Beyond agency and stewardship theory: Shareholder-manager relationships and governance structures in family firms

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Abstract

Purpose. Challenging the static view of family business governance, we propose a model of owner-manager relationships derived from the configurational analysis of managerial behavior and change in governance structure.

Design/methodology/approach. Stemming from social exchange theory and building on the 4C model proposed by Miller and Le Breton-Miller (2005), we consider the evolving owner-manager relationship in four main configurations. On the one hand, we account for family businesses shifting from a generalized to a restricted exchange system, and vice versa, according to whether a family manager misbehaves in a stewardship-oriented governance structure or a nonfamily manager succeeds in building a trusting relationship in an agency-oriented governance structure. On the other hand, we consider that family firms will strengthen a generalized exchange system, rather than a restricted one, according to whether a family manager contributes to the stewardship-oriented culture in the business or a nonfamily manager proves to be driven by extrinsic rewards. Four scenarios are analyzed in terms of the managerial behavior and governance structure that characterize the phases of the relationship between owners and managers.

Findings. Various factors trigger managerial behavior, making the firm deviate from or further build on what is assumed by stewardship and agency theories (i.e., pro-organizational versus opportunistic behavior, respectively), which determine the governance structure over time. Workplace deviance, asymmetric altruism, and patriarchy on the one hand, and pro-organizational behavior, relationship building and long-term commitment on the other, are found to determine how the manager behaves and thus characterize the owner's reactions in terms of governance mechanisms. This enables us to present a dynamic view of governance structures, which adapt to the actual attitudes and behaviors of employed managers.

Research implications. As time is a relevant dimension affecting individual behavior and triggering change in an organization, one must consider family business governance as being dynamic in nature. Moreover, it is not family membership that determines the most appropriate governance structure, but the owner-manager relationship that evolves over time, thus contributing to the 4C model.

Originality/value. The proposed model integrates social exchange theory and the 4C model to predict changes in governance structure, as summarized in the final framework we propose.

Keywords: Governance structure, governance mechanisms, social exchange theory (SET), 4C model, agency theory, stewardship theory, time orientation.

Paper type: Conceptual paper

Short title: Shareholder-manager relationships in family firms

1. Introduction

More than ever, businesses and business owners depend on the innovative power of their employees, and there is never a one-size-fits-all solution regarding the most suitable governance structure to unlock their full potential (e.g., Bammens, Notelaers, & Van Gils, 2015). Hence, currently challenges call for a new and more thorough understanding of governance mechanisms. In particular, the relationship between the owning family and the family business managers – family or nonfamily – is a key success factor in innovation-driven transformations, which begin with the commitment of the owning family. However, static structures do not fully capture the governance needs of family firms today (e.g., Lubatkin, Lane, Collin, & Very, 2007). A dynamic view is necessary to grasp the essence of modern owner-manager relationships and has implications on how to structure sound family firm governance for today's and tomorrow's challenges (e.g., Lambrecht, 2005).

Family firm governance has been a focus of investigation in the research field of family business (Madison, Holt, Kellermanns, & Ranft, 2016). Thus far, several issues have been discussed regarding boards of directors (Bammens, Voordeckers, & Van Gils, 2008; Walther, Calabrò, & Morner, 2017) and their composition as predictors of family business survival (Wilson, Wright, & Scholes, 2013), shareholders' interest protection, or managerial entrenchment (Deman, Jorissen, & Laveren, 2018) in order to understand how family firms differ from their nonfamily peers (Siebels & zu Knyphausen-Aufseß, 2012) and how governance mechanisms vary across different family businesses (Nordqvist, Sharma, & Chirico, 2014). These research contributions have been primarily built upon agency and stewardship theory, juxtaposing them and offering a rather static view of family business governance and behavior (Madison et al., 2016). Indeed, although advancing our understanding of family and nonfamily governance, contributions rooted in agency theory have revealed the sources of agency problems specific to family firms, and the incentive systems, monitoring mechanisms and conflict management tools to deal with them. For instance, Schulze and colleagues (2003a, 2003b; 2001) mainly discuss the negative consequences of altruism; Morck and Yeung (2003) offer a broad view on the entrenchment effects and expropriation opportunities related to the presence of family members in the company; and De Massis, Kotlar, Mazzola, Minola, and Sciascia (2018) analyze agency problems related to the multiple goals of family business owners leading to conflicting selves. On the other hand, also leveraging stewardship theory, scholars have theorized family firms and advanced our understanding of governance in this context. Indeed, Eddleston and Kellermanns (2007) investigate productive family relationships, showing the positive effect of conflict in some family firms; Miller, Le Breton-Miller, and Scholnick (2008) highlight the relevance for family firms of ensuring the continuity of the business, nurturing a community of employees, and seeking closer connections with customers to sustain the business; and Davis, Allen, and Hayes (2010) discuss the role of trust and commitment to family values that make family and nonfamily employees in the business perceive stewardship in the organization. In line with this contribution, a stewardship climate scale has been developed specifically to evaluate to what extent the governance of a family business is oriented toward stewardship (Neubaum, Thomas, Dibrell, & Craig, 2017).

Theoretical perspectives on agency and stewardship differ primarily in their underlying assumption about managers' behaviors, which in turn affects their relationship with firm owners, i.e., principals. Agency theory applies the economic model of man, assuming an agent opportunistically maximizing his[i] personal wealth (Fama, 1980). Asymmetric information and separation of ownership and control determine the misalignment of interests between owners and managers. Conflicting objectives can be addressed through specific governance structures and mechanisms that, although representing agency costs for the firm, ensure the owners' wealth maximization (Jensen & Meckling, 1976). This is opposed by the pro-organizational and collectivistic view of intrinsically motivated individuals assumed in stewardship theory (Davis, Schoorman, & Donaldson, 1997). Stewards behave in perfect alignment with the shareholders' interests, as they believe they will be rewarded for their commitment and effort toward wealth maximization. Altruistic and trustful relationships determine a governance system characterized by high involvement and collectivism at all organizational levels (Hernandez, 2012). Thus, we claim that a focus on the relationships between owners and managers over time can contribute to this debate. Relying on either theory to investigate the owner-manager relationship enables one to focus on specific governance mechanisms installed to define the relationship between a manager and the assets he controls on the owners' behalf (Davis et al., 1997; James, Jennings, & Jennings, 2017).

Along the continuum between agency and stewardship theory predictions, family businesses represent a highly relevant case to investigate as, when family members are active in management, their firms encounter the unique challenge of familial relationships between owners and managers (McGivern, 1978). According to management composition and in particular examining the family membership of the CEO, prominent studies in the field assume agency-oriented governance for nonfamily managers and stewardship-oriented governance for family managers (Madison et al., 2016). They assume, in particular, that nonfamily managers' personal goals must be aligned with those of the organization, whereas the family manager's interests are instinctively aligned through family affiliation (Chung & Yuen, 2003; James et al., 2017). However, recent studies have found no empirical evidence of this bifurcation bias, but rather observed nonfamily managers striving in a stewardship-oriented governance structure (James et al., 2017; Verbeke & Kano, 2012). Interestingly, little is known about the drivers of the choice of either agency-oriented or stewardship-oriented governance in family firms, in concert with the appointment of either a family or a nonfamily manager. We claim this to be relevant, as empirical evidence in nonfamily contexts shows that managers make different decisions in an agency-oriented setting than in a stewardship-oriented governance structure (Tosi, Brownlee, Silva, & Katz, 2003).

Our conceptual paper attempts to challenge the dominant view of an organization's governance structures as static (Madison et al., 2016). Only if governance structures are understood as a continuum can business owners design the relationship with their managers in a way that suits the challenges of the modern age. The key tenet of our analysis is the idea that individual attitudes and behaviors as well as relationships are subject to change over time (Cropanzano & Mitchell, 2005). Thus, we embrace a dynamic perspective on family business governance and managerial behavior (Lubatkin et al., 2007). Our aim is to identify triggers of change at the individual level to show how they affect 1) the owner-manager relationship and 2) the governance structure regulating that relationship. To this end, we borrow from Social Exchange Theory (SET) and the 4C model to understand how command, connection, continuity, and community characterize the relationships between owners and managers. Our findings contribute to the debate on managerial behaviors, owners' reactions, and governance mechanisms as subject to change over time (Lubatkin et al., 2007). By building on SET, we claim that a focus on owner-manager relationships (Daspit, Holt, Chrisman, & Long, 2016; Long & Mathews, 2011) can predict changes in individual behavior and governance structures along the continuum of agency and stewardship behaviors. Using this more thorough understanding of governance structures in family firms, we enable business owners to design their governance structures to foster the necessary flexibility to fully unlock innovative potential – without governance restraints.

2. Theoretical framework

2.1 Agency and stewardship governance in family firms

Classical agency governance contains control mechanisms that reduce agency problems (e.g., information asymmetries) in the owner-agent relationship and incentivize goal alignment (e.g., performance-based pay) (Madison et al., 2016). It assumes an opportunistic agent following self-serving interests. In contrast to this view, stewardship theory assumes a manager (steward) axiomatically aligning his interests with those of the firm, hence the owners (Davis et al., 1997), as he is intrinsically motivated. As the owner-steward relationship is based on trust, control mechanisms become expendable (Davis et al., 1997). Family firms in particular benefit from stewardship-oriented governance characterized by trust and commitment among family members (Corbetta & Salvato, 2004), fostered in particular by their "thick" blood ties (Davis et al., 2010).

Nevertheless, family firm principals often neglect the necessity of well-grounded governance structures, presumably due to the overlap of ownership and control, thus diminishing diverging interests and information asymmetries (James et al., 2017). This misapprehension is rooted in early theoretical studies on agency that suggested governance structures serve to protect shareholders' interests in the event of separation of ownership and control (Fama, 1980) – a condition absent in family firms. However, research has shown that family firms also require a sophisticated governance structure to serve the owners' interests (Schulze et al., 2003b). Remarkable efforts in researching governance mechanisms in family firms have discovered so-called nontraditional agency problems unique to family firms (e.g., asymmetric altruism and managerial entrenchment) (e.g., Corbetta & Salvato, 2004; Eddleston & Kidwell, 2012; Zahra, 2007). Despite contradicting findings related to governance structures in management research, family firm literature reveals clear trends. Stewardship governance is common for family members in management positions, whereas nonfamily managers are often closely monitored and explicitly incentivized – thus operating under agency-oriented governance (James et al., 2017). This bifurcation bias is rooted in the natural preference toward family members as opposed to nonfamily members (Verbeke & Kano, 2012). In particular, the debate over the effectiveness of aligning interests in opposing governance structures has revived this discussion (James et al., 2017). The distinct characteristics of managers in family firms and their likelihood of behaving as agents/stewards are at the core of this debate. The prevalent belief in the mutual exclusivity of these two theoretical approaches to governance barely captures reality. Not only can both approaches coexist in the same firm, but they are also subject to change. These changes often unfold over time due to the concentration of family ownership, personal relationships between owners and managers, lengthy managerial tenures and transgenerational orientation (Chua, Chrisman, & Sharma, 1999).

2.2 *Exchange relationships*

The focus on dyadic relationships is rooted in Social Exchange Theory (SET), a theory that suggests owner-manager relationships are characterized either by a generalized exchange system (GES) or by a restricted exchange system (RES). The former is associated with the owner-family manager relationship and espouses the premises of stewardship-oriented governance. The latter relates to the owner-nonfamily manager relationship, which is grounded in an agency-oriented governance structure (Daspit et al., 2016). SET has already found fertile ground in the family business context in analyses of relationships among family members and between family and nonfamily members with regard to succession (Daspit et al., 2016). A key aspect distinguishing GES and RES is temporality, as repeated exchanges over time nurture trust, obligations, and expectations characterizing the former rather than the latter (Daspit et al., 2016).

Theoretical frameworks distinguish between two basic forms of relationships: communal and exchange relationships (Clark & Mils, 1993). The business literature is mainly concerned with exchange relationships, as they rely on expectations of beneficial reciprocity, which adequately describe the relationships relevant to organizations. For the purpose of this article, we focus solely on these exchange relationships and use SET to explain interactions among individuals and groups. SET – among the most influential perspectives from which to investigate workplace behavior – deals with social exchange relationships that "involve a series of interactions that generate obligations" (Cropanzano & Mitchell, 2005, p. 874) and are often the result of trust in future reciprocity (Blau, 1964). Thus, it has also been used to study relationships in family firms (e.g., Barnett, Long, & Marler, 2012; Daspit et al., 2016; Long, 2011).

SET describes a relationship as a series of interactions that are interdependent on the actions of another person (Blau, 1964). Social interactions can occur over an extended period of time and reciprocal benefits can be delayed. Hence, social exchange relationships are based on direct as well as indirect reciprocity (Cropanzano & Mitchell, 2005). To further distinguish direct from indirect reciprocity in relationship exchanges, we differentiate between restricted and generalized exchange systems, although they form the two ends of a continuum (Long & Mathews, 2011).

Restricted exchange systems (RES) mainly contain actions of direct reciprocity. Thus, individuals expect an immediate return of comparable benefits for their actions (Cropanzano & Mitchell, 2005). These interactions are typically self-interested and self-serving at both ends, hence mutually beneficial for certain ends and are "characterized by a high level of individualism, competition, impersonality and contractualism" (Long & Mathews, 2011, p. 290). Agency theory relies heavily on this form of exchange by assuming the agent is entering into a contract with the principal to maximize personal benefits (Jensen & Meckling, 1976). The second distinct form is the generalized exchange system (GES) characterized by interactions that require no direct or immediate returns of comparable benefits (Cropanzano & Mitchell, 2005). GES is mainly found in long-term relationships, not only among individuals but also in groups where a direct exchange of comparable benefits is not feasible. Goals in family firms are often long-term and not directly attributable to an individual (Long & Mathews, 2011). Thus, GES are commonly associated with cooperation and collectivism, and require trust between both parties in the exchange. Stewardship theory relies heavily on this form of exchange relationships (Davis et al., 1997). A clear distinction is seldom possible and owner-manager relationships in particular exhibit elements of both. The extent to which a relationship is characterized by one or the other is the result of social construction and negotiations between the exchange parties (Long & Mathews, 2011).

2.3 The 4C model

How relationships unfold depends on managerial behaviors and organizational responses in terms of governance mechanisms that are installed to ensure that organizational goals are achieved. The behaviors that could trigger a change in the organization or strengthen the existing dynamics and mechanisms can be framed according to the 4C model (Miller & Le Breton-Miller, 2005), considering the agent-like and steward-like behaviors of managers in light of the command-connection-continuity-community dimensions. The model was developed by examining successful and unsuccessful family enterprises and suggests that a family business is prosperous over time, depending on its ability to manage those four priorities. Thus, command refers to the freedom to make courageous and adaptive decisions for the viability of the business; connection entails the ability to develop and maintain lasting, win-win relationships; continuity refers to the pursuit of an enduring and substantive mission; and community relates to the ability to nurture a cohesive and caring culture (Miller & Le Breton-Miller, 2005).

These dimensions incorporate temporal considerations, which are especially crucial when analyzing human behavior and relationships (Le Breton-Miller & Miller, 2014; Sharma, Salvato, & Reay, 2014), forming basis of examining governance changes in family firms. Time appears in many different aspects relevant to family firms, such as history, familial tradition, transgenerational thinking, or employee tenure (Lumpkin & Brigham, 2011). To capture these various facets of time, a long-term orientation is acknowledged, in order to account for the effect of family business characteristics on decision making, at both the individual and the organizational level (Lumpkin & Brigham, 2011). First, regarding command, we consider two possible managerial behaviors. On the one hand, managers can show *work deviance* behaviors, thus eluding extant control and monitoring mechanisms. On the other hand, they might show *pro-organizational* behaviors, being inwardly incentivized to maximize the firm's wealth, thus espousing the family's goals in pursuit of a sustainable business for future generations (Davis et al., 2010). Second, the emphasis on connections might be reflected in two behavioral traits. Managers might perceive *asymmetric altruism* (Schulze et al., 2003b) and thus either identify opportunities to expropriate wealth from the business, because they may feel disadvantaged in terms of career opportunities with respect to other siblings, when they are family members, or to family members, when they do not belong to the family (Verbeke & Kano, 2012). However, on the other hand, managers might engage in *relationship building*, getting involved in goal setting and pursuit with the family owners and engendering or strengthening a trustful relationship. Third, managerial behaviors are consistent with the organizational and cultural traits relating to continuity. Indeed, on the one hand, *patriarchy* is acknowledged as a possible setting characterizing a very hierarchical and rule-based cultural trait of the organization, which could manifest, for example, in primogeniture. Thus, patriarchal leadership might send a message that could be interpreted as parental devaluation, path-dependency and inertia to change, thus providing ample room to strengthen agent-like behaviors. On the other hand, the organization might be characterized by *long-term commitment*, thus leading managers to plan and implement best practices for the long run. This forward-looking attitude would entail a stronger steward-like behavior in the case of family managers, and a shift toward stewardship if the manager who displays this long-term commitment is a nonfamily member.

Overall, these change factors, framed in terms of command, connections, and continuity, would have an effect on the *community* dimension, in terms of the reaction of family owners in adapting the governance structure and mechanisms that could function most effectively in the family business.

In sum, command, connection, and continuity in family firms capture their members' mindset and thinking as part of the family firm's DNA. Hence, the community dimension is mirrored in the governance structures, thus affecting the family business's durability (Madison et al., 2016).

3. Governance structure changes in family firms

Given the focus on the relationship between shareholders and managers in defining the prevalence of an agency- and stewardship-oriented governance structure (Davis et al., 1997; Jensen & Meckling, 1976), whether or not a family firm manager is a family member will most likely be decisive for the initial governance structure the owning family installs (Madison et al., 2016). We define family manager in the following analysis as a family member who is the manager of the family firm but who does not yet have ownership (Chrisman, Chua, Kellermanns, & Chang, 2007). The literature clearly anticipates stewardship-oriented governance for a case involving goal alignment and intrinsic motivation driven by family membership (Verbeke & Kano, 2012). A nonfamily manager is at first likely perceived as a self-interested agent in need of an agency-oriented governance structure (Madison et al., 2016). We argue that this initial owner-manager relationship is subject to change, as relationships develop over time as a result of interactions and shared experiences.

Defining a firm's governance mechanism "as a dynamic ecological process that takes place at multiple levels of analysis within firms, involves multidirectional causalities and is path and history dependent—a 'co-evolutionary process'" (Lubatkin et al., 2007, p. 47), we shed light on the dynamic nature of family business governance and managerial behavior by observing specific processes that feature dyadic relationships in family firms. To this end, we consider two scenarios for our analysis, an owner-family manager relationship and an owner-nonfamily manager one, to analyze change factors characterizing managerial behavior and affecting the respective family businesses' governance structures in a 2 by 2 matrix. As mentioned above, on the one hand, *workplace deviance*, *asymmetric altruism*, and *patriarchy* make a family manager misuse the owners' trust implied in stewardship-oriented governance or a nonfamily manager exploit the chances to gain an extra reward in an opportunistic way. Consequently, the altered relationship results in changes in the governance structure, incorporating or strengthening agency-oriented governance mechanisms that allow the owner to monitor the manager's actions to prevent managerial opportunistic behavior in the future. On the other hand, *pro-organizational behavior*, *relationship building*, especially within the family, and *long-term commitment* trigger relational changes between owner and manager. In the latter case, we theorize either a change from agency toward stewardship orientation over time, with a decreased need to install control mechanisms and incentive systems to monitor the agent and align his interests to the owner's, or to reinforce stewardship mechanisms when a family member is intrinsically motivated and aligned with the goals of the family.

To this end, we have constructed four situations to illustrate our analysis and develop an overarching model for changes in owner-manager relationships and corresponding governance structures. Our analysis is based on the concept of restricted versus general exchange to differentiate family and nonfamily managers' relationships with the family owner and accounts for family firms' long-term orientation. The scenarios are structured as follows: we consider an owner-founder of a family firm who passes on the firm's management to either a family member – a family manager – (Scenario 1) or a nonfamily manager (Scenario 2) and design the governance structure accordingly. We stress explicitly at this point that our analysis focuses on the period after the management position has been transferred rather than the transition process itself. Additionally, we assume a stewardship-oriented governance structure to be more beneficial for family firms – irrespective of the manager being family or nonfamily – as it does not impose agency costs (e.g., monitoring efforts) and to be more suitable to the family firm's long-term orientation (James et al., 2017). We analyze both scenarios using a three-phase approach. First, during the *setup phase*, the governance structure is designed based on the exchange relationship between owner and manager. Second, the *action phase* describes the influence of command, connections, and continuity on the relationship, assuming only one change factor at the time with all other conditions being equal, to properly discuss the effect of each individual trigger. Third, the *change phase* demonstrates how these relational changes manifest in the governance structure, thus exemplifying the community dimension of the 4C model.

3.1 Scenario 1: the family manager

The first scenario analyzes the relationship of the owner-founder and the family manager after the management transition is completed. For the sake of clarity, we choose the son as the new family manager, but it could be any family member of the owner-founder.

Set-up phase: Familial relations are best described by GES as being characterized by a high level of trust and no expectations of reciprocity. The owner chooses stewardship-oriented governance, as he naturally refrains from monitoring/controlling family members. They are assumed to act pro-organizationally and serve the family legacy with no need of further goal alignment (Madison et al., 2016). Stewardship-oriented governance fosters the competitive advantage of family firms, as it allows faster decision-making and promotes long-term planning (Davis et al., 2010). In addition, from the son's perspective a stewardship-oriented governance structure is most suitable. Indeed, the manager identifies with the family firm and ties his personal satisfaction and reputation to it (Madison et al., 2016). Thus, he is intrinsically motivated to achieve high performance (Corbetta & Salvato, 2004). Accordingly, we assume that both will agree on a stewardship-oriented governance structure (Pieper et al., 2008).

Action phase: We consider the command, connection and continuity dimensions to be triggers for change in this first scenario, namely, *workplace deviance*, *asymmetric altruism*, and *patriarchy*. The first trigger is *asymmetric altruism.* The concept has strongly influenced the debate on nontraditional agency conflicts in family firms and basically describes parental altruism being greater than that of their children (Schulze et al., 2001). This asymmetry – only possible in a GES – leads parents to overestimate the abilities and skills of their children, not adequately judging their motivation and ethics (Eddleston & Kidwell, 2012). The son in our scenario may embrace different interests and future outlooks than his father. *Asymmetric altruism* leads to an inadequate level of control of his actions and a very limited ability for self-control (Chua, Chrisman, & Bergiel, 2009). This freedom triggers shirking, free-riding and other self-interested actions (Schulze et al., 2001). Major problems that arise include the difficult enforcement of implicit and explicit contracts between father and son, if the latter engages in opportunistic behavior, and embellished evaluations due to the father's overestimation of his son's capabilities and actions (Chua et al., 2009; Eddleston & Kidwell, 2012).

The second factor triggering a change in the owner-manager relationship is *workplace deviance*. The concept describes voluntary behavior that significantly violates organizational norms, thus threatening the well-being of the organization and its members (Eddleston & Kidwell, 2012). *Workplace deviance* at the management level may lead to performance decreases and cause business failure. It comprises free-riding, lying, insubordination, sabotage, abuse of privilege, harassment, theft, and lack of regard for cost control (Eddleston & Kidwell, 2012). In the context of family firms, *workplace deviance* has received special attention with regard to leadership succession among family members. Roles are often not clearly defined and the boundaries between work and private life are blurry at best. Further, parents find it difficult to punish their children for deviant behavior, as this might threaten the family harmony (Eddleston & Kidwell, 2012). *Asymmetric altruism* and *workplace deviance* in a stewardship-oriented governance structure induce a high likelihood of the son engaging in self-serving behavior, damaging the family firm over an extended period of time without being adequately punished. On the one hand, the father trusts his son and his abilities, and refrains from closely intervening in his actions. On the other hand, stewardship-oriented governance does not allow for close monitoring. Eventually, the father will detect the deviant behaviors and negative consequences on firm performance, thus severely damaging the father-son and owner-manager relationship. However, in accordance with LTO, to protect the family legacy over generations, the family firm omits the option of replacing the son as family manager to avoid reputational losses (Le Breton-Miller & Miller, 2006). To summarize, the problems caused by *asymmetric altruism* and *workplace deviance* are the misalignment of goals between owner and manager, the problem of self-control, opportunistic behavior and a lack of control mechanisms to detect such behavior.

The third change factor in this scenario is *patriarchy*, which describes the inability of the father to accept his retirement as leader and allow his son to be in charge of the family firm. In the founder generation in particular, this phenomenon is widespread, as the founder's personal identity is directly tied to the firm (Sonnenfeld & Spence, 1989). Transferring leadership to the next generation causes an identity crisis in the previous incumbent. The fear of losing the family's legacy and the frustration of not being able to fulfill future outlooks threatens the professional and personal father-son relationship (Sonnenfeld & Spence, 1989). The father is at risk of constantly interfering with his son's decisions, especially outside the business context, as the stewardship-oriented governance structure does not officially allow him to monitor his son's actions. However, he uses the familial relation with the manager to discuss, control and interfere with decisions (Cater & Kidwell, 2014). The son in turn feels overly supervised, distrusted, and constrained in his decision-making. This creates conflict in the owner-manager relationship. The father suspects his son of making fatal business decisions and tries to intervene, while the son feels controlled and consequently tries to hide his actions (Sharma, Chrisman, & Chua, 2003). This high level of mistrust and interventions leads to firm-damaging behavior. To summarize, we have an owner with an excessive need for control and a family manager who feels distrusted and patronized.

Nevertheless, when the managers do not perceive problems related to asymmetric altruism, as they have the same opportunities as any other sibling, family managers show pro-organizational behavior, further engaging in GES and aiming to pursue family goals without any hindrance. Generalized exchange between owners and family members would also be strengthened by the absence of an incentive to deviate from a continuous trust building within the family, as well as by the lack of patriarchal culture in the organization.

<u>*Change phase*</u>: The above-described behaviors are factors that alter the owner-manager relationship. As the father-son relationship is characterized by a GES, we assume that a stewardship governance structure was installed prior to the behaviors examined above (Madison et al., 2016). We theorize a change in governance toward either shifting to an agency-oriented structure or strengthening a stewardship-oriented structure. On the one hand, *asymmetric altruism* and *workplace deviance* cause a misalignment of goals between owner and manager exacerbated by the problem of self-control and opportunistic behavior. Moreover, *patriarchy* undermines the trust-based stewardship governance structure. Replacing an appointed family manager is highly unlikely. As the identified factors are nonetheless damaging for the family firm, they trigger changes in the governance structure to regulate negative consequences in the future. First, characteristics of an RES are introduced, such as clear roles and responsibilities, contractual agreements and reciprocity at the business level (Long & Mathews, 2011). Further, monitoring and control mechanisms, such as a board of directors, are likely to be installed (Siebels & zu Knyphausen-Aufseß, 2012). Second, preventive measures aim at goal alignment, taking the form of ownership transfer or share packages tied to organizational goals (Madison et al., 2016). Hence, we see a shift from stewardship to agency governance structure in the family firm over time – triggered by factors that have altered the relationship between the owner and the family manager

(Long, 2011). Conversely, in the second situation, the lack of asymmetric altruism, workplace deviance and patriarchy would further strengthen the steward-like mechanisms, granting goal alignment and the prioritization of family business interests before the manager's personal ones.

In light of the foregoing, we advance the following propositions to capture our arguments:

> *1a) Asymmetric altruism, workplace deviance, and patriarchy determine a shift from a generalized exchange system toward a restricted exchange system characterizing the owner–family manager relationship.*
>
> *1b) The lack of asymmetric altruism, workplace deviance, and patriarchy strengthens a generalized exchange system characterizing the owner–family manager relationship.*
>
> *2a) The altered owner–family manager relationship triggers the change from stewardship-oriented to agency-oriented governance in the family firm.*
>
> *2b) The strengthened owner–family manager relationship triggers the reinforcement of stewardship-oriented governance in the family firm.*

3.2 Scenario 2: the nonfamily manager

The second scenario we analyze is the case of an owner-founder who decides to hire a nonfamily manager to take on his management position in the company. Ownership remains with the founder, who is planning transgenerational control (Chua et al., 1999).

<u>*Setup phase*</u>: An RES characterizes the owner's relationship to his nonfamily manager based on direct reciprocity, self-interest, contractual agreements and market ethics (Long & Mathews, 2011). We assume a self-serving nonfamily manager, as he has no ownership or

psychological ownership of the firm. Hence, his goals must be aligned top-down with those of the family firm and its owner (Jensen & Meckling, 1976). Further, the owner must control his actions to ensure they serve the firm's best interest (Jaskiewicz, Block, Combs, & Miller, 2017). Thus, the owner designs an agency governance structure that aims at inducing a pro-organizational attitude and accordingly pro-organizational behaviors in the nonfamily manager (James et al., 2017). Family principals, indeed, are not only concerned with increasing firm performance and value but also with socioemotional factors such as identification with the family and its values (Jaskiewicz et al., 2017). We assume that at first both parties agree to this governance structure, although the nonfamily manager might feel resentment if he is naturally a steward (James et al., 2017).

Action phase: In this scenario, we also consider command, connections and continuity dimensions, looking in particular at *pro-organizational behavior*, *relationship building*, especially with the owning family, and *long-term commitment.* Time becomes a key aspect at this point, as *pro-organizational behavior* and *relationship building* will not immediately alter the governance structure, and *long-term commitment* can only be proven over time. Such behaviors must be present over an extended time period to build trust between the owner and nonfamily manager. Hence, we find trust to be the underlying mechanism in all three factors. As opposed to our first scenario, here the change factors only originate in the nonfamily manager and must be actively signaled to the owner. *Pro-organizational behavior* captures positive behavioral traits of employees toward their organization, thus describing a positive work ethic aiming at employee cooperation, empowerment and motivation (Davis et al., 1997). At the organizational level, such behavior is achieved by strong role models in a management characterized by an involvement-oriented and collectivistic culture. The nonfamily manager in this scenario embraces such a management style. He strongly identifies with the family firm and its values and does not engage in self-serving activities potentially damaging to the family firm (Madison et al., 2016). Building on this pro-organizational behavior, *relationship building* within the organization is an integral part of the pro-organizational management style. However, relationship building with the owner is a key aspect and has the power to change the governance structure over time (Blumentritt, Keyt, & Astrachan, 2007). In this second scenario, the owner naturally has reservations toward the nonfamily manager, considered an outsider (Madison et al., 2016). Thus, the manager must actively signal his willingness to internalize the family's values and align his personal goals with those of the firm. Only through proactive signaling over an extended period of time can the owner build up trust. Signals include close communication, involvement in decision-making processes, willingness to learn from the owner-founder, a genuine interest in understanding the family's values and vision for the firm, and espousing a transgenerational strategy (Blumentritt et al., 2007).

The last trigger is the *long-term commitment* of the manager, which is contingent on the other two change factors. Nonetheless, the resulting behavioral traits and their effects on the owner-manager relationship are discussed separately here. To signal *long-term commitment*, a nonfamily manager must internalize both the family firm's and the family's goals. Only when he fully refrains from self-serving behaviors, commonly observed in nonfamily managers (James et al., 2017), can the relationship shift toward a GES over time.

However, any event that would disable managers from implementing pro-organizational behaviors and undermine trust and long-term commitment would make RES continuously characterize the relationship between managers and owners.

<u>*Change phase*</u>: Whether a movement toward a GES and thus a change toward stewardship-oriented governance is possible depends primarily on the capability and openness of the owner to develop trust in the nonfamily manager. We expect the owner to have natural reservations toward

the nonfamily manager (James et al., 2017). To counteract these reservations, the nonfamily manager must engage in active signaling over an extended period of time. Problematic in this setting is the existing agency governance structure installed upon the entry of the nonfamily manager, counteracting the steward-like behavior of the nonfamily manager (Madison et al., 2016). Control mechanisms and strictly contractually agreed-upon processes are likely to reduce motivation among stewards and create resentment (James et al., 2017). If the nonfamily manager is able to preserve his steward-like behavior traits and make the owner aware of his *pro-organizational behavior* and *long-term commitment*, the owner might allow relationship building in order to instill family values in the nonfamily manager. During this process, the RES will rather automatically shift to GES characteristics, in turn creating a tension with existing governance mechanisms. The control mechanisms are now perceived as dispensable and external goal alignment efforts, such as large bonus payments, become obsolete. Hence, we see a change in the governance structure over time from an agency-oriented to a stewardship-oriented governance structure. Conversely, when managers do not exhibit pro-organizational behavior and long-term commitment and are unable to build a trusting relationship over time, the type of relationship would still resemble an RES and the owners would further install an agency-oriented governance structure, increasing control and monitoring mechanisms to ensure that managers do not exploit their powerful position.

From these situations, we advance the following propositions to capture our arguments.

> *3a) Pro-organizational behavior, relationship building, and long-term commitment determine a shift from a restricted exchange system toward a generalized exchange system characterizing the owner–nonfamily manager relationship.*

3b) Lack of pro-organizational behavior, relationship building, and long-term commitment strengthens a restricted exchange system characterizing the owner–nonfamily manager relationship.

4a) The altered owner–nonfamily manager relationship triggers the change from agency-oriented to stewardship-oriented governance in the family firm.

4b) The strengthened owner–nonfamily manager relationship triggers the reinforcement of agency-oriented governance in the family firm.

3.3 A conceptual model for governance structure changes in family firms

Based on the literature review on agency and stewardship theory in family firms and the analysis of the two scenarios presented above, we identified change factors that alter the owner-manager relationship as well as the corresponding governance structure. The two scenarios distinguish between the relationship between the owner-founder with either a family (stewardship governance in the setup phase) or a nonfamily manager (agency governance in the setup phase). Relying on and adapting the 4C model by Miller and Le Breton-Miller (2005), we argue that these opposing governance structures stem from the different exchange systems – RES versus GES – the relationships are based on. This initial governance structure is determined in Phase 1 of our model (Figure 1). In the consecutive Phase 2, we argue that several change factors trigger behaviors in the actors that alter their relationship over time.

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Insert Figure 1

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As a result of their changed relationship, the governance structure will be adapted accordingly in Phase 3. The theoretical model condenses the propositions from each scenario and contextualizes them in a holistic view of governance mechanisms in owner-manager relationships in family firms.

4. Discussion

Our paper aims to close the gap in the literature relating to the changes in governance structures and managers' behavior in family firms. The literature has focused thus far on explaining which theory, stewardship or agency, is more likely to explain manager behaviors and determine the most beneficial governance approach for the firm (James et al., 2017). This is rooted in the evolution of the application of both agency and stewardship theory to family business, in an attempt to develop a theory of the family firm. However, in both cases, scholars have neglected to take into account how the owner-manager relationship changes over time. In particular, in the context of family firms with management tenures of up to 35 years, it is crucial to acknowledge the effects of time on relationships (Le Breton-Miller & Miller, 2006; Lumpkin & Brigham, 2011). The traditional assumption that nonfamily managers need an agency-oriented governance structure to align their interests and protect the family firm from their self-serving interests is long outdated (James et al., 2017). Family managers represent a source of nontraditional agency problems (Schulze et al., 2001), while nonfamily managers may behave pro-organizationally despite being external to the family (Davis et al., 2010). Challenging the static view of governance structures (Lubatkin et al., 2007) enables one not only to introduce temporal considerations into the debate on family firm governance (Sharma et al., 2014) but also to develop a model of change that reconciles the discussion surrounding which governance structure is more beneficial.

4.1 Theoretical contributions

The model presented in this article, first of all, lays the groundwork for researching changes in governance structures in family firms. To study the owner-manager relationship through SET, we leverage the characteristics of the two opposing exchange systems, namely, restricted and generalized (Daspit et al., 2016). We create a setting in which the evolution of the owner-manager relationship can be examined over time (Lumpkin & Brigham, 2011). The findings of this analysis comprise change factors that trigger either a shift from an agency to a stewardship-oriented governance and vice versa, or a reinforcement of the existing governance structure (e.g., Madison et al., 2016). Thus, our theoretical model offers novel insights into evolving managerial behavior and governance structure, which in turn provide a basis for designing empirical research in this field. In sum, we launch a debate about why and how governance structures change over time in family firms.

Second, we enhance recent efforts to determine the most suitable governance mechanisms for family firms by theorizing that it depends not only on the origin of the manager (family or nonfamily) but on the underlying relationship between owner and manager. Our article calls for redirecting research efforts toward an analysis of the relationships among the actors involved and their effect on governance structures (James et al., 2017). For this purpose, we rely on the 4C model (Miller & Le Breton-Miller, 2005) and suggest, in particular, that the command, connections and continuity dimensions influence changes in the exchange systems characterizing owner-manager relationships, which in turn affect the change in or reinforcement of the governance in place in the organization. This explains how the family business can shape the community dimension, considering to what extent the family nurtures, via a specific governance structure, a cohesive and caring culture comprising committed and motivated individuals (Miller & Le Breton-Miller, 2005).

Third, we introduce the time component into the debate on governance structures. Time plays a particularly relevant role in family firms, given their transgenerational intentions (Chua et al., 1999). Thus, research must think across generations to consider the potential impact of time in all its facets (Lumpkin & Brigham, 2011; Sharma et al., 2014). Moreover, acknowledging that governance structures are subject to change contributes to the debate on bifurcation bias (Verbeke & Kano, 2012), as family and nonfamily members may perceive a different treatment at first, although this perception might change over time, given that it depends on “whose shoes you are in or think you are in” (Carsrud, 2006, p. 859). Hence, we claim that family affiliation might only be a minor indicator of the governance structure in family firms, whereas the relationship is the actual key to deterring it.

4.2 Practical contributions

Despite its conceptual nature, our research also offers implications for practice. Family firm principals must be alert to the need to adapt their businesses’ governance structure to cope with the actual relationships in place. In the case of deviant family managers, they must not be blindsided by their family affiliation, but adapt the governance structure to meet the needs of the family firm. Nontraditional agency problems can be a larger threat than traditional agency problems, as the former often go unnoticed for an extended time period. In the case of a nonfamily manager, family shareholders should be open to refraining from strict control mechanisms when the nonfamily manager is signaling a strong affiliation to family goals and pro-organizational behaviors. Shifting toward a stewardship-oriented governance structure is beneficial to all stakeholders and especially to the family firm.

However, managers might also behave in the same way over time, thus strengthening the type of exchange system characterizing the owner-manager relationship. Family shareholders must be ready to further motivate family managers who truly behave as stewards of the business and to increase the control and monitoring systems entailed by an agency-oriented governance structure.

4.3 Future research opportunities

Our conceptual research offers several future directions, especially related to governance structures as subject to change over time. Research may leverage the triggers of change identified in this paper to test our theoretical model within an empirical setting. Moreover, we have limited our analysis to three factors in each scenario. Although we have thoroughly chosen them from proven concepts in the literature, we believe that future research should extend our proposed list and examine the influence of additional factors such as multigenerational involvement, prior experiences of owner and manager, or mixed management teams, to name only a few. Furthermore, our scenarios both result from the first management succession (owner-founder as principal), which has offered a simplified setting in which to develop the proposed model and advance our propositions. Nonetheless, we excluded aspects that could further enrich the debate and potentially alter our results. In particular, the role of later generations (Sharma et al., 2003), involvement of several family members (Schulze et al., 2003a), ownership structure and experiences of previous succession processes play a crucial role in determining the most suitable governance structure in a family firm (Cater & Kidwell, 2014).

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[i] In order to improve readability, only the male form is used in this document. Nevertheless, we refer to both genders equally.

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Figure 1: A conceptual model for the change in exchange systems (RES/GES) and governance structures (agency- or stewardship-oriented) in family firms.

Action phase – command, connections, continuity

		Workplace deviance, asymmetric altruism, patriarchy	*Pro-organizational behavior, relationship building, long-term commitment*
Set-up phase	*Family manager as steward*	• Shift from GES to RES • Change to agency-oriented governance structure	• Strengthen GES • Reinforcement of stewardship-oriented governance structure
	Non-family manager as agent	• Strengthen RES • Reinforcement of agency-oriented governance structure	• Shift from RES to GES • Change to stewardship-oriented governance structure