

BENEVOLENCE BASED TRUST AND AGENCY RELATIONS
AMONG UPPER ECHELONS OF FAMILY-OWNED FIRMS*

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Abstract

We investigate how the family status of owners, CEO, and top management team (TMT) determine CEO's perceptions regarding the benevolence of his/her TMT and how in turn these perceptions of benevolence-based trust influence the nature of TMT control and incentive mechanisms. Using a sample of 122 Spanish firms, we find that CEOs' assessment of TMT benevolence in family firms is more positive when (a) the CEO is a family member and the family is in a stronger ownership position; (b) there is greater similarity in family status between CEO and top managers and (c) environmental turbulence is low. We also find that if the CEO believes TMT benevolence is high, the TMT agency contract tends to be more nurturing in nature and TMT variable pay mix tends to be lower. Our results also suggest that pay-performance sensitivity is greater among non-family executives.

Keywords

Family firms, Benevolence, Top Management Team, Corporate Governance

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INTRODUCTION

Mainstream management journals have just started to examine family businesses, their unique characteristics, and specific problems, despite being the predominant organizational form around the world¹. With some notable exceptions (e.g., Shulze et al., 2001, 2003a, 2003b), the prevailing view considers that being family-owned and managed gives family businesses highly desirable governance structures. This is because mutual beliefs in the good intentions and concern of the managers (what Mayer, Davis & Schoorman, 1995 refer to as the benevolence dimension of trustworthiness) tempers self-interest and fosters loyalty and commitment inside family businesses (Chrisman, Chua & Litz, 2004; Taguri & Davis, 1996; Gersick, Davis, Hampton & Lansberg, 1997; Davis, 1983; Habberson & Astrachan, 1997)².

Notwithstanding the widely held view that high benevolence permeates managerial relations in family firms, there is little empirical evidence of its presence, how it changes as professional managers and investors are brought into the family business, and its possible influence on agency contracts with top managers. This study contributes to both the corporate governance and family business literature by demonstrating that the perceptions of the CEO about his/her TMT benevolence is a function of CEO family ties embedded in a complex context that includes CEO-TMT family status congruency, family ownership concentration, and environmental uncertainty. We also show that two key features of corporate governance (namely control system for TMT members and pay mix) depend on the CEO's perceptions of TMT benevolence; furthermore, when family ties are present, TMT members are made to bear lower financial risks, as evidenced by a decoupling of variable pay from performance. Thus, this article represents a first attempt to conceptually and empirically integrate research on trust, family business relations, and agency contract design for top executives. It is also one of the first studies that examines the relationship between family and non-family executives from a corporate governance perspective, an important issue for family firms transitioning into a more mature stage. To test our hypotheses, we use a sample of 122 family businesses in Spain, a country where these organizations play a pivotal role in the economy³.

THEORETICAL FRAMEWORK AND HYPOTHESES

Most studies on trust set the trustor-trustee dyad as the unit of analysis (Whitener, Brodt, Korsgaard & Werner, 1998; Becerra & Gupta, 2003). The trustor is the one who holds certain expectations about another party's trustworthiness (i.e., the trustee) and, as a result, decides to which extent he/she is willing to become vulnerable to the actions of the trustee (Mayer et al.

¹ Although the estimates vary depending on the definition of family firm, family owned business account for 40 to 80 % of the US gross national product (Gersick, Davis, Hampton & Lansberg, 1997; Neubaur & Lank 1998) with some estimates being as high as 95% (Daily & Dollinger 1992). About 33% of Fortune 500 firms are largely controlled by family interests (Gomez-Mejia, Larzarr-Kinta & Marki, 2003) and around the world families directly or indirectly influence most economic activities (La Porta, Lopez de Silanes & Shleifer, 1999). Surprisingly, a content analysis of recent issues of *Academy of Management Review* and *Academy of Management Journal* by Dyer (2003) reveals that less than one percent of the articles published mentioned the family, concluding that it is "the missing variable in organizational research" (p. 402).

² According to Galve and Salas (2004), mutual trust within family firms makes them more efficient by reducing transaction costs. However, family firms are not necessarily more profitable because family ownership goes together with a strong preference for family control of the assets of the firm and hence this limits the firm's ability to grow.

³ In Spain, according to the Economics Ministry, more than 2.5 million firms representing 92% of the total number of Spanish firms are family owned; they contribute more than 65% of the GDP and employ over 80% of the working force (Amat, 2000).

1995; Rousseau, Sitkin & Burt , 1998). Either the trustor, the trustee, or both can be individuals, groups, organizations, or societies (McAllister, 1995; Gulati, 1995; Zaheer, McEvily & Perrone, 1996; Fukuyama, 1995). In our paper, we are going to focus within each family firm on a superior-subordinate dyad that comprises an individual trustor (the CEO) and a collective trustee; that is, the executives that form the top management team (TMT) of the organization. These upper echelons represent the main subject of interest in the corporate governance literature (Hambrick & Mason, 1984). We restrict our attention to benevolence since it serves as a bridge to tie the family business, agency, and trust literatures. Further, it is generally seen as a key factor that distinguishes family from non-family firms (Fiegener, Brown, Prince & File, 1994; James, 1999, Harvey 1999).

From an agency perspective, the principal uses all available (incomplete) information about the agent in order to curb self-serving behaviors that may be damaging to the principal's interests (Jensen & Meckling, 1976; Eisenhardt, 1989). Information about agent's positive or negative intentions is what the trust literature refers to as the benevolence dimension of trustworthiness (Mayer et al., 1995). As the agent's benevolence towards the principal increases actual or potential opportunism should decrease accordingly. Hence, subjective perceptions about agent's benevolence should eventually determine the nature of the control system developed by the principal to reduce moral hazard. Other things equal, a stronger belief in agent benevolence reduces the need for expensive monitoring mechanisms designed to prevent opportunistic behaviors. Extrapolating these arguments to the special case of family businesses, we will analyze how the CEO's perceptions of TMT benevolence arise and its impact on the CEO-TMT relationship, taking into account the possible effects of family ties.

Determinants of CEO's Perceptions of Top Managers' Benevolence in Family Businesses

CEO Family Status and Family Ownership Concentration. CEOs who are kin of those who own the firm should be less vulnerable to TMT opportunistic actions⁴ than professional CEOs, who could be more easily disciplined and even dismissed by family owners. At the same time, the power position of the family that enables it to shield one of their own (CEO, in this case) from harm should increase as its ownership position increases. In the management literature, there is abundant empirical evidence that CEO's vulnerability depends on who controls the organization in terms of the majority of voting rights (Gomez-Mejia, Tosi & Hinkin, 1987; Werner & Tosi, 1995; Finkelstein & Hambrick, 1995). In the specific case of family firms, there is also substantial evidence that CEO entrenchment is greater (and hence, vulnerability is lower) when

⁴ Almost all corporate governance research examining opportunistic managerial behavior focuses on the CEO as agent with shareholders (and/or their representatives, the board of directors) as principals (see reviews by Tosi et al., 1999). However, there is a large organizational literature spanning a diverse domain that deals with multitude ways that top executives may act opportunistically and hence undermine the CEO's welfare. These include, among others, pursuing the subunit's interest at the expense of the organization (what Cyert & March, 1963, referred to as "local rationality"); hoarding resources such as budgets and personnel to enhance the executive's prestige (Tosi, 1975); manipulation of accounting data (Herchinger & Sidel, 2005); formation of coalitions to impede the successful implementation of CEO's agenda (Pfeffer & Salancik, 1977); leaking damaging information about the CEO (Colvin, 2003); creation of a power base that provides the executive with greater leverage to bargain with CEO for resources and general support (Salancik & Pfeffer, 1974); "impression formation" behaviors to withhold negative information and create a favorable image to superiors (Ferris & Judge, 1991); and negotiating easier to reach performance targets (which the CEO may not be able to discern because of information asymmetries) in order to facilitate the achievement of evaluation criteria (Prendergast, 1999).

the incumbent is a family member (Gomez-Mejia et al., 2001) and as family ownership concentration increases (Gomez-Mejia et al., 2003).

It seems reasonable to expect that the higher the concentration of ownership inside the family, the greater the family's ability to impose its interests and goals, and, thus, the higher the empowerment of the family CEO. In this case, the family CEO will enjoy higher employment security, power, and discretion (Gomez-Mejia et al., 2003) and this protective shield (i.e., lower vulnerability) should positively affect his/her mind set about the TMT and its possible intentions. Thus, a family CEO in a business with substantial family ownership may be more buffered from the negative consequences of potential TMT trust violations and hence can better "afford" the downside risk associated with making positive benevolence attributes to TMT. In fact, the trust literature recognizes that the greater an individual's autonomy within the organization (which should be higher when the family is more capable of empowering the CEO), the less exposed and vulnerable this person will be to the actions of others and, therefore, the greater the perceived benevolence from other people within the organization (Deci & Ryan, 1987; Becerra & Gupta, 2003).

Thus, we can formulate the following hypothesis:

Hypothesis 1: When the incumbent is a family member, CEO perceptions of the benevolence of top managers towards him/her will be greater the larger the concentration of ownership in family hands.

CEO-TMT Family Status Congruency. Family similarity in the CEO-TMT relationship should also affect the CEO's perspective with regard to the benevolence of top managers. Several literatures point in this direction. Research on trust suggest that similarity between individuals enhances the perceptions of benevolence (McAllister, 1995; Mayer et al., 1995; Chattopadhyay, 1999). Organizational demography research has shown that many organizational outcomes could be predicted on the basis of the difference or the similarity in some particular characteristic between members of a dyad or within a group (Tsui & O'Reilly, 1989; Wagner, Pfeffer & O'Reilly, 1984; O'Reilly, Caldwell & Barnett, 1989; Zenger & Lawrence, 1989; Belliveau, O'Reilly & Wade, 1996). Several authors maintain that individuals develop a positive social identity thorough self-categorization (Tajfel & Turner, 1986). Through this process, "*individuals classify themselves and others into social categories on the basis of demographic characteristics to derive social identities. Individuals perceive themselves and similar others as forming an in-group and see dissimilar others as forming an out-group*" (Chattopadhyay, 1999: 273). These internal classifications influence beliefs and attitudes (McAllister, 1995), which make individuals more likely to perceive out-group members as dishonest and untrustworthy than in-group members (Brewer, 1979).

The literature on family business documents differences between family and professional managers that are likely to engender in-group and out-group distinctions that may aggravate negative benevolence perceptions of the other group's members. For instance, a survey by Daily and Dollinger (1993) found that family managers diverge from non-family managers in terms of goals and expectations. Gomez-Mejia et al. (2003) note that family managers face higher exit

barriers and greater organizational commitment than non-family managers since their human capital is firm-specific and involve higher personal risk as a result of business failure (what Gomez-Mejia et al. 2003, refers to as “the family handcuff”). Haynes et al. (2004) argue that, in comparison to professional managers, the risk faced by family managers is not only financial, but also socioemotional. Litz (1995) and Casson (1999) add that apart from the fact that family managers “have grown together”, the idea of the family business as something to pass through generations gives family managers a longer decision horizon compared with non-family ones. Other common “in group” characteristics for family and non-family managers that sets them apart (such as tenure, formal business training, and decision making style) are discussed by Chua et al. (2003).

In short, the extent to which the CEO believes that members of the TMT might cause harm to him/her will depend on their family status congruency, so that greater similarity in terms of CEO-TMT family status should mitigate CEO’s vulnerability and improve expectations about top managers’ benevolence. Thus, we can formulate the following hypothesis:

Hypothesis 2a: CEO’s perceptions of the benevolence of top managers towards him/her will be greater the larger the similarity in family status between the CEO and top managers.

It seems logical to expect that the effect hypothesized above should not be symmetrical, with CEO-TMT family status dissimilarity having a stronger negative influence on TMT perceived benevolence in the case of the more vulnerable non-family CEOs. Non-family CEOs are not only at an informational disadvantage as familiness of the TMT increases, but they face another hurdle that augments their vulnerability: they have formal authority over the TMT, yet TMT family members have a kin relationship with (and in most cases unrestricted access to) those in charge of appraising, rewarding, and contracting or dismissing the CEO (i.e., family owners). In the extreme, this may create a situation for the non-family CEO of having formal authority without power over TMT family members. This means that the non-family CEO is more likely to suspect that the family may act to discipline him or her in case of disappointing outcomes, even for reasonable decisions turned sour as a result of actions by those under his/her supervision. And “the non-family CEO knows that [when things go wrong] it would be difficult for him to pass blame on family executives” (Gomez-Mejia et al., 2001: 92). Hence, potential family TMT trust violations (for instance, leaking negative information about the CEO) may have dire consequences for non-family CEOs and this greater vulnerability is likely to attenuate his/her TMT perceived benevolence. Formally stated:

Hypothesis 2b: The inverse relationship between CEO -TMT family status incongruity and TMT perceived benevolence will be greater in the case of non - family CEOs.

Environmental Risk. The previous hypotheses deal with the internal context in which the CEO manages the family business, and its influence on TMT perceived benevolence. We have described how CEO family status, ownership concentration, and CEO-TMT family congruence molds the CEO’s perceptions of benevolence of top managers inside family businesses. Now, we

will explain how these hypothesized effects may be moderated by forces outside the firm, namely the degree of environmental uncertainty that the CEO faces.⁵

Environmental risk that reflects industry-wide forces exposes the firm to performance uncertainty over which it may exert very little control (Bloom & Milkovich, 1997; Gray & Canella, 1997). Typically defined as greater variability in organizational returns, uncertainty over firm outcomes may lead to corporate bankruptcy (Gray & Canella, 1997; Miller & Bromiley, 1990) and, in the case of family firms, to the family's ruin. This negative outcome is more threatening in family businesses for which only limited opportunities of diversification may exist (Galve-Gorriz & Salas-Fumas, 1996, 2004; Gómez-Mejía et al., 2003). From the CEOs perspective, high external risk may involve the prospect of losing both wealth and employment (if they are family) and dismissal (if they are non-family).

The higher the external uncertainty, the more difficult it becomes for the CEO to monitor managerial behavior, because the information about agents becomes less reliable and more costly to obtain (Demsetz & Lehn, 1985). At the same time, high turbulence means that "poor or good outcomes are largely independent of the agent's efforts and this may mean that agents react by withholding information or by taking evasive actions designed to reduce their risk exposure... making it less likely that he or she would engage in strategies congruent with principal's preferences" (Miller et al., 2002: 745-746). In other words, high turbulence augments the possibility that agents might not act in the principal's interest and makes it more difficult for principals to discern agent's intentions (i.e., information asymmetry increases).

Extending the above argument to our particular case, environmental uncertainty increases CEO's risk bearing and aggravates agency problems with TMT directors, placing the CEO in a more vulnerable position within the organization. In these circumstances, the CEO (as principal) is less likely to uncritically believe in the positive intentions of the TMT (as agents). Thus, external risk is likely to affect the psychological state of the trustor in forming his or her expectations of the trustee's benevolence. This would be buttressed by the fact, as documented in the stress literature, that external threats increase anxiety levels which makes individuals more apprehensive and suspicious of the motives of those around them, particularly when they are dependent on them (Hyman, 2002; Beehr et al., 2000; McGrath, 1976). Formally stated:

Hypothesis 3a: CEO perceptions of the benevolence of top managers towards him/her will be lower the higher the degree of environmental uncertainty.

Following our basic argument, potential threats to the CEO (as principal) from the TMT (as agents) under high environmental uncertainty should be accentuated when the family CEO is in a weaker position (that is, when family ownership concentration is low) and also as family status dissimilarity increases between CEO and TMT. The simultaneous presence of those conditions with environmental uncertainty makes the CEO more vulnerable and hence more cautious when judging TMT benevolence. Conversely, high family ownership in the case of family CEOs and CEO-TMT family status congruency become more valuable shields in protecting CEOs from

⁵ For the sake of simplicity, we treat the terms environmental risk, environmental instability, environmental uncertainty, and environmental turbulence as synonymous to refer to variability in organizational returns attributed to industry forces.

potential harm as environmental turbulence increases. Thus, given these conditions the CEO can afford to accept greater vulnerability from the actions of his/her TMT. The following two hypotheses concern the moderating effect of family ownership concentration and family status congruency on the relationship between environmental uncertainty and CEO's TMT perceived benevolence.

Hypothesis 3b: The hypothesized positive effect of family ownership on the family CEO's perceptions of top managers' benevolence should be greater under high environmental uncertainty.

Hypothesis 3c: The hypothesized positive effect of similarity in family status between the CEO and top managers on the CEO's perceptions of top managers' benevolence should be greater under high environmental uncertainty.

Consequences of CEO's Perceptions of Top Managers' Benevolence in Family Businesses

The first three set of hypotheses dealt with the antecedents of TMT perceived benevolence in family firms. Our last set of hypotheses focus on the "so what" question, that is, the effect of TMT perceived benevolence on certain key features of corporate governance.

Nature of control system. Managers are likely to develop a special sensitivity to the personal needs and objectives of their peers and subordinates that they consider to be trustworthy, and arguably they desire to respond to such needs and goals in a tangible way (McAllister, 1995; Whitener et al., 1998). Regardless of their family relationship, we expect that when the CEO perceives that top managers have benevolent intentions towards him or her, the CEO will feel compelled to reciprocate and design a relational contract with a higher concern for the welfare of TMT members. Such a relational contract may relieve pressure and stress from the TMT member by considering the executive's wishes, reducing employment risk, minimizing tax burdens, allowing for qualitative judgments in the appraisal process so that the executive may not necessarily be held responsible for poor performance outcomes (for instance, these may be blamed on fortuitous events beyond the individual's control) and the like (Tosi & Gomez-Mejia, 1989).

Benevolent perceptions, driven to a large extent by positive affect, may thus influence the principal-agent contract by including relational obligations that involve a variety of socio-emotional nurturing concerns that are frequently ignored in the traditional agency literature (Portales, Ricart & Rosanas, 1998; Mustakallio, Autio & Zhara, 2002). When TMT perceived benevolence is high, the CEO is likely to see him or herself as part of a joint collegial endeavor with other TMT members, all of whom collaboratively share a common mission and objectives. The CEO may be more confident of the "good faith" execution of delegated tasks and that TMT members will use their talent and initiative to support the success of the CEO and his/her goals.

In this high benevolence context, strict controls are likely to be considered unnecessary regardless of family status since agent's opportunism is believed to be low. The CEO may want to relate to TMT members in a way that they feel valued, well treated, protected, and with a high

consideration to personal needs and desires. We refer to this type of agency contract as high caring. In this line, Rousseau et al. (1998) claimed that there is an apparent incompatibility between strict controls [i.e., low caring contract in our terminology] and positive expectations about the intentions of another party [i.e., high perceived TMT benevolence]. In other words, there is tension between fostering a principal-agent relationship predicated on perceived benevolence and reducing the risk of opportunism through a low caring contract that could potentially preempt benevolence initiation. Thus, we expect that when the CEO believes in the high benevolence of top managers, their contracts will be designed taking into account the managers' general welfare.

On the other hand, when TMT perceived benevolence is low, TMT members are no longer seen by the CEO as colleagues or peers committed to a common cause, but as subordinates with more dubious intentions. Hence, the control system may be designed to mitigate opportunistic behaviors, which the CEO is likely to see as more probable. These low caring agency contracts would emphasize institutional controls, which Davis, Schoorman and Donaldson (1997) characterized by a high degree of formality, use of specific metrics to which executives are held accountable for, existence of elaborate monitoring policies with limited tolerance for individual preferences, and a distinct focus on organizational needs rather than the welfare of agents.

In short, the CEO is likely to reciprocate TMT perceived benevolence by showing respect and concern for TMT's welfare. This exchange should occur independent of family relations (although family relations do affect perceived TMT benevolence, which is an antecedent of this exchange, as per Hypothesis 2). Formally stated:

Hypothesis 4: CEO's perceptions of high benevolence of the top managers will be positively associated with the use of more nurturing elements in the design of TMT agency contracts (i.e., a high caring contract).

Compensation mix. The use of caring controls that aim at nurturing the relations with top managers is likely to be associated with a smaller percentage of variable pay for many reasons that we will review now. First, because variable pay could potentially transfer firm level uncertainty to the managers (Betty & Zajac, 1994), a CEO with the intention to nurture and to care for his or her team may want to isolate them from compensation "at risk". Second, given the lower likelihood of opportunism (at least from the CEO's perspective in this situation), there is less need to establish clear performance criteria to distribute incentives (Eisenhart, 1985; Zajac & Whestpal, 1995; Rousseau & McLeanParks, 1993). Third, a heavy emphasis on variable pay is not compatible with the use of high caring controls that attempt to subjectively consider the intangibility of results and the many factors that influence observed performance outside of agent's sphere of influence. Lastly, as noted by Whitener et al. (1998: 520), "if managers want to create relationships built on the voluntary discharge of reciprocal obligations [i.e., high caring controls in our terminology], this should lead to exchanges that have little or unclear economic benefits...such benefits are rarely specified apriori" [i.e., opposite would be the case if remuneration is largely based on incentives]. Thus:

Hypothesis 5: The greater use of caring controls, the lower the proportion of variable compensation for the top management team.

Buffering effect of family ties on compensation risk bearing. The previous discussion addressed how the CEO's perceptions of unlikely opportunistic behavior of his or her team (i.e., high TMT benevolence as perceived by CEO) may lead to the development of a caring relational contract (Hypothesis 4) and how this in turn is going to affect the proportion of TMT variable compensation, independently of family relationship (Hypothesis 5). However, as argued below, family status may play a role on the criteria used to allocate variable pay (Hypothesis 6), which is a distinct issue from the composition of the pay package (the subject of Hypothesis 5 above).

The literature on family business suggests that altruistic motives are manifested irrespectively of whether or not the employee is perceived as trustworthy. For example, parents tend to be generous with their heirs even though this increased generosity may cause the children to free-ride (Buchanan, 1975). This has consequences for family firms: Driven by family altruism, family members usually enjoy more support, privileges, and perquisites than non-family members (Gersick et al 1997; Ward, 1987). For instance, Gomez-Mejia et al. (2001) report that the probability of a family CEO being dismissed as a result of poor performance is far lower than that of a non-family CEO. Further, these authors found that families often target non-family executives who are second in command to the family CEO as scapegoats for the company's problems (even though the family CEO was the one who led the company into trouble).

The exposure of executives to risk depends on the criteria used to award variable pay. Risk becomes greater as incentives are more closely linked to firm performance (Tosi & Gomez-Mejia, 1989; Carpenter & Sanders, 2002; Yermak, 1995). While the proportion of variable pay may not differ as a function of TMT family status, it may be more performance sensitive for non-family TMT members. There are several reasons for this expectation, as argued below.

First, as reported by Gomez-Mejia et al. (2003: 230), "executives with family ties to owners receive lower total pay than professional managers and thus their relative pay disadvantage increases as the firm's family ownership position improves [which depresses the pay of the family CEO]." Gomez-Mejia et al. advance several explanations as to why professional managers demand more compensation than family executives to work for a family firm, including lower discretion, higher employment risk, absence of a "family handcuff", and greater labor market opportunities. Second, family executives realize that while the family firm needs to pay a premium to attract professional managers, they enjoy greater income security, which is not only attained by a lower probability of termination but also by decoupling variable pay from performance. If the variable pay-performance sensitivity were to be the same regardless of family status, this would lower the exchange value of income security derived from family ties as a trade off for lower pay. Third, as noted by Tosi and Gomez-Mejia (1989), while pay mix is plain for everyone to see, the actual risk bearing associated with what is purportedly variable compensation is much harder (and in some cases almost impossible) to discern. This fact allows firms to legitimize greater executive compensation by layering inelastic firm performance-incentives on top of fixed salary. In the case of family firms, we will expect that there is pressure to make incentives look fair by equalizing the proportion of variable pay between family versus non-family executives (which is visible and relatively unambiguous) but reduce the risk bearing

to income stream attributed to that pay among family executives (i.e., decreasing its elasticity to firm performance). Lastly, we can invoke the classical agency argument in support of greater variable pay-performance sensitivity for non-family executives in that for these agents information asymmetries are higher. This asymmetry is reinforced by the fact that family firms are reluctant to hire professional managers unless these have the specialized skills and knowledge that home-grown executives do not possess.

In summary, all of the above arguments suggest that a caring contract resulting from high TMT perceived benevolence benefits all managers in terms of higher assured compensation (i.e., lower variable pay). However, those with family ties to owners receive an additional buffer from risk emanating from lower elasticity in variable pay-performance relations. This leads to our last hypothesis:

Hypothesis 6: Variable compensation will be more closely based on financial performance in firms where the CEO and most of the top managers are not members of the controlling family.

METHODS

Sample Selection and Data Collection

To test our hypotheses, we used a combination of archival data and survey measures drawn from a sample of 122 family firms in Spain. We followed a painstaking process to identify those firms and secure the cooperation of their CEO on a sensitive topic like trust. This process involved several steps, which are described below.

In Step 1, we pretested the initial draft of survey to ensure the questions were readily understood, that items translated from English into Spanish (for instance, benevolence items) were meaningful to respondents, that the format was appropriate, and that the survey could be completed within the allotted time. To this end, we secured the services of a well-known and highly reputable Spanish firm (Sigma 2) that specializes in conducting survey based research. After incorporating their suggestions, we conducted face to face interviews with three CEOs in order to clear up any remaining problems and fine tune the final questionnaire prior to general use in our sample.

In Step 2, we obtained access to data from the annual reports filed by 8,095 Spanish firms with more than 50 employees that are part of Sistemas de Analisis de Balances Ibericos (SABI) data base. This data base is similar to COMPUSTAT in the United States, including financial information, age, industry sector, and board information for each company. Unlike COMPUSTAT, however, firms submitting information need not be publicly traded. This is an important advantage since it provides access to a broader cross-section of firms and, in particular, family firms.

In Step 3, we manually inspected the reports filed by these firms in order to identify those that provided sufficient and reliable information to be unambiguously considered as family owned. While there is no consensus in the literature as to what constitutes a precise ownership cut-off

point to define a firm as family owned, we adopted the minimum threshold of 20% stock ownership by a single family recommended by La Porta et al. (1999: 476-480) since theirs is probably one of the most rigorous, detailed, and comprehensive study on ownership structures around the world. Our final sample consisted of 1,070 firms. The remaining 7,025 firms (out of the original set of 8,095) were excluded for a variety of reasons: failure to meet the 20% family ownership threshold noted above, missing ownership information, being part of a conglomerate owned by a group of shareholders, and extinction (those that had ceased to exist between the latest SABI reporting period in 2001 and when our survey was conducted in late 2002).

The fourth and last step consisted of an attempt to contact by phone the CEO of each of the 1,070 firms identified in Step 3 to explain the purpose of the study and set up an appointment for a phone interview. We were successful at personally contacting and interviewing 122 or 11% of these CEOs. While ideally we would have liked to have a greater CEO participation rate, we considered 11% a success considering several factors. First, unlike paper and pencil surveys that can be completed at a convenient time or with the help of staff, CEOs had to make a formal appointment and devote approximately half hour out of their hectic schedule to answer questions from the interviewer. Second, in contrast to mailed in surveys, CEOs could not remain anonymous and this requires additional commitment on their part to participate. In spite of our absolute promise that we would never divulge the interviewee's name, the CEO still had to take our word for it in order to collaborate in this project. Third, the survey dealt with highly confidential and sensitive information which, if misused, could damage the CEO's internal relations. Hence, CEOs may be understandably reluctant to participate. Lastly, despite the handicaps noted above, our 11% CEO participation rate is comparable to "the 10.12 percent rate typical for studies which target executives in upper echelons" (Geletkanycz, 1997: 622; Hambrick, Geletkanycz, & Frederickson, 1993; Judge & Dobbins, 1995; Koch & McGrath, 1996; MacDougall & Robinson, 1990). More to the point, our participation rate is similar to those obtained in prior paper and pencil surveys completed by top executives of Spanish family firms (Gallo & Villaseca, 1996; Gallo & Cappyuns, 1997) and slightly higher than the 10.3 response rate obtained in the Arthur Andersen Center for Family Business's survey which forms the basis of several recent publications on family firms appearing in respected academic journals (see Schulze et al., 2001, 2003a,b).

While we were satisfied with an 11% participation rate given the considerations noted above, we conducted several analyses to check on non-response bias. Fortunately we found no evidence to suggest this was a problem. A t-test comparison of known firm characteristics between respondents and non-respondents indicated no significant differences in geographical location, age, size, and performance (measured as return on assets in 2001). Furthermore, descriptive statistics for our sample (see Table 1) are in line with prior studies among family firms conducted in Spain (Gallo & Villaseca, 1996; Gallo & Cappyuns, 1998).

On average, our sample of firms had been operating for more than 30 years. Of the 122 CEOs that agreed to participate in our study, 23% (n=28) were non-family CEOs and 77% (n=94) were family ones. The top management team, however, often had a high proportion of non-family managers. Indeed, the mean proportion of family directors in the TMT (excluding the CEO) is 0.49 and in 29% of the cases (n=35) the TMT is made up only of non-family members. Tenure of both CEO and TMT is around 14 years. Average tenure for those teams composed exclusively of

family members is higher than the average tenure of teams with only non-family managers (17.37 vs. 14.38 years), which is similar to figures among Spanish newspapers provided by Gomez-Mejia et al. (2001). One last interesting observation about our sample is that the pay structure of the top management team is in line with a prior study of executive compensation of Spanish family firms derived from a large consultant's data base (Ortin-Angel & Salas-Fumas, 1998). Seventy-six (76%) percent of the firms in our sample provide variable pay to their executives vis-à-vis 72% in that study. These comparative figures add confidence to the representativeness of our sample.

Objective Indicators

As noted earlier, we used a combination of secondary and primary data sources. The latter was used when psychological assessment was required (for instance, perception of benevolence) and when the archival data was incomplete or unavailable for a particular variable of interest (for instance, pay mix of top management team). In this section, we describe objective indicators used to measure demographic, firm, and environmental characteristics of interest. The benevolence scale, which is perceptual in nature, is described later.

Family Status of Chief Executive Officer and Members of Top Management Team.

The SABI data base provides the name of the CEO but, unlike Compustat in the USA, it does not consistently include the names of the top executives. To identify these individuals, we asked each CEO to list by name the top six executives of his/her TMT.

We considered that a family relationship exists when the last names coincide (between CEO and firm owners, between CEO and TMT members, and amongst TMT members). To double check on family status, interview questions asked the CEO to indicate whether he/she is a member of the owning family.⁶ The CEO was also asked to report any familial relationship he/she may have with members of the TMT and amongst the TMT members. Originally we thought of asking the specific nature of family ties (for instance, husband/wife, brother/sister, cousin) but we decided not to do it because this data is not available in the archival sources and for the survey it would greatly increase its complexity. In the pretest we did of the interview protocol, we were also told that this type of information would be too intrusive (see Step 1 under sample selection and data collection).

Difference in Family Status. To measure the dissimilarity in family status between CEO and members of the TMT, we created a relational index following Wagner et al. (1984) and Tsui & O'Reilly (1989). This variable was computed by squaring the difference between the CEO family status and the TMT family status. CEO family status is a dummy variable that takes the value of one when the CEO is a family member and zero when she or he is not. TMT family status is a continuous variable that measures the percentage of family members in the TMT. The squared term is used to derive an absolute difference score. Hence, zero distance in the family variable means that the CEO and all members of the TMT have the same family status (i.e., all of

⁶ In 91% of the cases, there was agreement between CEO's self-reported family ties to firm owners (from survey) and the congruence of last names between CEO and firm owners (as obtained from SABI).

them are family or are non family). Likewise a value of one indicates “maximum dissimilarity” (that is, the CEO is part of the family and all TMT members are not or viceversa, the CEO is non-family and the entire TMT is composed of family members). Thus, each firm would fall somewhere in between these two extremes (0 for maximum homogeneity and 1 for maximum dissimilarity in family status of the CEO and the TMT).

Environmental Risk. Following previous studies, the standard deviation of Return on Assets or ROA (obtained from SABI) within each industry sector during the 1996-2001 period was used as a measure of environmental stability (Haleblian & Filkenstein, 1993). The industry sector that a particular firm belongs to was identified by a three digit code which is similar to the corresponding SIC code in the United States. We could not use stock market return data to calculate systematic and unsystematic risk (see Miller et al., 2002) as most of these firms were not publicly traded.

Firm Performance. This was measured as the firm’s Return on Assets (ROA) and it was obtained from the SABI data base for the previous year (2001). This is probably the most widely used indicator of firm performance according to a metaanalysis of the executive compensation literature conducted by Tosi & Gomez-Mejia (2000). (See also Carpenter & Sanders, 2002.)

Family Ownership. This was measured as the percentage of firm’s equity that is owned by the family group.

TMT Variable Compensation. Pay data is a closely guarded secret in Spain and firms are not required to disclose it even for upper echelons. Thus, we asked directly CEOs to indicate the percentage of total pay that TMT members receive on average in the form of bonuses and long-term income. This ratio has been extensively used in the compensation literature as a proxy for “pay at risk,” and calculated both from archival (e.g., Carpenter & Sanders, 2002; Bloom & Milkovich, 1998) as well as self-reported sources (e.g., Tosi & Gomez-Mejia, 1994; McConaughy, 2000). The CEO should have accurate information on TMT pay since TMT members report directly to him/her.

The last three objective measures described below (namely, firm size, CEO tenure and TMT tenure) were used as control variables in the analysis.

Firm Size. This was measured as the average value of firm sales for the period 1996-2001 and it was obtained from the SABI data base. It was expressed as a logarithm term to reduce heteroscedasticity.

CEO Tenure. It was measured as the number of years that the CEO has been working with the firm.

TMT Tenure. It was measured as the average number of years that TMT members had been working with the firm.

TMT Caring Control System. In order to measure to what extent TMT’s contracts were designed with a high concern for executives’ welfare, we used four items included in a monitoring scale developed by Tosi and Gomez-Mejia (1989) in the United States which capture

the degree to which the agency contract is designed to protect the executive from potential harm⁷. Factor analysis indicated that the four items, completed by the CEO, load into one single factor of “Caring Control.” The Caring Control Scale reached an acceptable level of internal consistency ($\alpha = .70$). Hence, we created a composite by averaging the four items that are part of the scale.

Perceived Benevolence

To measure CEO’s perceived benevolence of the TMT, we used a composite scale developed by Mayer and Davis (1999). Because the four items that composed this scale were originally part of a larger set of items measuring different dimensions of trustworthiness (i.e., benevolence, ability, and integrity), we decided to include Mayer and Davis’ complete instrument in the survey. The CEO was asked to rate TMT members on each item using a 5 point Likert scale ranking from Strongly disagree to Strongly agree. Since the CEO was asked to make assessments about TMT as a group and not about each of its individual members, we were forced to slightly modify the wording of some of the original items.⁸

The original trust scales developed by Mayer and Davis (1999) were empirically validated in the United States. To ensure that benevolence (the core interest of this study) represented a distinct construct that could be distinguished from other trust dimensions (namely, ability and integrity) in a different language and cultural context (Spain), the benevolence items were subject to standard item analysis techniques as described below.

First, a principal component factor analysis with varimax rotation shows the existence of three different factors with eigenvalues greater than one. These three factors correspond to the trust dimensions proposed by Mayer and Davis (1999). The benevolence scale, which taps our theoretical variable of interest, reached a high Cronbach alpha of .87. The cross-loadings were very small and none of them exceeded .30. The correlation between benevolence with the other two composite scales reached .28 (for integrity) and .26 (for competence).

Second, we used EQS to conduct a confirmatory factor analysis of all Mayer et al.’s items. A correlated three-factor model, each of them representing one of the dimensions proposed by Mayer and Davis (1999) (i.e., benevolence, ability and integrity) fitted the data well (non significant chi-square of 52.41). Given that our sample size is lower than 250, the comparative fit index (CFI) is the most appropriate goodness of fit measure (Bentler, 1990). We obtained a CFI is 0.98 indicating excellent fit between the proposed model and the data. The results for the one factor model (Chi squared = 285.10 $p \leq 0.000$, CFI = 0.56) represent an extremely poor fit of the data and a substantial decrement from the overall fit of the 3-factor model. Hence, we were very confident that the benevolence scale is distinct from the other two dimensions, internally

⁷ The items asked respondents to rate on a 1 “completely disagree” to 5 “completely agree” scale the extent to which the evaluation and reward of executives are designed with the following objectives in mind, all of which tend to protect the executive from potential harm: “Reducing employment risk, “Considering wishes of executives”; “Minimizing taxes;” and “Use of qualitative performance measures”.

⁸ The four items composing the benevolence scale are: “These managers really look out for what is important to me,” “These managers are very concerned about my welfare”, “My needs and desires are important for these managers”, and “These managers will go out of their way to help me.”

consistent, and robust in spite of translation to a different language and its application within a different cultural context.

ANALYSIS AND RESULTS

All hypotheses were tested using hierarchical regression analysis. As customary, control variables were entered first, followed by main effects. Multiplicative terms were added later to examine the hypothesized interactions.

Descriptive statistics and correlations appear in Table 1. As can be seen in that table, benevolence is significantly correlated with the use of caring controls (positive), family ownership (positive), and firm size (negative). Caring control, in turn, is correlated with firm size (negative), TMT variable compensation (negative), and CEO family status (positive). TMT and CEO tenure are both positively related with family status. In general, these bivariate correlations are consistent with our expectations. No problem with multicollinearity seems to exist.

Insert Table 1 here

Table 2 reports the regression results of CEO perceptions of TMT benevolence as the dependent variable. Model 1 includes only the control variables. In smaller firms with a long-tenured CEO and large family ownership, the CEO tends to have a more positive perception about the benevolence of his/her TMT, probably driven by this cozier environment. Turning to the test of Hypotheses 1, Model 3 provides clear support for it. As predicted, when the CEO is a family member and family ownership increases, the perceptions of the CEO about the benevolence of the TMT is greater ($p \leq .01$).

Insert Table 2 here

To further examine the interaction in Hypothesis 1, we plotted the data in a 2x2 matrix for: 1) complete family ownership of the firm versus partial family ownership, and 2) family versus non-family CEO. Figure 1 shows those results. As expected, family ownership positively affects perceived TMT benevolence when the firm has a family CEO. However, the presence of non family investors appears to decrease family CEO's perceived TMT benevolence. Thus, only if the CEO is a family member, greater family ownership is associated with greater TMT benevolence, measured from the perspective of the CEO⁹.

Insert Figure 1 here

As shown in Model 3 of Table 2, greater difference in family status of the CEO versus the TMT reduces the perceptions of TMT benevolence, as Hypothesis 2a claimed ($p \leq .05$). To test the

⁹ As an additional exploration of the first hypothesis, we conducted separate regression analyses for firms with family and non-family CEOs at the helm and tested the significance of the difference between the two subsamples via a Chow test (Chow, 1970). The family ownership effect was positive for the family CEO subsample and negative for the non family one ($\beta = 0.32, p \leq .001$ vs. $= -0.38, p \leq .10$). The Chow test reached 11.61 ($p \leq .001$) providing further support for the hypothesized interaction effect.

asymmetrical effect on perceived benevolence of the difference in family status between CEO and TMT as argued in Hypothesis 2b, we did the following sub-sample analysis, shown in Figure 2. First, we divided the sample based on the family status of the CEO (family versus non family member), and then the firms were separated in two groups based on the proportion of family members in the TMT (the split point is the median). The results were very clear. In the “CEO family/high TMT family proportion” combination, the benevolence scale reached a mean of 4.05, whereas in the “CEO non-family/high TMT family proportion” combination, it was only 2.56. For the other two possible combinations with a low TMT family proportion, the family status of the CEO does not seem to affect the level of benevolence. These differences were statistically significant at $P \leq .01$. In other words, while dissimilarities in CEO-TMT family status leads to lower TMT perceived benevolence as predicted in Hypothesis 2a, its effect is not symmetrical: the presence of family managers seems to exert a more negative influence on non family CEO perceptions about his/her TMT benevolence than non-family managers exert on a family CEO¹⁰. Consistent with Hypothesis 2b, these results suggest that the family CEO, being more protected, is less threatened by the presence of non-family members in the top management of the firm; in contrast, a non-family CEO may have more reasons to doubt the ulterior motives and interests of the top managers when they are part of the owner family.

Insert Figure 2 here

The results for Hypothesis 3a, which predicts an inverse relationship between environmental turbulence and TMT perceived benevolence, may be found in Model 2 of Table 2. This hypothesis is supported ($P \leq .01$). The results for Hypotheses 3b and 3c may be found in Model 4 of Table 2. The three way interaction amongst CEO family status, family ownership, and external risk was not significant. Greater environmental uncertainty does not seem to moderate the positive effect of family ownership on the perceptions of a family CEO about TMT benevolence, failing to support Hypothesis 3b. The interaction effect that crossed the difference in family status of the CEO and the TMT with the external risk measure was also insignificant, failing to support Hypothesis 3c. Thus, external threats that are largely beyond the CEO’s influence seem to exert the same negative impact on the CEO’s perceptions about TMT benevolence regardless of family status considerations; their impact is fully captured by the main effect.

While the analysis so far has focused on the determinants of TMT perceived benevolence, Tables 3 and 4 deal with its consequences, as argued in Hypotheses 4-6. Now, TMT perceived benevolence becomes an independent variable. As can be seen in Table 3, perceived TMT benevolence is positively associated with the use of a caring control approach, explaining six percent additional variance in the dependent variable ($p \leq .01$). The effect of benevolence is significant even after including the control variables from the earlier analysis. This provides clear support for Hypothesis 4; that is, when the CEO perceives high TMT benevolence, the family firm sets a relational contract that is more protective of the TMT managers.

Insert Table 3 here

¹⁰ Subsample regressions (available upon request) indicates that the presence of family managers has a significant negative effect in TMT perceived benevolence for non family CEOs, but that the effect is insignificant when the family CEO is at the helm ($\beta = -0.39$ $p \leq 0.05$ vs. $\beta = .07$ n.s, Chow test = 5.75 $p \leq 0.05$).

Hypothesis 5, which posits a negative relationship between the use of caring controls and variable pay, also finds support in Table 4, Model 1. Independently of the agent's family status, less overall variable compensation is provided in family businesses that utilize a caring control system for its top executives. But this is only part of the story, as argued in Hypothesis 6, which receives support in Model 2 of Table 4: when the CEO and TMT are non-family members financial performance (ROA) is a stronger determinant of the amount of variable compensation that TMT managers receive.

This differential effect in variable pay-performance sensitivity by family status was investigated further. The sample was divided into two groups: family managed business (those where both CEO and most of the TMT are family members) and professionally managed businesses (those with a non-family CEO and a majority of TMT non-family members). A partial correlation coefficient between ROA and TMT variable compensation (controlling for size and other firm characteristics) was computed in both subsamples. In the family managed subsample, the correlation was an insignificant $-.04$, whereas in the professionally managed subsample, the correlation was a highly significant (p value $\leq .001$) $.85$. Thus, there is strong evidence that financial performance is used to determine the variable compensation of the TMT only when both CEO and TMT are not family members; conversely, factors other than financial performance are used to allocate variable compensation when family ties loom large at the top executive ranks.

Insert Table 4 here

DISCUSSION AND CONCLUSIONS

These results offer the first empirical evidence of benevolence based trust within family firms and, more specifically, its effects on the control and incentive mechanisms of its top managers. Probably to a greater extent that it is usually presumed, family firms are complex organizations that comprise a wide array of relationships among family and non-family actors. Our study shows that family firms are not necessarily the "high trust" organizations often depicted in the literature, and that they are capable of manifesting varying degrees of benevolence based trust depending on power and kin relations among their top managers and other contextual factors associated with risk exposure. Thus, more research efforts must be devoted to the study of family firms' heterogeneity as organizations (Chrisman et al., 2004).

Our results suggest a U shape relationship between family status homogeneity and TMT perceived benevolence. The latter is higher when CEO-TMT share family ties, lower as the firm mixes family and non-family executives, and eventually turns high again as upper echelons become staffed by non-family members. The caring features of TMT agency contract seems to change accordingly, that is, high, low, and high caring depending on the corresponding level of TMT benevolence. Thus, the combination of family and non-family managers seems to be a critical challenge for family businesses in their possible road towards fully professionalized firms as this leads to a period of more negative expectations of benevolence. One intriguing question raised by these cross-sectional findings is what happens to the effectiveness of control systems in family firms as these become more caring in nature in later stages (i.e., when upper echelons become more homogeneous in their non-family status). Does this lead to greater opportunism as

a result of laxed controls or improved leadership at the top as a result of better working relationships and enhanced managerial commitment?

Two findings attest to the importance of vulnerability as a precursor of a CEO's willingness to believe in the benevolence of subordinates. First, when the CEO is well protected, that is, when she or he is a family member with large firm ownership, the CEO usually has more positive expectations regarding the TMT's benevolence. Second, riskier environmental contexts (which makes the CEO more vulnerable) reduce CEO's perceptions of TMT's perceived benevolence. Both of these results support the argument that the evaluations of benevolence based trustworthiness are not independent of the risk exposure of the person making the evaluations, contrary to what Mayer, Davis, and Schoorman (1995) suggested. In other words, risk exposure affects the evaluations of the CEO regarding the trustworthiness (i.e., benevolence) of his/her TMT.

The above has interesting implications for the critical relationship between benevolence based trust and risk, acknowledged by researchers on trust, but still far from clear, which deserves further discussion. Mayer, Davis, and Schoorman (1995) argued that the level of trust (defined as the willingness to accept vulnerability, which result from the evaluations of another party's trustworthiness) is compared to the level of perceived risk in a situation. They claim that if "the level of trust surpasses the threshold of perceived risk", the trustor will engage in the actual risk taking behavior in relation to the trustee (Mayer et al., 1995: 726). Though this is certainly logical, it may be an excessively rational description of human behavior, because the evaluations of risk and trustworthiness do not seem to be actually done separately. In our study, CEOs that have a more secure position (i.e., members of a family having large ownership of the business or competing in a business with overall smaller uncertainty) provide higher evaluations of the benevolence dimension of trustworthiness of their TMTs. Thus, the context in which the assessment of trustworthiness is done, particularly as it relates to risk exposure, has important effects on the perceptions of benevolence. These results are, therefore, closer to the view of Rousseau et al. (1998) that risk is a necessary condition for trust whose variation can alter the level of trust itself, than to that of Mayer, Davis, and Schoorman (1995) who seem to posit a fully independent evaluations of risk and trustworthiness. The study shows empirically how context (in our case the position of the CEO within the family business and external business risk) is critical to understanding trust and how it is formed, as Rousseau et al. (1998) argued.

Contrary to our hypothesized family mediation effects (Hypotheses 3b and 3c) there seems to be forces under various CEO-TMT family combinations that produce a similar inverse relationship between external threats and CEO's perceptions of TMT benevolence. There are several plausible causal reasons for this finding (all of which produce greater CEO vulnerability and hence lower TMT perceived benevolence). In the case of family CEO-non-family TMT, environmental turbulence may increase information asymmetries and hence CEO's vulnerability. In the case of non-family CEO-family TMT, the CEO may fear becoming a scapegoat for the firm's potential misfortune and TMT family members may be seen as instrumental in this process (for instance, they have direct access to family owners and thus may act as informants against the CEO). The case of family CEO-family TMT is more intriguing and defies an easy explanation. It may be that external threats increase stress for both family CEO and TMT family members, who are not only risk averse but also have few employment opportunities in an open

labor market (Gomez-Mejia et al., 2003). This stress in turn may lead to mutual suspicion, blaming each other for imaginary or actual incompetence, “getting on each other’s nerves” and the like. Hence, positive effects of CEO–TMT family ties on TMT perceived benevolence may be negated by insecurities associated with environmental turbulence. Alternatively, family CEOs may feel that they have little option but to keep TMT relatives on board even though rapidly changing environmental conditions call for more outsiders, and this may generate tensions between both parties leading to lower perceived benevolence. This interpretation finds indirect support in Olson et al. (2003) who report that controlling for firm performance “owner managers’ perceptions of their success went up with every non-family member hired but went down with each family member employed.” Perhaps this perceived burden by CEO of carrying too many family members in TMT is exacerbated when the firm is subject to greater external threats. In the end, however, these are somewhat speculative post hoc explanations for unexpected results that deserve additional research in the future. What is clear from our results is that regardless of family status CEOs respond to external threats by adjusting downward their TMT’s perceived benevolence.

The second set of results address the consequences of perceived benevolence on the contractual relationship with the TMT. Our theoretical view expands traditional agency theory arguments, which have been criticized for ignoring good social relationships that might exist among actors involved in running a business (Ghoshal & Moran, 1986; Hendry, 2002). Our results confirm that when the CEO as principal believes in the good intentions of the members of the TMT, he/she will be more concerned with the agents’ welfare, rather than controlling their behavior to reduce the threat of opportunism. Thus, we have obtained empirical evidence of the substitution effect of principal-agent benevolence based trust in lieu of control mechanisms made by a growing number of agency scholars who believe that “trust’s role in constraining opportunistic behavior allows parties to adopt less elaborate safeguards...and in turn, altering the choice of governance structure” (Chiles & McMackin, 1996).

The analysis also provides new light to previous studies that claim that relational contracts reduce risk sharing considerations between the principal and agent, and relax the need for clear performance criteria. The governance literature offers two competing explanations for the decoupling of executive pay and performance as CEO tenure increases: One, the *learning argument*, states that as the principal’s familiarity with the agent increases monitoring and the linking of pay to desired outcomes is not necessary (Murphy, 1986). An alternative explanation based on the concept of *managerial entrenchment* (Walsh & Seward, 1990) claims that over the time, the executive can use his/her position to reduce employment or compensation risk. In our study we show that, after controlling for CEO and TMT tenure, it is the belief in the good intentions of the top managers that reduces the need for costly monitoring and incentive alignment systems.

Our results show that the presence of caring controls (which in turn are a function of high CEO perceptions of TMT benevolence) leads to lower reliance on incentive alignment systems, as evidenced by a negative relationship between caring controls and TMT variable pay mix. Interestingly, this was found to be true regardless of family status considerations. Yet, the firm holds the non-family executives’ feet to the fire by linking their variable pay to firm

performance, while no such relationship exists for the TMT family member. This suggests three comments that we would like to discuss further.

First, at least within family firms, variable pay mix may be a faulty indicator of executive risk bearing since in many cases it is decoupled from performance outcomes (i.e., for family executives in our sample). This is an important issue given the widespread use of variable compensation as synonymous with “pay at risk” (see, for instance, Gray & Canella, 1996; Tosi et al., 2000).

Second, family firms attempt to create a perception of equitable treatment between family and non-family executives by designating the same proportion of pay as variable regardless of family status. This dual policy (i.e., same pay mix, but different pay-performance sensitivities) may allow the family firm to convey the illusion to non-family executives that they are not at an unfavorable position vis-à-vis their family counterparts. Hence, family owners probably believe that this enhances cooperation and cohesiveness between family and non-family TMT members.

Lastly, family owners may be torn between creating the illusion of equal treatment and protecting TMT family members. Family firms apparently handle this dilemma by offering similar proportions of purportedly performance based pay for family and non-family executives alike. Yet, the former are less exposed to the risk associated with random fluctuations in observed performance outcomes. This result confirms the Gomez-Mejia et al (2003) finding that altruistic family motives are very important in setting the compensation of family members within the firm, but these motives manifest themselves not in higher pay, but rather in higher risk protection. It also provides an explanation to Schultze’s finding as to why the use of incentives for family members were not related to firm performance, while this relationship was significant for non-family managers (Schulze et al. 2001). These are issues that deserve more attention in the future since they are likely to affect the relationship between family and non-family executives. For instance, it would be interesting to ascertain the degree to which non-family executives view these legitimizing discriminatory practices as a violation of procedural justice. And if so, what impact does this have on cooperation, cohesiveness, and a sense of shared direction within the TMT?

We finish this paper with two concluding comments. First, we recognize that there is probably a reciprocal influence between TMT perceived benevolence and the use of a caring contract. That is, TMT members operating under a high caring contract may express more benevolence than those operating under a low caring contract. We can’t tease out these reciprocal effects with our data. However, our analysis suggest that the effect is stronger in the hypothesized TMT perceived benevolence–contract design direction than the other way around. TMT benevolence does not affect the incentive system directly (it is uncorrelated) but only through contract design: A high caring contract leads to less use of incentives while the opposite is true for a low caring contract. Greater use of incentives has no effect on TMT benevolence. Furthermore, perceived benevolence is being assessed from the point of view of the CEO as trustor and contract designer rather than the TMT as trustee and monitree. Nevertheless, this is an interesting issue to explore in further research by contrasting the views of both parties in the principal-agent relation.

Lastly, for the sake of parsimony, we have focused our theoretical development and empirical tests on the one dimension of trust that is considered the most important among family firms, namely benevolence. It is also a key factor that undergirds agency theory notion of opportunism since agent benevolence is the antithesis of self-serving behaviors to take advantage of principal. We are not negating the importance of other trust dimensions such as ability and integrity (Mayer et al., 1995), which are weakly correlated with benevolence, but these are complex variables that would need to be examined in a study of their own. We have shown that almost all of our hypotheses hold in the case of benevolence whether it is used as a dependent or independent variable. At the same time, we have done some preliminary analyses and found that ability does not relate to any of our predictors or moderators of interest (for instance, family ownership concentration, CEO-TMT family status congruence, and environmental risk). Integrity only reaches weak marginal significance (R square change at $p \leq .10$) when introduced as a dependent variable in lieu of benevolence in the test of Hypothesis 1; it is non-significant when used as a substitute for benevolence in any of the remaining hypotheses. This adds confidence in the obtained results reported in this paper by reducing the possibility of method variance effects on the benevolence measure. It also suggests that a different theoretical lens should be used to analyze trust dimensions other than benevolence in a family business context.

TABLE 1: Descriptive Statistics and Correlations Table

		Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11
1	BENEVOLENCE	3.83	1.10											
2	TMT CARING CONTROL SYSTEM	3.59	0.77	.286**										
3	FIRM SIZE	4.34	0.54	-.231*	-.222*									
4	FAMILY OWNERSHIP	91.60	16.16	.211*	.125	-.199*								
5	ENVIRONMENTAL RISK	1.76	1.67	-.255**	.079	.205*								
6	TMT FAMILY STATUS	0.49	.414	.088	.171	-.409**	.033	-.031						
7	TMT TENURE	13.85	.427	-.101	-.023	.005	.025	-.017	.074					
8	CEO FAMILY STATUS	0.76	.427	.064	.208*	-.158	.132	.059	.399**	.211*				
9	CEO TENURE	14.01	10.79	.143	.151	-.062	.021	.061	.198*	.282**	.296**			
10	DIFFERENCE IN FAMILY STATUS	0.28	0.39	-.155+	-.047	.256**	-.037	.049	-.572**	.051	.253**	-.059		
11	TMT VARIABLE COMPENSATION	18.74	21.59	.094	-.225*	.197*	-.06	-.027	-.123	-.071	-.088	-.078	.017	
12	FIRM PERFORMANCE	0.06	0.08	-.049	.094	.017	-.033	-.068	.025	-.074	.106	.127	.240	.040

N = 122

+ p ≤ 0.10

* p ≤ 0.05

** p ≤ 0.01

FIGURE 1. Interaction of CEO family status and family ownership in predicting perceived benevolence

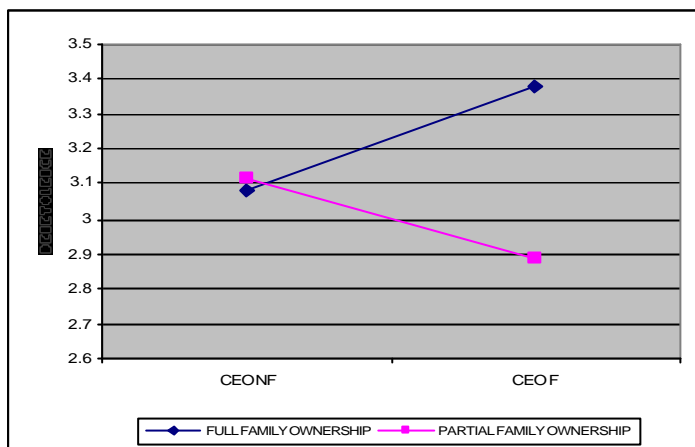


FIGURE 2. Difference in Family Status and Perceived Benevolence

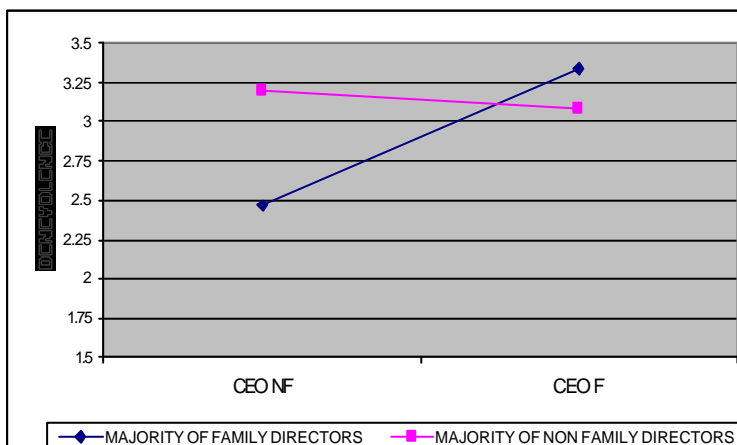


TABLE 2: Regression Analysis of Perceived Benevolence

	DEPENDENT VARIABLE: PERCEIVED BENEVOLENCE			
	MODEL 1	MODEL 2	MODEL 3	MODEL 4
FAMILY OWNERSHIP	.010+ (.005)	.009+ (.005)	-.013 (.009)	-.013 (.009)
FIRM SIZE	-.334* (.170)	-.258 (.170)	-.393* (.169)	-.404* (.173)
TMT FAMILY STATUS	-.043 (.237)	-.034 (.232)	-.707* (.334)	-.688* (.342)
TMT TENURE	-.018 (.012)	-.019+ (.011)	-.019+ (.011)	-.019+ (.011)
CEO FAMILY STATUS	-.005 (.221)	.041 (.217)	-2.368* (.949)	-2.368* (.960)
CEO TENURE	.015+ (.008)	.015+ (.008)	.014+ (.008)	.014+ (.008)
ENVIRONMENTAL RISK		-.118** (.050)	-.116** (.048)	-.090 (.107)
CEO FAMILY STATUS x FAMILY OWNERSHIP			.032** (.010)	.032** (.010)
DIFFERENCE IN FAMILY STATUS			-.743* (.323)	-.755* (.375)
CEO X FAMILY OWNERSHIP X EXTERNAL RISK				.000 (.000)
DIFFERENCE IN FAMILY STATUS x EXTERNAL RISK				.021 (.060)
Change in R2		0.04*	0.09*	0.01
R2 (unadjusted)	0.118	0.159	0.249	0.246
R2 (adjusted)	0.072	0.108	0.184	0.170
F	2.565*	3.085**	4.036***	3.257***

N=122

Unstandardized Beta Coefficients are shown in the table .Standard Errors in Brackets

+ p ≤ 0.10

* p ≤ 0.05

** p ≤ 0.01

TABLE 3 Regression Analysis of Caring Control System

	Dependent Variable: Caring Control System
FAMILY OWNERSHIP	.002 (.003)
FIRM SIZE	-.146 (.096)
ENVIRONMENTAL RISK	.054+ (.029)
TMT TENURE	-.003 (.006)
TMT FAMILY STATUS	.033 (.130)
CEO TENURE	.004 (.005)
CEO FAMILY STATUS	.160 (.122)
BENEVOLENCE	.145** (.052)
Change in R2	.06**
R2 (unadjusted)	.171
R2 (adjusted)	.112
F	2.906**

N=122

Unstandardized Beta Coefficients are shown in the table .Standard Errors in Brackets

+ p ≤ 0.10

* p ≤ 0.05

** p ≤ 0.01

TABLE 4: Regression analysis of TMT variable pay

	Dependent Variable : TMT Variable Pay	
	MODEL 1	MODEL 2
FAMILY OWNERSHIP	.024 (.124)	.022 (.118)
ENVIRONMENTAL RISK	6.933 (3.83)	7.711 (3.68)
FIRM SIZE	.017+ (1.22)	-.581* (1.20)
TMT TENURE	-.137 (.271)	-.134 (.262)
CEO TENURE	-.089 (.194)	-.065 (.188)
TMT NF DUMMY (NON FAMILY)	4.943 (4.42)	9.900 (6.96)
CEO NF DUMMY (NON FAMILY)	-1.064 (4.97)	-6.312 (7.08)
BENEVOLENCE	4.780* (2.28)	3.135 (2.29)
CARING CONTROL SYSTEM	-9.618** (3.97)	-5.506 (4.05)
		6.562 (27.57)
FIRM PERFORMANCE		
TMT NF x FIRM PERFORMANCE		-104.573 (72.47)
CEO NF x FIRM PERFORMANCE		91.872 (96.02)
TMT NF X CEO NF		-19.668 (12.49)
TMT NF x CEO NF x FIRM PERFORMANCE		463.392** (175.649)
Change in R2	.004**	0.11**
R2 (unadjusted)	0.126	0.24
R2 (adjusted)	0.05	0.14
F	1.801+	2.433**

N=122

Unstandardized Beta Coefficients are shown in the table .Standard Errors in Brackets

+ p ≤ 0.10

* p ≤ 0.05

** p ≤ 0.01

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