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# Family Social Capital Versus Nepotism in Family Businesses

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**Abstract**

In the scientific literature on family business management, nepotism – standing for owners' preference for hiring family members rather than unrelated job applicants – is considered to be problematic and a potential threat for the development of family firms due to the conviction that the nepots are likely not to have the appropriate professional capabilities to take on managerial positions. They may engage in the business less, make mistakes and demotivate non-family employees. Some academics claim that family plays a positive role in the business but only at the first, entrepreneurial stage of its life circle, and later it may be detrimental to the business undertaking. Contrary to popular opinion in this field in Poland, the author tries to acknowledge that the influence of nepotism on a business, regardless of its size, is positive and constitutes a kind of continuum between the neutral effect and strong competitive advantage resulting from the family social capital – an intangible, strategic resource inherent only in close family relationships. The author refers to selected concepts and theories applied in the science of management, such as: the sociological theory of organized action, **organizational** equilibrium theory**,** social exchange theory, agency theory and stewardship theory.

**Key-words:** family business, nepotism, family social capital, competitive advantage.

**JEL codes**: F23, F20, F00, F61, L26, M16, M21, O19, O32, O30

## 1. Introduction

The operational assessment of family businesses in Poland and in the world is conducted through the prism of existing and unfavourable stereotypes which refer to such companies and hinder the recognition of the indubitable role these entities play in the market economy from the economic and social perspective. One such unjust stereotype is the belief in their impeded management professionalisation that stems from nepotistic practices and a lack of will to employ specialists and professional managers from outside the family circles, which may lead to the limitation of developmental abilities, or even to marginalisation in the conditions of the knowledge-based economy. On numerous occasions, the author has come across opinions stated by management experts who claimed that the formula of a family business is useful only in the initial phase of the entrepreneurial life cycle of any given company, i.e. when it is struggling for survival and when the support of family members in the form of a workforce, ready to make sacrifices and become committed to investing their private savings and resources in the mutual enterprise, is invaluable. This type of unconditional personal involvement and 'primary accumulation of capital' can only occur in an environment populated by people who are linked by emotional bonds and trust based on feelings. The very same experts also believe that when a business survives and enters a growth phase, the family becomes a barrier in the process of managing the growth due to the lack of appropriate managerial competences, reluctance to delegate decision-making powers in the case of a necessary decentralisation, and a strong orientation to the needs of the family and not to the young business itself. This kind of selective thinking is unjustified due to the fact that all young enterprises – medium and small, family and non-family – experience a competence barrier, and nepotism may not only be limited to favouring family members regardless of the size, age and type of business or any other social organisation. *The purpose of this article is to demonstrate that nepotism and its related phenomena are common, and even if nepotism in state-owned institutions and companies, i.e. in the public sector, possesses the features of social pathology, in a family business it is natural and morally justified since it is the family that owns the business assets there and since it has a positive influence upon the firm's functioning.* The positive impact of family nepotism on a business decreases in exceptional conditions, which the author will discuss further in the article.

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## 2. Nepotism and related terms

Nepotism means favouring family members in the process of filling vacancies and granting privileges, regardless of the competences these family members possess. As early as the middle ages, popes were accused of nepotism, and nowadays, the term is most commonly applied to powerful family clans such as the Kennedys or the Bushes, to dictatorship regimes and… to family businesses. The incomprehension of the role of family relationships in a family-run business and their unfair association with negative consequences turned nepotism into a flagship accusation and into the basis of criticism aimed at family businesses.

At the same time, in the public sector there are nepotism-related phenomena such as 'clientelism' and 'cronyism', which – in the majority of cases – do not regard family relationships and are considered to be social pathologies since they breach the official rules of the political and economic game.

Clientelism is a system of informal relationships that are economic and social in their nature. An influential political decision-maker or a disposer of economic goods promises protection or assistance to a social group (clientele) in exchange for political support. Connections of this type disturb the proper distribution of political and economic goods and create a space unsubjected to general social control. Clientelistic bonds are mainly the subject of endeavours conducted by political parties in young democracies within undeveloped political systems, where the propagation of a populist policy, and the bonding of a socially and economically ill-suited part of society to the political programmes proclaimed by expressive, ambitious and power-oriented leaders, is a method these leaders undertake to mark their presence. In non-democratic countries, where there is only one political formation that monopolises the processes of filling vacancies and granting privileges in the public sector, clientelism is the order of the day. In Poland, the process of political transformation involved the dismantling of the structure within the old order, exchanging the old bureaucratic personnel for a new one, which was linked to the new parties responsible for the political changes, thus creating the perfect conditions for a 'new' clientelism. Nowadays, the sectors of the economy which are still under a substantial influence of the state are still at risk of such phenomena. In mature democracies, parties which create clientelism are a rare occurrence, the only manifestation of which can be an element of 'localism' within the state's policy, i.e. the presence of local interests among the set of any given country's priority goals [Antoszewski, Herburt, 2001, p.p. 60-68].

Cronyism is a globally common phenomenon that means mutual support exercised by people belonging to the same reference group in order to reach social positions and achieve financial gains regardless of the assessment of values and competences these people possess. The basic relationship in cronyism is 'connection', i.e. a term that is wider in its meaning than nepotism, since it not only refers to relatives, but also to friends and acquaintances. *Transparency International* aims to combat corruption and cronyism in the public sphere and to introduce standards of transparency therein.

## 3. Nepotism in organisational and management theory

In this part of the article, the author refers to selected concepts and theories which are applied in management science and studies, and which can illustrate the positive influence of nepotism on the functioning of family businesses. These are: the concept of organisational game, organisational equilibrium theory, social exchange theory, agency theory and stewardship theory.

In social organisations, whose official forms include family and non-family enterprises, each person is a participant of a social game, aiming at his own goals and interests. He anticipates the behaviour of others – both allies and opponents – and is well aware of the consequences of his actions. The game between 'actors' [Crozier, Friedberg, 1982, p. 22, p.p. 104-110] involves co-operation that is necessary to fulfil such interests, and a generally understood struggle whenever these interests diverge or conflict. The larger the area of insecurity within an organisation that each 'actor' controls, and the greater the power he holds, the bigger the abilities of individual 'actors'. Within the applied rules of the game, and in order to increase its influence, he can opt for teamwork by belonging to or creating a group of a shared or concordant interest. The survival of the business is what bonds all its actors and imposes certain limitations upon them within the game. The rules of the game must be formulated in a manner that ensures the continuity of the business and prevents the participants/actors or their groups from destroying the organisation. Within the organisation, there may be numerous groups of interest

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which fight (play) against one another, struggling for influence and benefits. The pool of benefits that the game is played for is limited and, therefore, it triggers competitive behaviour in individual actors and coalitions. Only when rational rules of the game are accepted by everybody can there be an acceptable level of co-operation between all actors and groups, and a growth of the total amount of benefits, which makes everyone gain, although to a different degree. A group of people with a common interest or a coalition of groups which is most influential becomes a group/coalition that dominates within the organisation and decides on its form and future. The values and ambitions of the dominant group have an impact on the goals of the business and the applied strategies which are necessary to achieve such goals, or there is a discrepancy between the initial goals of the business and the ambitions of the dominating group, which results in the execution of a strategy that does not entirely serve the interests of the business. In family businesses, the family is a relatively stable dominant group. Due to the scope of its power (ownership), the goals and interests of this exceptional group are unthreatened by the interests of the remaining participants within the organisation. This group does not have to confront others and may focus on the execution of its own purposes, which should be, and most often are, concordant with the interests of the whole organisation and the expectations of the outside world. In the case of non-family businesses, there is a lack of such stability in relationships, and the acceptance of the rational rules of the game by everybody is more difficult to achieve. The scope of insecurity among the currently dominating group is larger and the group itself is exposed to attacks conducted by other groups of interest. In order to keep the loyalty of its members and to increase – to a greater extent – the scope of its power, it applies ‘practices of nepotism’. Nepotism in family businesses is a natural phenomenon, stemming from family relationships, and – as shown in the latest research – is a building material of the most valuable form of social capital, which makes it possible to maintain and increase the competitive advantage of the organisation. However, ‘nepotism’ in non-family companies means a distortion of the rules of the organisational game, leading to confrontation between various and sometimes private interests, which are often divergent with the interests of the whole organisation and/or the expectations of the outside world.

The convergence of the organisation’s goal with the individual goals of its participants or interest groups conditions its internal organisational coherence and survival. The harmonisation of these goals depends on the character of people’s participation in the organisation. In his typology, Etzioni [Bielski, 1997, p.p. 92-93] distinguishes between alienating, calculative and moral participation. In the first one, a participant is not mentally committed to the implementation of the organisation’s goals, does not identify with its goals and does not consider them as a means of implementing his own individual goals. In the second case, which is most common in business organisations, a participant cannot identify with the organisation’s goals or does not do this to the full. He is ready to contribute to its operations in exchange for adequate benefits. Moral participation takes place when a participant identifies with the goals of the organisation, considers them to be his own, and gets fully involved in their implementation. This type of participation dominates, for instance, in political parties, associations, churches, and in family businesses in reference to family members and those participants who identify with the moral and ethical infrastructure of the family.

Organisational equilibrium theory, created by Barnard and developed by Simon [Bielski, 1997, p.p. 160-162] explains the relationships between the organisation and its calculative and moral participants as a mutual exchange of benefits. A calculative participant makes a specified contribution, useful in the process of implementing the organisation’s goal, and in return obtains financial gains (salaries, bonuses, subventions) and social benefits (distinctions, recognition). Such a participant will be a member of the organisation for as long as the obtained gains and benefits are equal to or larger than the contribution he makes. He subjectively calculates the benefit-contribution balance, on the basis of the level of his aspirations, his position versus other participants, and the possibility to gain benefits in other organisations. An unfavourable balance triggers his sense of injustice, evokes frustration and leads to his departure from the organisation or to a decrease in his contribution, which was the subject of the transaction. In the case of a moral family member’s participation in a family business, the mechanism of the mutual exchange of benefits is similar, but the character of the benefits offered to him is different, since they are mainly internal in their nature and are rooted in his psyche and in the needs for social, emotional and ethical security and self-fulfilment. Financial and social gains are in the background. Thus, the participation of family members in a family enterprise increases and consolidates its equilibrium, developing moral and emotional intelligence, which guarantees the cohesion between the mutually shared and obeyed value systems, goals and behaviours (strategies).


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The sociological theory of exchange describes the social world as a system of exchange of material and non-material goods between people [Szacki, 2002, p. 839]. Each social interaction takes the form of a transaction – 'quid pro quo'. Every man takes an action with a personal benefit in mind. Non-material gain may take the form of respect shown by others, obedience, satisfaction, security, prestige, etc. On the basis of social exchange theory, an attempt was made to explain the role of nepotism in family enterprises and to determine the conditions in which nepotism has a positive influence on the results returned by the business and on its competitive position [Jaskiewicz at al., 2013, p.p. 121- 139]. Between related people, a *complete social exchange* occurs, which is connected with frequent, deep and long-term interactions, based on the principle of deferred and indirect reciprocity, on the idea of reciprocal concessions, and on emotional trust. The precondition of such a form of social exchange is the correlation between family members, a long history of interactions between them, and a strong morally-ethical infrastructure, which has been jointly shaped and obeyed by such members. A *complete social exchange* within a family that runs a business becomes an equivalent of the social capital of the family and a reason why the family cultivates a form of *nepotism of reciprocity*, which is beneficial for the family and the business. Supporters of exchange theory see the main benefit of *nepotism of reciprocity* for the family business in the effective management of a unique type of business knowledge – tacit knowledge, which involves its transfer, application, development and protection. In a small or medium family company, the transfer of tacit knowledge is performed only between family members, i.e. the people who are bonded by an emotional trust and a strong, morally-ethical infrastructure. They recognise the importance of the knowledge accumulated through experience, understand its unique nature, and try to use it in the process of building and increasing the competitive advantage of the business. They expand the knowledge because they know its sources and they have a will to continue family traditions. They protect it with the intention of long-term employment in the business and with regard to loyalty and the principle of reciprocity that are binding within the family.

Employing a family member in the family business may, in some cases, involve a negative form of *titular nepotism*. This happens when there is a limited nature of social exchange between the family candidate and the other relatives involved in the business, due to a weaker correlation, a lower frequency and intensity of acts of exchange, and a complete lack of, or a limited participation in the creation and consolidation of the family's ethical standards. The emotional trust between the candidate and the remaining family members is weaker, and the reciprocity of exchange is immediate, direct and quite often asymmetrical in its nature. In such conditions, it is difficult to be assured of the security and effective protection of tacit knowledge and of gaining other profits that stem from the *complete social exchange*.

Between unrelated people, just like in the aforementioned case, there is only a possibility for a *limited social exchange* to occur. Thus, hiring executives from outside the family circles in family businesses is a formidable challenge for their owners, at least as far as the protection of tacit knowledge is concerned. In large family companies, where it is beyond the family itself to effectively manage the business and where there is a necessity to hire managers from outside the family circles, the risk of a leak of tacit knowledge to the competition is higher and requires such managers to be offered appropriate benefits in order to increase their level of loyalty and to keep them in the business.

The author believes that the concept of *reciprocal and titular nepotism* in family businesses, proposed by the supporters of social exchange theory, is original, convincing and makes an unquestionable contribution to the ongoing discussion on the phenomenon of nepotism in family-run companies. It may, however, be doubtful to consider titular nepotism that occurs in family businesses as unambiguously negative, since the potential of a social exchange that occurs only between family members will always be greater than the potential of a social exchange that happens between unrelated people. It should rather be assumed that the influence of nepotism upon the results returned by the family business is a form of continuity between the boundary of neutrality and the boundary of maximum benefits resulting from the complete social exchange. Apart from this, except for the management of tacit knowledge, the proposal based on social exchange theory does not include other benefits stemming from the fact that nepotism in family businesses is practised.

Positive consequences of employing family members in a family business can also be justified by referring to the theories of agency and stewardship. The combination of functions of ownership and management in such entities eliminates opportunism and other negative agency-related phenomena. The phenomenon of agency takes place when a manager with full access to information acts as an agent in relation to the company owner, who has limited possibilities to monitor the agent's usage and appropriation of financial resources which could normally


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be the source of the owner's benefits. This issue stems from the information asymmetry between the parties and from the discrepancy between the motives underlying their behaviour [Ang, Cole, Lin, 2000, p.p. 81-106]. In family businesses, the costs of agency may be inconsiderable when there is convergence or even uniformity of interest between owners and managers. Nevertheless, in family businesses another type of agency-related costs might occur, the source of which are discrepancies of the interests and goals of the ownership minority and the majority of the owner family that plays 'the parasitic role of agents'.

Owner-managers act as stewards of resources that constitute the business. The term 'stewardship' is applied when managers are not guided by their own private goals, but adopt the expectations and targets of the owners (employers) as their own [Davis, Schoorman, Donaldson, 1997, p.p. 20-47]. Altruism is an attribute of a steward. It helps him implement the goals set by the owner family and secure the survival and development of the business itself. Stewardship theory proclaims that numerous leaders and managers aspire to higher-order goals. They are not self-oriented individualists, pursuing their own economic benefits. Instead, they often take altruistic actions for the benefit of the organisation as a whole and its stakeholders [Fox, Hamilton, 1994, p.p. 69-81]. It is acknowledged that stewards are internally motivated by higher-order needs (the need for respect, membership or self-fulfilment), the need to act for the sake of the collective welfare. They identify with the organisation and take up the challenge of implementing its goals. They care that the organisation is successful, even at the expense of their own personal sacrifice [Davis, Shoorman, Mayer, Tan, 2000, p.p. 563-576]. The stewardship philosophy will be particularly dominant in family businesses whose leaders are either members of the owner families or emotionally bonded to the family. Such managers become deeply involved in the implementation of the business's mission and are motivated to work for the owner family and other stakeholders [Miller, Le Breton-Miller, 2005, p. 30]. Stewardship behaviour may contribute to the development of distinctive skills in the process of creating strong internal and external social relationships and generating extraordinary financial results of the business.

## 4. The positive influence of nepotism upon a family business

The overview of the selected concepts and theories within management studies, the results of the majority of world empirical comparative research into the financial results returned by family businesses and their non-family counterparts [Popczyk, 2011, p.p. 115-131], as well as the research into international expansion of family businesses and their non-family counterparts carried out by the author himself [Popczyk, 2013] make it possible to state that nepotism has a positive influence upon the functioning of family-run enterprises. This influence is manifested by:

- the ability to build and use the social capital of the family, which consists of: emotional trust, identity, reputation, and high ethically-moral standards in the internal relationships of the business and its external relationships with the environment at a national and global level,
- the possibility to reduce agency-related phenomena and costs,
- effective management of the most valuable knowledge in business, which determines competitive advantage (tacit knowledge), and a unique and non-coded type of knowledge. In its own circle, the family accumulates it in time, expands it, transfers it intergenerationally and protects it, by preventing it from 'leaking' to the competition,
- greater flexibility and strength of survival in the competitive economy in periods of a weak market (moral participation of family members in the business),
- greater social sensitivity and responsibility.

There are also certain conditionings in which the positive power of nepotism may wither away. Following the growth and expansion of the business, and in non-traditional and more demanding sectors, family relationships must be reinforced by the competences and talents of family managers. This requirement may be fulfilled when plans for the succession and professional preparation of the younger generation for business roles are prepared well in advance. The second important condition of maintaining a positive nature of nepotism in the business are the following features of family relationships: solid and strong family ties, unobstructed communication channels between family members, a high frequency of interactions (contacts) between family members and their long history, and the family's culture of respecting high ethically-moral standards.

The fulfilment of the second condition can, to a certain degree, compensate for potential shortages in the competences that are listed in the first condition, which does not mean that moral and emotional intelligence is


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capable of substituting rational and technical intelligence in the family business. These four types of intelligence must be complementary in their nature so that the business could be successful.

## 5. Conclusions

It should be borne in mind that enterprises – as social and technical systems – are equifinal in their nature, i.e. they are able to enjoy the final success even if they begin at various initial terms and reach it through very different approaches and methods. Although it does happen that the system-entry position of family businesses when it come to the sources of financing and HR is weaker in comparison to the corresponding position of non-family companies, the former record equally good, and in numerous cases even better results than the latter.

Since nepotism can be an effective means of gaining success, so be it. The criticism of nepotism in family businesses is based on false and biased stereotypes related to the specific nature of their functioning. These stereotypes are strong enough to silence all facts that prove their large potential for success and higher financial effectiveness in comparison with their non-family counterparts. Thus, the best form of supporting family entrepreneurship is to abolish unfavourable stereotypes and create a strong image of family businesses, an image that they fully deserve.

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