

Why do so many family firms hand the top job to a relative?

Hard-to-measure family and sustainability goals can make a less-skilled relative the smarter hire

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Most hiring advice boils down to a single rule: find the most capable person you can and give them the job. Family firms break that rule on purpose, and they do it constantly. Around a quarter of Fortune 500 firms have both a family officer and a family director on their boards, and among large Italian family firms with turnover above €50 million, roughly 69% are run by a family CEO. To many economists this looks like a puzzle. The case against family management is well rehearsed: nepotism, altruism that clouds hard decisions, thinner managerial skills, and a tiny pool of candidates to choose from.

Jenny Kragl, Alberto Palermo, Guoqian Xi and Jörn Block answer that puzzle with an economic model rather than an opinion. Their conclusion is reassuring for business families: appointing the relative can be the rational, value-maximising choice even when, on paper, that person is the weaker manager. The key lies in what family firms are actually trying to achieve – and in how badly we measure half of it.

WHAT WE STUDIED

This is a conceptual paper, not an empirical one. The authors build a multitask principal-agent model in which the principal is the owner family and the agent is the manager they hire, either a family member or an outsider. The manager has to perform two jobs at once. The first is economic – growing sales, protecting margins, raising the value of the firm. The second is non-economic – maintaining family harmony, reputation and tradition, preserving dynastic control, and increasingly pursuing stakeholder and

sustainability goals such as protecting local jobs or limiting environmental harm.

Two features drive everything that follows. The first is measurement. Profit shows up cleanly in the accounts; reputation and harmony do not. So the performance measure the family can actually write into a contract captures the economic task well but the non-economic task only partially – what the authors call a distorted measure.

The second feature is interference between the two tasks. Sometimes they are substitutes: closing an unprofitable plant in the family's home town lifts the financial numbers but damages the firm's standing as a loyal local employer. Sometimes they are complements: setting up a philanthropic foundation lifts the family's reputation and attracts customers and talent at the same time.

The two manager types differ in predictable ways. Outsiders tend to be stronger on the economic task – they are selected from a competitive market where a strong financial track record signals ability. Family managers tend to be stronger on the non-economic goals, because they understand the family's values and can speak for them credibly. Family managers may also personally care about the family's wellbeing, but the headline result deliberately does not depend on that goodwill.

KEY INSIGHTS

Incentive pay quietly pushes managers toward the numbers

Whenever pay is tied to a measure, both types of manager shift effort toward the task that measure

captures best — the economic one. The non-economic goals get under-served as a result. This effort distortion is the central tension of the model, and it bites hardest on non-family managers, who already lean toward the financial side of the job.

A weaker manager can still be the better hire

The model's most striking result is that a family manager can be the optimal choice even when their average ability is lower than an available outsider's. If the family's non-economic goals genuinely matter and the relative is truly strong on them, that strength can outweigh a thinner commercial record — especially when the two tasks reinforce each other.

Measurement is the hinge

The case for a family manager gets stronger the better the firm can measure its non-economic goals. The logic flips at the extreme: when those goals are nearly impossible to measure and the two tasks actively pull against each other, the outsider becomes the better hire after all.

Why family CEOs are often paid less — and sometimes more

When a relative genuinely cares about the firm, they need a smaller bonus to work hard, which fits the long-standing observation that family CEOs are often paid less than outside hires. But the model adds a twist: when the performance measure is poor, it can be optimal to pay the family manager a *higher*-powered bonus, precisely to pull their attention back toward the economic side of the job.

TAKEAWAYS

Pulling the threads together, the model points to a fairly clear checklist. The case for hiring a family manager rises when:

- the firm's non-economic goals — reputation, legacy, sustainability, stakeholder relationships — genuinely matter to the owners;
- the candidate is demonstrably strong on those goals, even if their commercial track record is thinner;
- economic and non-economic goals reinforce rather than trade off against each other;
- the firm can measure progress on non-economic goals with some precision;
- the relative also personally cares about the family's wellbeing — a bonus, not a requirement.

The balance tips toward an outside professional when the non-economic goals are hard to pin down and routinely clash with profit.

IMPACT

One of the quieter contributions here is that it runs the usual sustainability-in-family-firms conversation in reverse. Most work asks how being a family firm shapes the pursuit of sustainability goals. This model shows the influence runs both ways: as hard-to-measure, long-term sustainability goals rise in importance, they change who it makes sense to put in charge — and, over time, the character of the firm itself. A family that prizes such goals has a built-in reason to keep leadership in the family, while a family that lets economic measures dominate may, paradoxically, end up handing the firm to outsiders and becoming less recognisably a family business.

It also offers business families a defence against accusations of nepotism. Rather than insisting the appointment simply feels right, owners can point to a reasoned argument that, given their goals, the choice is value-maximising.

Because the work is theoretical, its predictions are an invitation to test rather than settled fact, and the authors are candid about what they leave out: the timing of succession, conflicts between family and non-family shareholders, attitudes to risk, and the way a committed outsider can learn the family's priorities over time — as with the adopted adult heirs long used in Japanese family firms.

RECOMMENDATIONS

1. Before benchmarking candidates on their commercial record alone, write down the firm's non-economic goals explicitly and decide how much weight they carry.
2. Invest in measuring those goals. Better tracking strengthens — and makes safer — the case for a family leader, and it makes any bonus scheme more effective.
3. Ask whether your economic and non-economic goals reinforce or undermine one another. Complementarity favours a family manager; persistent conflict favours an outsider.
4. Design incentive pay deliberately. Genuine intrinsic commitment may justify a lower bonus, but where non-economic results are hard to measure, a higher-powered bonus can keep economic performance on track.
5. If a capable relative is the choice, document the reasoning. The model provides language to defend the appointment to co-owners, boards and outside stakeholders.

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