

Family Ownership Can Undermine Financial Health

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However, those who invested more in R&D and operated in countries with strong and supportive institutions enjoyed better market capitalizations.

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Family-run companies have unique challenges—balancing family interests with the goals of investors and the company itself. Yet there is not enough clarity on how this affects performance in different countries.

We wanted to fill that gap. Our work set out to understand how family involvement in a company affects its financial performance, especially through research and development (R&D), which may be more or less effective depending on the institutional support and regulatory environment in different regions of the world.

We expected that family involvement in a business might reduce financial performance because of the potential conflicts and control-enhancing mechanisms that can harm minority shareholders. At the same time, we recognized that the quality of a country's institutions—such as legal enforcement and regulatory frameworks—could mitigate these negative effects, helping to explain why empirical findings on family involvement and firm performance are often mixed. We

also expected that R&D could be a key factor, meaning that in places with good institutions, family businesses might perform better by investing in innovation. We also expected that having a family CEOs would have a bigger negative impact on performance, no matter where the company is based, because family CEOs, often appointed based on kinship, implement poor management and incentive practices that cannot be fully mitigated even by strong institutional environments.

Theory and Hypotheses

Families often prioritize socioemotional wealth (SEW) over maximizing profits; they pursue nonfinancial goals and cling to traditional ways of doing business, which can limit organizational resources and reduce risk-taking. Family managers may engage in nepotism, appointing relatives regardless of competence, and use control-enhancing mechanisms or extract private benefits, further harming firm value. Poor management and incentive practices, intergenerational conflicts, and underinvestment in R&D also contribute to lower financial performance. In undertaking our study we predicted that family ownership and management negatively affect firm financial performance, but that two factors could mitigate this affect: R&D intensity and the quality of institutions in the firm's home country.

What We Studied

We analyzed public data on 3,322 publicly traded companies in 32 countries over nine years. Our goal was to see how three things relate to financial performance: how involved families are in the company, how much the company spends on research and development (R&D), and how strong the country's institutions are.

We treated family involvement in ownership as the share of the company controlled by family members, and family involvement in management as whether a family member is the CEO. We measured R&D intensity by how much money the company invests in research and development.

To capture “institutional quality,” we looked at things like government effectiveness, the rule of law, and the fairness and reliability of the regulatory system—in short, how strong and predictable the business environment is in each country. For performance, we focused on market value (market capitalization—the total value of the company’s shares). We also used Tobin’s Q, which compares what the market says a company is worth to what it would cost to replace its assets. When the market value is higher than the replacement cost, Tobin’s Q is higher, which generally makes the company more attractive to investors.

What We Found

Our results showed that when families own a larger share of the company, financial performance tends to be weaker. Strong institutions—like effective governments and reliable legal systems—lessen this negative effect, but don’t eliminate it.

In countries with strong institutions, the hit to market value from family ownership is smaller—about an 8.5% drop in Tobin’s Q—compared with about a 10.9% drop in countries with weak institutions. In other words, better laws and enforcement soften the downside of family ownership, but don’t make it go away.

Having a family member as CEO hurts performance regardless of the country’s institutions. On average, a family CEO is linked to about a 9.8% lower Tobin’s Q.

Spending more on R&D helps family firms. When family businesses underinvest in R&D, their performance suffers, especially in countries with weaker institutions. Put simply, innovation spending can offset some of the negatives tied to family control, and this payoff is even more important where the business environment is less reliable.

Takeaways

Family business owners and managers can learn a few important lessons from our research:

- Family ownership can bring advantages, but it

might also hurt financial performance if the family holds too much control. Family CEOs can often be a disadvantage because they might not bring the best management practices. It might be worth considering external management to help improve company performance. Family firms might consider hiring non-family members for leadership positions (like CEOs) to better manage the company and make better strategic decisions.

- Family businesses should not let family interests stop them from investing in innovation because it could hurt their long-term success. Firms should prioritize R&D investment, even if it’s tough for the family to let go of some control. Companies that innovate tend to perform better in the long run.
- If the company operates in a country with weak institutions, family businesses need to be especially careful. They need to manage risk carefully by professionalizing management, strengthening internal governance, and being cautious with R&D investments. Forming partnerships with firms from stronger institutional contexts can also help reduce uncertainty and improve financial outcomes, while preserving socioemotional wealth.

What might surprise family business owners is how negative family involvement in management (especially having a family member as CEO) is for the company’s financial performance. Even in countries with good institutions, having a family CEO can still hurt the business. However, hiring the right non-family leaders, a commitment to R&D, and developing the right safeguards in countries with poor institutions can at least partly offset this challenge.

Explore the Research

Family Involvement and Firm Performance: A Worldwide Study Unveiling Key Mechanisms
(<https://journals.sagepub.com/doi/10.1177/08944865241290856>)

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