

ThinkBox

Socioemotional wealth preservation in family firms

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Abstract

In this article, we review literature on socioemotional wealth. We explain how the concept of socioemotional wealth builds on previous family firm research showing that family-owners derive utility from the nonfinancial aspects of their firm. We also discuss how family firms' need for socioemotional wealth preservation explains behavioral differences between family and nonfamily firms in managerial decision making. Finally, we discuss the current state of socioemotional wealth research and propose potential directions for future research.

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Introduction

Research shows that family-owned firms make decisions unlike those of nonfamily firms (Gómez-Mejía, Cruz, Berrone, & De Castro, 2011). Extending previous research, Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, and Moyano-Fuentes (2007) explain those dissimilarities by proposing that family-owners' seek utility in the form of preserving socioemotional wealth generated by the noneconomic aspects of family businesses.

Family-owners derive socioemotional wealth from several sources, including having the family name associated with their firms, emotional attachment to the firm, and the satisfaction of family members working for the company (Gómez-Mejía et al., 2011). However, since one task of a family firm is to sustain and increase owners' socioemotional wealth, its preservation affects the business decision-making of family-owners and the firm's managers. In other words, decisions that seem unprofessional to outside observers, such as appointing an inexperienced family member as the CEO of the firm, might be logical to family-owners because they provide nonfinancial benefits. Hence, family's desire to preserve socioemotional wealth affects family firms' long-term performance both positively and negatively. The effects might negate each other as research yields mixed results regarding how family ownership affects firm performance (Gómez-Mejía et al., 2011). This study explains and provides examples of socioemotional wealth and encourages future research to investigate processes that mediate how family-owners' desire to preserve socioemotional wealth affects their firms.

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Socioemotional wealth

Empirical research consistently shows that family and non-family firms behave differently in significant ways (Berrone, Cruz, & Gomez-Mejia, 2012; Gómez-Mejía et al., 2011). Building on previous research on family firms, Gómez-Mejía et al. (2007) propose the concept of socioemotional wealth to explain those differences in behaviors of family and nonfamily firms. Socioemotional wealth, they explain, encompasses “the utilities family-owners derive from the noneconomic aspects of the business” (Gómez-Mejía et al., 2007).

Family-owners derive socioemotional wealth from several sources. For instance, they feel connected with the family firm; hence, forming an emotional bond with the firm (Kets de Vries, 1996; Tagiuri & Davis, 1996). This emotional bond between the family and the firm affects how the family-owners manage the firm (Baron, 2008). Members of the owning family often identify with their firm, especially if it bears the family name, and value their firm’s public image because it reflects on the family (Dyer & Whetten, 2006). In other words, a positive public image of the firm enhances the socioemotional wealth derived from the firm.

Family-owners also rely on the firm to diffuse the family’s values among employees and throughout society (Gómez-Mejía et al., 2011). Over time, these values permeate the organizational culture of family firms. Finally, the impulse to improve the welfare of the family unit motivates family firms strongly (Gómez-Mejía et al., 2011). Family-owners are gratified that family members work for the firm. For instance, the founder is gratified by providing an opportunity for her children to work for the family firm.

As explained above, family-owners derive socioemotional wealth from several sources and they are keen to sustain their socioemotional wealth endowment. To achieve this goal, families are willing to make decisions that seem financially inexplicable and unprofessional become logical in light of the family’s desire to preserve socioemotional wealth. Consequently, executives making managerial decisions in family firms are concerned of both financial factors and socioemotional wealth preservation. While executives in nonfamily firms are mainly concerned with financial factors, family firms are less driven by prospects that are financially lucrative but threaten socioemotional wealth. This possibility explains why empirical research finds that behaviors of family and nonfamily firms differ. It also explains why determining whether family firms financially outperform nonfamily firms is inconsequential. Above, we have discussed how family and nonfamily firms differ. Next, we will examine effects of socioemotional wealth preservation in managerial decision making in family firms.

The effects of socioemotional wealth preservation

The family’s need for socioemotional wealth preservation affects how family firms make managerial choices. In their discussion of socioemotional wealth preservation, Gómez-Mejía et al. (2011) classify the managerial choices of family firms into five dimensions: management processes, strategic

choices, organizational governance, stakeholder relationships, and business venturing. Following their categorization, we now examine how family-owners’ desire to preserve socioemotional wealth affects their strategic decision-making and organization governance.

Strategic decision-making

Previous research on family firms has shown major differences between family and nonfamily firms in strategic decision-making (Gómez-Mejía et al., 2011). In general, family firms are more risk averse—and therefore, generally more stable—because the family’s wealth might be tied to their firm, making family-owners wary of high-risk strategies that could diminish their wealth. However, family firms are not always risk averse. On the contrary, family firms are willing to take large financial risks to prevent extensive losses on their socioemotional wealth. If the family firm is threatened, for instance, family-owners might take risks to guarantee its survival and associated socioemotional wealth. That said, however, family-owners appear happier than nonfamily-owners with lower financial returns if they preserve socioemotional wealth. Therefore, the desire to preserve socioemotional wealth might lead to higher or lower risk-taking, depending on how outcomes are perceived to affect socioemotional wealth.

Family firms are also less likely to diversify than nonfamily firms. Diversification often means seeking financing via debt financing or equity participation, which dilutes family ownership. Either reduces family control over the firm and diminishes family’s socioemotional wealth. Therefore, family firms are less likely to diversify. In addition, family firms might lack the specialized knowledge or talent needed to diversify successfully, and hiring external help would increase information asymmetries, diminishing socioemotional wealth and making diversification unappealing. These considerations also explain why family firms are less likely to make acquisitions and finance operations via debt. Their reluctance is grounded in the desire to preserve socioemotional wealth.

That desire influences strategic decisions such as choice of accounting practices (Gómez-Mejía et al., 2011). Agency theory suggests that family firms would aggressively avoid taxes because family-owners benefit relatively more from tax avoidance than other owners of the firm. However, Chen, Chen, Cheng, and Shevlin (2010) show that family firms avoid taxes less aggressively than nonfamily firms. Their finding follows the logic of socioemotional wealth because family-owners fear negative outcomes associated with aggressive tax avoidance that may diminish family’s socioemotional wealth. Gómez-Mejía et al. (2011) conclude that family firms apparently value their reputation and firm image over short-term benefits of accounting practices that could reduce socioemotional wealth. Their conclusion suggests that corporate family firms value corporate citizenship.

In conclusion, the desire to preserve socioemotional wealth affects how family firms make strategic decisions in comparison with nonfamily firms. To preserve socioemotional wealth, family firms are generally less willing than nonfamily firms to take

big risks although they do so to preserve socioemotional wealth if it is threatened. Next, we will discuss how socioemotional wealth preservation affects corporate governance in family firms.

Organizational governance

Socioemotional wealth preservation is important for family owners and Gómez-Mejía et al. (2011) suggest that this affects the governance of family firms. The literature of corporate governance traditionally regards family ownership as an exemplary mode of governance (Fama & Jensen, 1983); however, Schulze, Lubatkin, Dino, and Buchholtz (2001) show that this is not the whole picture. Family firms have governance problems not dissimilar to those of nonfamily firms, but their origins differ. Family-owners' desire to preserve socioemotional wealth means that family firms might, for instance, prefer projects that are financially less optimal or hire family members irrespective of their abilities. Again, these decisions might provide other benefits to the family firm, such as improving its reputation or retaining more devoted employees.

Another difference between family and nonfamily firms is the position of top executives. Gómez-Mejía et al. (2011) propose that family CEOs are less likely to be dismissed than nonfamily CEOs; however, their compensation is generally lower than those of nonfamily-firm CEOs. That is, family firms provide greater job security but less compensation.

Finally, the preservation of socioemotional wealth affects the composition of boards of directors of family firms. For example, if investors in a publicly-traded family firm perceive it to have governance problems, the firm might appoint outside directors to signal its quality and legitimacy. To conclude, boards of family firms serve functions absent in nonfamily firms because of the preservation of socioemotional wealth.

We have discussed how family-owners' desire to preserve socioemotional wealth affects the governance of family firms in comparison with nonfamily firms. Both face governance issues; however, those issues are distinctive because the desire to preserve socioemotional wealth guides decision-making in family firms but not in nonfamily firms.

Conclusion

To explain the disparate results of studies examining family and nonfamily firms, Gómez-Mejía et al. (2007) proposed that the owners of family firms desire to preserve their socioemotional wealth, which is the utility that family-owners derive from the noneconomic aspects of the firm. The authors built on the previous research showing that family-owners value highly the nonfinancial benefits that they derive from the family firm. The authors also suggested that family-owners' need to preserve socioemotional wealth is a major factor explain differences in behaviors of family and nonfamily firms. When making managerial decisions, family firms consider the preservation of

socioemotional wealth alongside financial factors. Therefore, decisions that may seem unprofessional might be motivated by family-owners' desire to preserve their socioemotional wealth. Empirical studies strongly support these results, and we find it inconsequential that they do not definitively answer whether family firms financially outperform nonfamily firms.

To conclude, we are not suggesting that the research on socioemotional wealth has reached its peak; on the contrary, the most of the current research limits its scope to examining how family-owners' desire to preserve socioemotional wealth affects managerial choices. Therefore, it would be important that future research would help us to understand processes that mediate the relationships between family-owners' desire to preserve socioemotional wealth and outcome variables. For instance, researchers could apply the logic of socioemotional wealth in the field of entrepreneurship to explain how family firms become entrepreneurially orientated. Doing so suggests that the level of the analysis should shift from managerial-level to employee-level. Furthermore, such research could advance the understanding of how family and nonfamily firms differ and whether the differences are limited to the higher levels of organizations or are they also observable at the lower organizational levels. This research would provide important implications for all family firm researchers.

Conflicts of interest

The authors declare no conflicts of interest.

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