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Nonfamily CEOs Are Most Vulnerable in the Middle Stage of Their Tenure

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Family businesses tend to give all CEOs time to prove themselves, but are tougher on outsiders who don't deliver results after a few years.

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Academic research has long shown that family firms treat CEOs who are family members (i.e., family CEOs) more favorably, holding them less accountable for firm performance than CEOs who are not family members (i.e., nonfamily CEOs). However, we've also seen that family owners sometimes treat nonfamily CEOs like family members, keeping them in the position even when firm performance drops.

We wanted to find out when family owners would hold nonfamily CEOs more accountable for firm performance than family CEOs and when they would not. This is an important question to explore because it will help us better understand when family businesses use firm performance to evaluate a CEO's competence and make CEO replacement decisions.

We expected that families would give both family and nonfamily CEOs time to prove themselves before they used firm performance to evaluate their competence and decide whether someone else should be at the helm. Because it often takes some time for CEOs to develop and put their strategies into action, CEOs are less likely to impact firm performance when they are new in office. We therefore thought that family owners would be less likely to rely on firm performance for evaluations early in the CEO's tenure, but would expect more results after the CEO has served for a few years.

Once they've earned the family's trust by delivering strong performance for several years, we hypothesized that the family would go easier on the CEO during evaluations, and would be less likely to consider his or her impact on firm performance as time went on. Because family owners give all CEOs a grace period at the beginning of their career and are more forgiving to proven CEOs even if company hits a rough patch, this would make the middle period of the CEO's career the most critical. Our research showed that this period is when nonfamily CEOs are most vulnerable.

What We Studied

We collected data from a sample of 326 family-controlled firms in Taiwan between 1999 and 2015. Because these firms were publicly traded companies, they tended to be quite large and successful. We measured firm performance, using industry-adjusted returns on assets (ROA), and examined its impact on the turnover of family versus nonfamily CEOs during different stages of CEO tenure through logistic regression analysis. Based on prior research and our preliminary analysis, we considered the first three years of CEO tenure as the early stage, years 4 to 9 as the mid-stage, and year 10 and beyond as the late stage.

What We Found

Consistent with our expectations, we found industry-adjusted ROA had more of a negative impact on CEO turnover during the mid-stage of CEO tenure (years 4 to 9), than during the early and late stages. This finding suggests that family owners rely more on firm performance to evaluate CEOs and make CEO replacement decisions during the mid-stage of CEO tenure. We also saw that family firms were more likely to replace nonfamily CEOs than family CEOs in years 4 to 9 if their ROA is not satisfactory, but not during the early and late stages. This finding suggests that family owners do hold nonfamily CEOs more accountable for firm performance than family CEOs, but only during the mid-stage of their tenure. These findings contribute to our understanding of how family owners treat family versus nonfamily CEOs during different points in time.

Takeaways

Our research can help family business owners and CEOs better manage their relationships and expectations at different stages of CEO tenure. Here are some things to consider.

Set Expectations. Business owners may want to communicate to CEOs clearly that they will not rely on firm performance to make CEO replacement decisions during the early stage of CEO tenure, thus enabling new CEOs to focus on developing and implementing long-term strategies without worrying too much about short-term firm performance.

Read the Tea Leaves. CEOs, especially nonfamily CEOs, can also be more proactive in gauging family business owners' expectations so that they are more able to meet the expectations and develop a long-lasting and mutually beneficial relationship with them.

Accountability is Most Critical in Years 4-9 . Family business owners and advisors should recognize that CEO accountability and replacement decisions should be tailored to tenure stage, rather than applying uniform expectations throughout a CEO's tenure. In the early stage, greater patience and support may be beneficial as the CEO adapts, while in the mid-stage, performance should be closely monitored to ensure continued alignment with business goals. In the late stage (10 years and beyond), succession planning and leadership transition may take priority over short-term performance considerations.

Give New CEOs Time. Family businesses should consider the stages of CEO tenure when evaluating his or her competence and impact on the business. This is especially important when the family is hiring a nonfamily member as the CEO. Our results suggest that many large and successful family businesses are doing this.

Tie Evaluations and Transition Strategies to CEO Tenure. Family owners do not consistently hold nonfamily CEOs more accountable; this only happens during the mid-stage of tenure. This suggests that nonfamily CEOs may face increased scrutiny not immediately upon hiring but rather once they are expected to deliver sustained results. Understanding these tenure-driven shifts in accountability can help family businesses develop more effective CEO evaluation and leadership transition strategies.

Recognize Biases in CEO Accountability. Family businesses may unconsciously favor family CEOs over nonfamily CEOs when performance declines. To ensure fairness and objectivity, they should establish clear, tenure-sensitive performance evaluation frameworks that apply to both family and nonfamily CEOs.

Strengthen Mid-stage CEO Oversight. Since accountability is highest in the mid-stage, businesses should use this period to reinforce governance structures, set clear performance benchmarks, and proactively address any leadership concerns.

Explore The Research

Do Family Owners Hold Nonfamily CEOs More Accountable Than Family CEOs for Firm Performance? (https://journals.sagepub.com/doi/10.1177/08944865241273370) A Dynamic Perspective, Family Business Review, August 2024.

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