Spotlight
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How do family SMEs retain top talent without formal HR practices?

Relational capital and shared values substitute for structured HR systems in retaining key employees

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Attracting and retaining talented employees is a universal challenge, but family-owned SMEs face it under distinctive conditions. They operate with fewer formal structures and rely more heavily on personal relationships and shared values than on sophisticated HR systems. The assumption in much of the management literature is that this puts them at a disadvantage. This study finds the opposite: family SMEs not only get by without formal high-performance work practices—they often outperform non-family firms on employee retention.

The research surveyed **232 SMEs in Austria and Hungary**, spanning both family and non-family firms with 10 to 250 employees, primarily in food production and electronics. It examined six categories of high-performance work practices (HPWPs)—selective staffing, intensive training, career development, compensation, performance appraisals, and employee participation—and their influence on the retention of employees identified by management as "valuable."

WHAT WE STUDIED

Retention was measured through both subjective managerial assessments and actual turnover data over a two-year period. The study also analyzed variation within family firms: whether the CEO was a family member, and whether the firm was still in its first generation of ownership. The theoretical framework draws on social exchange theory, which explains how informal reciprocity and relational trust can generate commitment that formal contracts and incentive systems cannot.

KEY INSIGHTS

Family firms use fewer formal practices but retain better

Compared to non-family firms, family SMEs adopt fewer HPWPs across all six categories. Despite this, they report higher retention of key employees. The finding directly challenges the assumption that structured HR tools are necessary for talent retention. Family firms achieve similar or better outcomes through informal systems—personal relationships, a sense of shared purpose, and the cultural cohesion that comes from family involvement in daily operations.

Relational capital substitutes for formal incentives

Social exchange theory provides the explanatory mechanism. In family firms, employees are often treated as extended family. The culture fosters trust, respect, and long-term commitment, creating emotional reasons to stay that formal incentive structures cannot replicate. Non-family employees in particular may feel valued and included in a way that larger, more bureaucratic organizations struggle to achieve. The relational capital built through daily interaction and shared history functions as an informal retention system.

Adding formal HR practices yields diminishing returns in family contexts

HPWPs do correlate with better retention across the full sample. But in family firms specifically, the marginal benefit of adding formal practices is significantly smaller. The study interprets this as a substitution effect: the emotional and relational resources already present in family firms make certain formal practices redundant. Investing heavily in structured HR systems may not yield returns

proportional to the cost—the informal system is already doing the work.

CEO type matters less than family influence

Whether the CEO is a family member or an outside professional does not significantly affect retention outcomes. What matters more is the overall level of family involvement and the cultural imprint of family values on the organization. A non-family CEO operating within a strong family culture can achieve the same retention benefits as a family CEO. The mechanism is cultural, not positional.

First-generation firms hold a slight advantage

First-generation family firms show modestly higher retention, likely reflecting the founder's deep personal investment and the strong cultural coherence that founders typically establish. Later-generation firms still benefit from family-based relational structures, but the intensity of the founder's imprint fades over time. Generational transitions require deliberate effort to maintain the relational advantages that earlier generations built.

TAKEAWAYS

Value informal retention systems explicitly

Family SMEs should recognize that their relational capital—trust, mutual respect, shared history—is a genuine competitive advantage in talent retention. Rather than dismissing informality as a weakness, leaders should identify what makes their culture sticky and protect those elements deliberately.

Professionalize selectively

Some formal HR structure becomes necessary as firms grow, but over-engineering HR systems in a family SME context may not yield proportional returns. Resources are often better invested in strengthening the existing culture and relationships than in importing generic HR frameworks designed for larger, non-family organizations.

Prepare succession to preserve relational strengths

The slight retention advantage of first-generation firms signals that generational transitions need careful management. Successors should understand not just the business strategy but the relational fabric of the organization—and take active steps to maintain it.

IMPACT

This study challenges the blanket recommendation that family firms should professionalize their HR practices. It demonstrates that informal, relationship-based retention systems can match or outperform formal ones in family SME contexts. The contribution is both theoretical—extending social exchange theory into the family business HR domain—and practical, providing evidence that family firm leaders can use when deciding how much formalization their organizations actually need. The key insight is that culture and emotional bonds are not soft extras. They are structural features of family firm governance with measurable effects on talent retention.

RECOMMENDATIONS

1. **Preserve relational strengths during professionalization.** When introducing formal HR tools, ensure they complement rather than displace the informal trust and reciprocity that already drive retention.
2. **Invest in values-based leadership development.** Train next-generation leaders to understand and reinforce the family culture that underpins employee commitment, not just the operational side of the business.
3. **Use formal HR tools selectively.** Adopt specific practices where gaps exist—such as compensation benchmarking or structured onboarding—without imposing a full corporate HR framework.
4. **Communicate the firm's long-term vision to all employees.** Employees who understand where the family wants to take the business—and see themselves as part of that trajectory—are more likely to stay.

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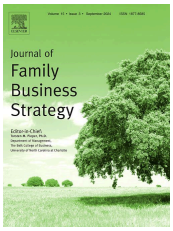
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