in a family firm can become less attractive managers with no kinship ties to the family.

5. Conclusion

Our study advances the family business literature by exploring the relationship between family involvement and the use of incentive compensation for non-family managers in SME family firms. Drawing upon and extending the socioemotional wealth perspective, we suggest that family ownership, management, and intra-family succession intentions will be negatively associated with the propensity to compensate non-family managers. Even though offering compensation incentives to managers (family and non-family) might lead to higher firm performance and is low risk because incentive payouts are only given if performance increases, the economic benefits are usually not valued as highly as the potential loss of socioemotional wealth that might ensue.
Our findings support the contention that two dimensions of socioemotional wealth, family influence and control and intra-family transgenerational succession intentions, are negatively related to the propensity to use incentives such as bonus and profit sharing to compensate non-family managers. It is interesting to note that the significant interaction effect of family ownership and management implies that family ownership without management involvement may shift the relative importance of economic and non-economic goals away from the latter and toward the former. Thus, while ownership may be enough for defining a firm as a family firm, it may not be enough to prompt family members to sacrifice economic performance for non-economic benefits because without family managers there is no one to provide altruistic benefits and, potentially no one in the family to run the firm (Schulze and Gedajlovic, 2010; Chrisman *et al.*, 2012). In such situations, the family may be more likely to treat the firm as an economic instrument rather than a family institution.

Our study contributes to the literature in two important ways. First, this paper extends the socioemotional wealth perspective by considering the trade-offs between economic and non-economic goals in situations where downside economic risk is low or absent. This theoretical perspective suggests that the size of the pay-offs from the pursuit of economic goals must be weighed against the socioemotional wealth at risk. In other words, our study allows for the possibility that aversion to loss of socioemotional wealth may be limited by the amount of economic rewards available. Our results indicate, however, that disproportionate gains are likely to be necessary to cause family owners to forego socioemotional wealth in the pursuit of economic wealth. Particularly, our study shows that family ownership, management, and succession intentions attenuate the use of incentive compensation for non-family managers even though such compensation does not need to be paid unless the firm's economic performance improves.

Second, our focus on non-family managers in SME family firms implies that stakeholders outside the family may be affected by a family's preoccupation with its socioemotional endowments. Thus, non-family managers may not be given the opportunities to advance either professionally or financially that they might otherwise have if the firm pursued more traditional, economic goals. This may also result in unbalanced or negative perceptions of organizational justice (Barnett and Kellermanns, 2006) that can isolate a non-family manager from behaving as a contributor to the business or even as a follower of the family vision. Likewise, the constraints in growth and profitability that might result can have serious repercussions on economic development at the societal level, especially given the dominant role of family firms around the

world. Consequently, although concerns for socioemotional wealth can have positive ramifications for stakeholders outside the family firm (Berrone *et al.*, 2010), the possibility of negative impacts needs equal treatment.

5.1 Limitations

Our study has several limitations. First, our sample includes firms that are relatively small and new so they may not be able to exploit the full benefits of employing non-family managers owing to their scope of operations. Although our unit of analysis properly states the study of small- and medium-sized firms, the results cannot be generalized to family firms who may be older or larger. Hence, future studies should explore non-family managers' compensation in larger family firms. In addition, when considering older firms, it may be possible to determine how the succession process has affected the compensation of non-family and family managers. Furthermore, older and/or larger family firms may also rely on outsider support (e.g. independent or external board members, advisory boards, or family business consultants) in making compensation decisions. In that regard, it may be possible that families will be influenced by outsiders to offer compensation packages to managers regardless of kinship ties. Second, the data collection was cross-sectional in nature and we cannot determine causality from our observations. Thus, we encourage future studies to utilize longitudinal research designs. Third, although our analysis suggested that common method bias was not a problem (Podsakoff and Organ, 1986), multiple sources of objective and perceptual data would improve the design of future studies. Fourth, data limitations required that transgenerational succession intentions be measured as a categorical variable. Future research would benefit if a multi-item scale for operationalizing this variable was developed.

5.2 Future research directions

In addition to addressing the limitations of this study, there are several other avenues for future research that should be considered. Aside from the determinants of non-family managers' compensation in family firms that we have pointed out in this paper, there may be other determinants that affect these decisions in family firms, such as the family firm's degree of professionalization (Chua *et al.*, 2009; Dyer, 1988). We expect that family firms may be more willing to hire and offer higher incentive compensation to non-family managers as the degree of professionalization increases. In addition, studies can also seek to investigate the feedback loop that goes from the business to the family subsystem to continue the exploration of Litz (2008) model. Particularly, it is needed to empirically test the fairness perceptions of the non-family managers and employees toward the HR practices employed by the family (e.g. Barnett and Kellermanns, 2006).

Studies can also examine the impact of incentive compensation paid to non-family managers' on firm performance or on the preservation of socioemotional wealth. While our results suggest that there is a positive association between perceived performance and the propensity to use incentives for non-family managers, future studies may need to examine the reverse relationship. Studies that complement those conducted with family managers (e.g. Chrisman *et al.*, 2007) to inquire about the benefits of hiring, retaining, and compensating non-family managers are also needed. Indeed, many family firms continue to operate in the long run not because they are

highly profitable, but because the firm serves the attainment of non-economic goals of the family (Gomez-Mejia *et al.*, 2007).

Another future research avenue can be the investigation of the relationship between the composition and compensation of the management teams in family firms. Some family firms may prefer to reflect a professional family firm image and make effort to hire and retain non-family managers. It would therefore be interesting to examine how these family firms build a positive image and reputation for professional human resources management practices. Future research might also investigate whether incentive compensation for non-family managers' varies depending upon the life-cycle stages, culture, and strategic orientation of family firms (Gersick *et al.*, 1997) or the potential moderating effects that may exist when the family firm has other governance structures (e.g. board of directors, advisory boards, etc.). On one hand, a family firm with a growth orientation may exhibit a higher propensity to offer incentive compensation to non-family managers as it needs expertise and know-how from outside the family to position the firm in the industry. On the other hand, non-family managers can also be needed when family firms are competing in mature or declining industries and additional entrepreneurial efforts are needed to navigate in the market. Finally, future investigation may also consider the potential non-linear effects that family involvement exerts over compensating non-family managers. Future researchers may want to expand our framework at both the conceptual and empirical level to complement our findings in the study.

5.3 Practical implications

A primary implication of this study is that family owners and managers are apt to let their concerns for socioemotional wealth influence their decisions on whether to provide incentive compensation to non-family managers. There is nothing inherently wrong with this, but the decision should be consciously made because it can have important affects on the firm. Thus, family owners and managers need to take a careful look at their economic and non-economic goals and attempt to understand the trade-offs among them. While non-economic goals are important, they can often come into conflict with the attainment of economic goals and their relative utility can depend upon which goal is threatened, a situation that is likely to change over time. Understanding these trade-offs will assist in determining whether to offer incentive compensation to non-family managers. Without an understanding of their priorities, family owners and managers are likely to make decisions on the compensation the non-family managers arbitrarily.

Family owners and managers also need to understand that non-family managers may be driven by a different set of goals and ignoring their needs is not the answer. Although some non-family managers may behave as stewards rather than agents, the best among them will still gravitate toward firms with goals and strategies that they believe are compatible with their own. Importantly, non-family managers are less likely to understand the non-economic goals of family members, which may vary substantially. Furthermore, the training of non-family managers makes them better suited to assist in obtaining the firm's economic goals. Therefore, it is necessary to communicate the family's non-economic goals for the firm to non-family managers, explain how that affects the way the business is operated, and ensure that efforts to accomplish

those goals are rewarded appropriately and consistently. The ability to do so will assist in both the alignment and achievement of the interests of family and non-family members alike.

In conclusion, we hope our results will motivate practitioners and family business consultants to guide family leaders to develop compensation packages that can meet the expectations of non-family managers and lead to their retention in the family firm. Otherwise, valuable human resources can be lost or even become potential competitors to the current family firm if those non-family managers leave the organization. Making wise decisions toward compensating non-family managers is important to maintain the level of competitiveness of the family firm in the long run.

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