Spotlight by CeFEO

Why do some family business leaders embrace risk while others avoid it?

Five theoretical lenses explain how psychology, governance, and values shape strategic risk

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What makes one CEO bet the company on a bold acquisition while another in the same industry hoards cash and avoids any move that might disrupt the status quo? The question of managerial risk-taking has been studied for decades, but no single theory has proven sufficient. Risk decisions are shaped by incentives, psychology, reference points, identity, and personal biography—often simultaneously.

This comprehensive review by Hoskisson, Chirico, Zyung, and Gambeta synthesizes the major theoretical perspectives on managerial risk-taking, drawing from decades of scholarship across eight top management journals. The result is a multi-lens framework that explains not just whether leaders take risks, but why they frame risk the way they do—and what governance and organizational conditions amplify or suppress their willingness to act.

WHAT WE STUDIED

The authors reviewed empirical and conceptual research on how CEOs and top management teams make high-stakes decisions under uncertainty. They organized the literature around five dominant theoretical frameworks: **agency theory**, the **behavioral theory of the firm**, **prospect theory**, the **behavioral agency model and socioemotional wealth**, and **upper echelons theory**. Each offers a distinct mechanism for explaining risk behavior, and the authors show where these perspectives converge, diverge, and can be productively combined.

KEY INSIGHTS

Agency theory: incentives shape risk appetite, but not always as intended

Agency theory starts from the premise that managers are naturally more risk-averse than shareholders because their personal wealth and careers are concentrated in one firm. Compensation tools—stock options, performance bonuses, equity stakes—are designed to align managerial risk-taking with shareholder interests. The evidence largely supports this: equity-based compensation does increase strategic risk-taking. But the relationship is not straightforward. Overly aggressive incentive systems can push executives toward reckless bets, and in family firms where ownership and management overlap, the standard principal-agent dynamics require significant reinterpretation.

Behavioral theory: performance relative to aspirations drives risk behavior

The behavioral theory of the firm introduces a powerful mechanism: managers compare current performance to aspiration levels—historical benchmarks, peer comparisons, or internal targets. When performance falls below aspirations, leaders become more willing to take risks. When performance exceeds expectations, they play it safe. This "problemistic search" framework explains why struggling firms often make bold moves while successful ones become conservative. In family firms, where aspirations may be shaped by generational expectations or socioemotional goals rather than purely financial targets, the dynamics become more complex.

Prospect theory: framing determines whether leaders see risk or opportunity

Prospect theory, rooted in behavioral psychology, shows that decision-makers are loss-averse—they take bigger risks to avoid losses than to achieve equivalent gains. The critical variable is the reference point: how a decision is framed determines whether it feels like a potential loss or a potential gain. In family firms, where decisions are often emotionally charged and reference points include legacy, reputation, and family unity alongside financial performance, framing effects can be especially powerful. A proposal to divest a division may feel like losing part of the family's identity, triggering risk-seeking behavior to avoid the "loss"—even when divestiture is financially rational.

Behavioral agency and SEW: non-financial stakes reshape the risk calculus

The behavioral agency model integrates elements of agency theory and prospect theory but adds a crucial dimension: the non-financial value that owners derive from controlling and identifying with their business. In family firms, this is captured by the concept of socioemotional wealth (SEW)—the emotional endowments of control, identity, social ties, and generational continuity. When SEW is threatened, family leaders may take significant risks to preserve it, even at financial cost. When SEW is secure, they become conservative. This framework explains behaviors that look irrational through a purely financial lens but are entirely logical when emotional stakes are included in the equation.

Upper echelons: the leader's biography shapes strategic choices

Upper echelons theory argues that a leader's background, personality, and experiences shape their strategic behavior in systematic ways. Age, education, career path, tenure, and psychological traits like narcissism or overconfidence all influence risk tolerance. The implication for governance is direct: the person you put in the CEO chair is not a neutral executor of strategy. Their biography is a strategic variable. In family firms navigating succession, this means the choice of leader is also a choice about the firm's risk profile—and that choice deserves explicit attention.

TAKEAWAYS

No single theory is sufficient

Risk-taking in organizations is overdetermined—multiple mechanisms operate simultaneously. Leaders who rely on a single mental model (incentives alone, or psychology alone, or governance alone) will miss critical drivers. The most effective approach combines insights across frameworks, recognizing that financial incentives, aspirational benchmarks, emotional framing, identity stakes, and personal biography all contribute to how strategic decisions are made.

Design incentives that match your ownership context

Standard compensation packages designed for publicly traded firms may not translate well to family-controlled businesses. Incentive structures should reflect the firm's actual goals—including socioemotional ones—rather than importing templates from contexts where ownership and management are fully separated.

Treat leadership selection as a risk management decision

The leader's background and psychological profile are not soft variables. They have direct, measurable effects on strategic risk-taking. Succession planning should explicitly assess how candidates' risk orientations fit the firm's strategic needs at its current stage.

IMPACT

This review makes a strong case for cross-theoretical thinking in the study of managerial risk-taking. By placing five frameworks side by side, the authors reveal both the strengths and the blind spots of each—and show where integration across perspectives can produce richer explanations. The contribution is especially relevant for family firm scholars and practitioners, where the interplay of financial incentives, emotional stakes, generational dynamics, and personal biography creates a risk landscape that no single theory can fully capture.

RECOMMENDATIONS

1. **Develop explicit risk conversations.** Encourage open dialogue across generations about what "acceptable risk" means in the firm's specific context, including both financial and socioemotional dimensions.
2. **Align incentives with the full set of goals.** Reward behaviors that serve long-term family and business objectives, not just short-term financial performance.
3. **Use leadership profiling in succession.** Assess how candidates' psychological traits and career experiences shape their risk preferences before making leadership decisions.
4. **Balance internal knowledge with external perspective.** Governance structures that combine family insight with independent board input are better equipped to make balanced risk decisions.

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