AN EXPLORATION OF AGENCY PROBLEMS IN THE FAMILY FIRM: 
THE CASE OF DISTRIBUTING EQUAL SHARES TO CHILDREN

We show that agency problems exist in the family firm although ownership and management are not separated. This is counter to the common belief in the finance literature that agency costs do not exist in the owner-managed firm. Altruism may exacerbate the shirking problem but mitigates an adverse selection problem.

Agency problems are used by financial economists to explain capital structure (e.g., Jensen & Meckling, 1976), managerial incentives (e.g., Grossman & Hart, 1982), roles of majority and minority shareholders (e.g., Holderness & Sheehan, 1988), and other decision issues in firms where ownership and management are separated. It is generally assumed, however, that agency problems are negligible or nonexistent in the owner-managed firm because ownership and management are not separated (e.g., Jensen & Meckling, 1976; Ang & Cole, 2000). This may not be true because in the family firm where the parent and the children co-own the business and, together, manage the business, there could still be shirking and adverse selection problems.

Family firms are ubiquitous in the global economy. For instance, a study by Deloitte & Touche (1999) suggests that Canadian family firms provide as many as 4.7 million full time jobs and 1.3 million part-time jobs. Yet agency problems in family firms have not been studied by finance researchers. This exploratory study is a step in that direction.

Assumptions

In this study, we differentiate the family firm from the non-family firm by two attributes. First, we assume the possibility of altruism among family members. Second, we assume that the family - parent and kids together - through their efforts, determine the value of the firm. Thus, technically, altruism and a joint production function are what differentiate the family firm from the non-family firm.

Families frequently divide the family wealth equally among the children. For example, this is the tradition in Chinese families and it is required for sons in Islamic ones. Even among Canadian firms, it must be quite common because the first lesson that the Canadian Association for Family Enterprise gives a new member is "fair is not equal". For this exploratory study, we

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investigate how the practice creates agency problems specifically related to shirking and adverse selection.

We make the following assumptions in order to focus on the issues of interest and to simplify the discussion. We shall use the masculine pronoun exclusively to simplify the exposition.

A1. The family consists of a parent (p) and two kids (k1 and k2). k1 is more productive than k2.

A2. Each family member maximizes his single-period utility when making decisions.

A3. The three family members, together, own all of the shares of the family firm; the parent's share is Sp, while each kid's share is S_{ki} (i=1, 2).

A4. No family member receives a fixed wage; instead, a family member's income consists entirely of his share of the firm's value.

A5. Family members do not save; they consume all of the income they make.

A6. The parent unilaterally decides the ownership distribution.

A7. The parent, in his wish to be loved equally by the two kids, has announced credibly that he will distribute equally between the two kids whatever ownership shares that he does not keep.

A8. The parent and the kids are risk averse and have the following single-period concave personal utility functions, respectively.

\[ u_p = \frac{1}{(S_p \cdot V)^{1/2}} - Z_p \] and \[ u_k = \frac{1}{(S_{ki} \cdot V)^{1/2}} - Z_{ki} \] (i = 1, 2)

where V is the value of the firm and Z is work effort.

A9. Family members may be altruistic and, if so, will have a single-period total utility function of the form

\[ U_i = u_i(\cdot) + \sum a_{ij} \cdot u_j(\cdot) \]

where \( U_i \) is family member i’s total utility function, \( u_i \) is the person’s single-period personal utility function, \( a_{ij} \) is the degree of altruism family member i holds toward j, and \( u_j \) is family member j’s single-period personal utility function.

The degree of altruism, \( a_{ij} \), determines how much, in relative terms, a family member’s total utility is affected by another family member’s personal utility. If the parameter \( a_{ij} \) is zero for all i and j, the person is egoistic. If \( a_{ij} \) is positive, individual i is altruistic toward j.

A10. The parent has a fixed work effort that is known.

This assumption allows us to concentrate on shirking by the kids who are co-owners and co-managers. The parent, especially if he is the founder, typically has a life that revolves around the business and has little outside interest (Rubenfeld & Gupta, 1992). As a result, he normally devotes all of his available time, even when he is not in the office, to the business.
A11. The homogeneous degree one joint production function for the single-period firm is:

\[ V = Z_p^{1-\beta_1-\beta_2} Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2} \]

where \( \beta_1, \beta_2 \) and \( \beta_p = (1 - \beta_1 - \beta_2) \) are the productivities of the first kid, the second kid, and the parent, respectively. We assume that \( k_1 \) is more able than \( k_2 \); so \( \beta_1 > \beta_2 \). We abstract from capital, organization, technology, industry, and competition and focus on labour as the rest are not relevant to the theoretical problem in which we are interested. By not explicitly taking into account the wages of the family members, we assume that the parameters in the production function are capable of measuring the income of the family firm net of the family members’ wages.

A12. The family firm pays no taxes.

Tax planning is a specialized field beyond the scope of this study and including a simple tax payment would only complicate the presentation without yielding additional insights.

The Model

Given the assumptions and using the symbol \( S_k^* \) to represent the equal ownership shares of the kids, the utility maximization problems of the two kids are:

\[
\max_{U_{k1}} = \left[ (S_k^* \cdot Z_p^{1-\beta_1-\beta_2} Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2})^{1/2} - Z_{k1} \right] + a_{k1p} \cdot \left[ \left( S_p^* \cdot Z_p^{1-\beta_1-\beta_2} Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2} \right)^{1/2} - Z_p \right] \\
+ a_{k1k2} \cdot \left[ (S_k^* \cdot Z_p^{1-\beta_1-\beta_2} Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2})^{1/2} - Z_{k2} \right] \\
= \left[ (S_k^*)^{1/2} \cdot (1 + a_{k1k2}) + a_{k1p} \cdot \left( S_p^* \right)^{1/2} \cdot Z_p^{1/2} \cdot Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2} \right] - \left( Z_{k1} + a_{k1p} \cdot Z_p + a_{k1k2} \cdot Z_{k2} \right)
\]

\[
\max_{U_{k2}} = \left[ (S_k^* \cdot Z_p^{1-\beta_1-\beta_2} Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2})^{1/2} - Z_{k2} \right] + a_{k2p} \cdot \left[ \left( S_p^* \cdot Z_p^{1-\beta_1-\beta_2} Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2} \right)^{1/2} - Z_p \right] \\
+ a_{k2k1} \cdot \left[ (S_k^* \cdot Z_p^{1-\beta_1-\beta_2} Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2})^{1/2} - Z_{k1} \right] \\
= \left[ (S_k^*)^{1/2} \cdot (1 + a_{k2k1}) + a_{k2p} \cdot \left( S_p^* \right)^{1/2} \cdot Z_p^{1/2} \cdot Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2} \right] - \left( Z_{k2} + a_{k2p} \cdot Z_p + a_{k2k1} \cdot Z_{k1} \right)
\]

The first-order conditions for each kid’s work effort are

\[
\frac{\partial U_{k1}}{\partial Z_{k1}} = \frac{\beta_1}{2} \cdot \left[ (S_k^*)^{1/2} \cdot (1 + a_{k1k2}) + a_{k1p} \cdot \left( S_p^* \right)^{1/2} \cdot Z_p^{1/2} \cdot Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2} \right] - 1 = 0
\]

\[
\frac{\partial U_{k2}}{\partial Z_{k2}} = \frac{\beta_2}{2} \cdot \left[ (S_k^*)^{1/2} \cdot (1 + a_{k2k1}) + a_{k2p} \cdot \left( S_p^* \right)^{1/2} \cdot Z_p^{1/2} \cdot Z_{k_1}^{\beta_1} Z_{k_2}^{\beta_2} \right] - 1 = 0
\]
Shirking

There are many ways to define shirking. For example, shirking is defined by the dictionary as "avoiding work or duty". In situations involving agency problems, it seems reasonable to define shirking as a function of contribution to firm value; so we define shirking here in terms of relative contribution to firm value. Since the two kids are to be given equal share ownership, we expect the two kids to make equal contributions to firm value. If the two kids had the same productivity, then shirking by this definition would simply be devoting less effort than the sibling. But when the more able kid devotes less effort, he may still be making an equal contribution to the value of the firm through his higher productivity. Therefore, only when the less able kid works less than the more able kid is there unambiguous shirking by our definition. Consequently, we focus our analysis of shirking on the conditions under which the less able kid works less than the more able kid.

Egoistic Kids

To examine the influence of altruism on the kids' work efforts, let us look at the case in which the two kids are egoistic first. The two kids' optimal work effort strategies, given the share distribution determined unilaterally by the parent, are:

$$Z_{k1}^* = \left( \frac{1}{2} \right)^{2-\beta_1-\beta_2} \cdot \beta_1 \cdot \beta_2 \cdot Z_p \cdot (S_k^*)^{2-\beta_1-\beta_2}$$

$$Z_{k2}^* = \left( \frac{1}{2} \right)^{2-\beta_1-\beta_2} \cdot \beta_1 \cdot \beta_2 \cdot Z_p \cdot (S_k^*)^{2-\beta_1-\beta_2}$$

Comparing the work efforts of the two kids, it can be shown that

$$\frac{Z_{k1}^*}{Z_{k2}^*} = \frac{\beta_1}{\beta_2}$$

when \( a_{k1k2} = a_{k2k1} = a_{k1p} = a_{k2p} = 0 \). Since \( \beta_1 > \beta_2 \), \( Z_{k1}^* |_{S_k^*} > Z_{k2}^* |_{S_k^*} \). This means that, regardless of the level of share ownership, the more able kid will actually work harder than the less able kid. For the less able kid to contribute as much as the more able kid to the value of the firm, the less able kid should work harder. Therefore these results show that the less able kid will unambiguously contribute less and is shirking.

**Proposition 1.** In the family firm where egoistic kids have equal ownership, the less able kid will shirk regardless of the total shares distributed by the parent.

Kids Altruistic Toward Parent But Not Toward the Sibling

If the kids are altruistic toward the parent but not toward the sibling, \( a_{k1p} > 0, a_{k2p} > 0 \), and \( a_{k1k2} = a_{k2k1} = 0 \). Then their optimal work effort strategies become
and the ratio of their work efforts is
\[
\frac{Z_{k1}^*}{Z_{k2}^*} = \frac{\beta_1 \cdot [(S_k^*)^2 + a_{k1p} \cdot (S_p^*)^2]}{\beta_2 \cdot [(S_k^*)^2 + a_{k2p} \cdot (S_p^*)^2]}
\]

As opposed to the case where there is no altruism, the two optimal work effort strategies now intersect and the more able kid works harder only when

\[
S_{min}^* = \frac{(a_{k2p} \cdot \beta_2 - a_{k1p} \cdot \beta_1)^2}{(a_{k2p} \cdot \beta_2 - a_{k1p} \cdot \beta_1)^2 + (\beta_1 - \beta_2)^2} < S_k^* \leq \frac{1}{2}
\]

This means that when the ownership distributed by the parent is less than \(S_{min}^*\) (which is always positive since all terms are squared), the more able kid will work less than the less able kid. This means that unambiguous shirking occurs only within the share distribution range defined above. Therefore, we have the following proposition.

**Proposition 2.** In the family firm where the kids have equal ownership and the kids are altruistic toward the parent but not toward each other, there exists an ownership distribution range that promotes shirking by the less able kid.

Since \(a_{k1p}>0\) and \(a_{k2p}>0\), however, we see that, for each given ownership distribution decided by the parent,

\[
Z_{k1}^* \bigg|_{a_{k1p}>0, a_{k2p}>0, a_{k1k2}=a_{k2k1}=0} > Z_{k1}^* \bigg|_{a_{k1p}=a_{k2p}=a_{k1k2}=a_{k2k1}=0}
\]
\[
Z_{k2}^* \bigg|_{a_{k1p}>0, a_{k2p}>0, a_{k1k2}=a_{k2k1}=0} > Z_{k2}^* \bigg|_{a_{k1p}=a_{k2p}=a_{k1k2}=a_{k2k1}=0}
\]

This means that, at each ownership level, the kids with altruism toward the parent will work harder than in the case where they are not altruistic. Proposition 3 follows from this result.

**Proposition 3.** In the family firm where the kids have equal ownership and the kids are altruistic toward the parent but not toward each other, both kids will work harder than in the family firm where the kids are egoistic.

**Kids Altruistic Toward Parent and Sibling**
If each kid is altruistic toward the parent and toward the sibling, $a_{k1p}>0$, $a_{k1p}>0$, $a_{k1k2}>0$, and $a_{k2k1}>0$ and

$$Z_{k1}^* = \left(\frac{1}{2}\right)^{2-\beta_1-\beta_p} \cdot \beta_1 \cdot Z_p \cdot \beta_2 \cdot \left(1-a_{k1k2}\right)^2 \cdot \left(1+a_{k1p}\right)^2 \cdot \left(1-2S_k^*\right)^2 \cdot \frac{1}{\beta_1 \beta_p}$$

$$Z_{k2}^* = \left(\frac{1}{2}\right)^{2-\beta_1-\beta_p} \cdot \beta_2 \cdot Z_p \cdot \beta_1 \cdot \left(1-a_{k1k2}\right)^2 \cdot \left(1+a_{k1p}\right)^2 \cdot \left(1-2S_k^*\right)^2 \cdot \frac{1}{\beta_1 \beta_p}$$

Since $a_{k1p}>0$, $a_{k1p}>0$, $a_{k1k2}>0$, and $a_{k2k1}>0$, it can be shown that, at each ownership distribution level decided by the parent,

$$Z_{k1}^* \mid_{a_{k1p}>0, a_{k2p}>0, a_{k1k2}>0, a_{k2k1}>0} > Z_{k1}^* \mid_{a_{k1p}>0, a_{k2p}>0, a_{k1k2}=a_{k2k1}=0} > Z_{k1}^* \mid_{a_{k1p}=a_{k2p}=a_{k1k2}=a_{k2k1}=0}$$

$$Z_{k2}^* \mid_{a_{k1p}>0, a_{k2p}>0, a_{k1k2}>0, a_{k2k1}>0} > Z_{k2}^* \mid_{a_{k1p}>0, a_{k2p}>0, a_{k1k2}=a_{k2k1}=0} > Z_{k2}^* \mid_{a_{k1p}=a_{k2p}=a_{k1k2}=a_{k2k1}=0}$$

In other words, altruism of the kids toward the parent increases the optimal work efforts of the kids. Furthermore, altruism of the kids toward each other on top of their altruism toward the parent increases their optimal work efforts even more. Thus, we have the following proposition.

**Proposition 4.** In the family firm where the kids have equal ownership and the kids are altruistic toward both the parent and the sibling, both kids will work harder, compared to the case in which both of them are egoistic and the case where both of them are altruistic toward the parent but not the sibling.

It can be shown that $Z_{k1}^* \mid_{S_k^*} > Z_{k2}^* \mid_{S_k^*}$ when

$$S_{min2} = \frac{(a_{k2p} \cdot \beta_2 - a_{k1p} \cdot \beta_1)^2}{(a_{k2p} \cdot \beta_2 - a_{k1p} \cdot \beta_1)^2 + [(1+a_{k1k2}) \beta_1 - (1+a_{k2k1}) \beta_2]^2 < S_k^* \leq \frac{1}{2}}$$

Again, altruism leaves a range between $S_{min2}$ (which is always positive because all terms are squared) and 1/2 wherein the more able kid will work harder.

**Proposition 5.** In the family firm where the kids have equal ownership and the kids are altruistic toward both the parent and the sibling, there will remain a range of ownership share distribution that promotes shirking by the less able kid.

Concentrating on the ownership ranges $(S_{min1}, 1/2)$ and $(S_{min2}, 1/2)$ where the more able kid works harder than the less able kid, the gap between their work efforts when:
\[
\frac{(a_{k2p} \cdot \beta_2 - a_{k1p} \cdot \beta_1)^2}{(a_{k2p} \cdot \beta_2 - a_{k1p} \cdot \beta_1)^2 + [(1 + a_{k1k2}) \beta_1 - (1 + a_{k2k1}) \beta_2]^2} < S_k^* < \frac{1}{2}
\]

is:

\[
Z_{k1}^* - Z_{k2}^* = \left( \frac{1}{2} \right)^{\frac{2}{2-\beta_1-\beta_2}} \cdot \beta_1^{\frac{2-\beta_1}{2-\beta_1-\beta_2}} \cdot \beta_2^{\frac{2-\beta_1}{2-\beta_1-\beta_2}} \cdot \frac{1-\beta_1-\beta_2}{Z_p^{2-\beta_1-\beta_2}} \cdot \left[ (S_k^*)^{\frac{1}{2}} \cdot (1 + a_{k1k2}) + a_{k1p} \cdot (1 - 2S_k^*)^{\frac{1}{2}} \right] \]

\[
\cdot \left[ (S_k^*)^{\frac{1}{2}} \cdot (1 + a_{k2k1}) + a_{k2p} \cdot (1 - 2S_k^*)^{\frac{1}{2}} \right] \]

where \( Z_{k1}^* > Z_{k2}^* \).

It can be shown that

\[
\begin{align*}
\hat{c}(Z_{k1}^* - Z_{k2}^*) & > 0 \text{ and } \\
\hat{c}(Z_{k1}^* - Z_{k2}^*) & > 0
\end{align*}
\]

This means that, ceteris paribus, the stronger the more able kid’s altruism toward either the parent or the sibling the wider will be the gap between the work efforts of the two kids.

**Proposition 6.** The shirking problem caused by the equal distribution of ownership may be exacerbated by the more able kid’s positive altruism toward the parent and that toward the less able sibling.

In summary, our six propositions show that, even in a riskless world, agency problem in the form of shirking can exist in the family firm even when all parties are both owners and managers. Positive altruism may actually exacerbate the problem rather than solve it.

**Adverse Selection**

Adverse selection arises from asymmetric information and occurs when the seller has more specific information than the buyer about the asset (Akerlof, 1970) thus causing an "unfair" exchange in the sense that the buyer pays more than the asset’s intrinsic value. In the family firm studied here, the parent has decided to distribute equal shares of the firm to the two kids despite their different productivities because of tradition, religion, or emotional reasons. Therefore, adverse selection in the sense of receiving lower value than the price is ambiguous because the parent may have received an increase in total utility from his altruism toward the less able kids equal to the decrease in total utility from his altruism toward the more able kid. Adverse selection also occurs, however, when the buyer ends up buying the inferior good. There is a situation where the family firm suffers from unambiguous adverse selection in this sense. This is when the more able kid leaves the firm and the less able kid stays. Our examination of adverse selection in the family firm focuses on this situation.

For this study of adverse selection in the family firm, we assume the following about the information available to the external labour market.
A13. The external labour market has information about how hard the kids work, the value of the family firm, and the ownership shares of each kid.

If the external market knows the value of the firm and the work efforts of the kids, then it knows the average productivity of the kids but not necessarily their individual productivities. We further assume the following regarding each kid's shares in the family firm and value in the external labour market.

A14. If either kid leaves the firm, then the kid has to return his shares to the parent.

A15. The external labour market value for kid $i$ is $W_i(Z_{ki}^*)$, a function of the market's expected work effort.

**Egoistic Kids**

As shown previously, in the absence of altruism, the more able kid will work harder than the less able kid throughout the possible ownership range. Assuming that the external labour market value of the more able kid is $W_{k1}(Z_{k1}) > S_k V^*$ (where $V^*$ is the firm value when the kids work optimally), and considering that the market cannot differentiate between the productivities, the external labour market will offer the two kids a compensation package marginally above $S_k V^*$, demanding the work effort $Z_{k1}^*$. The more able kid will accept the offer because the package is better than what he gets from the family firm. On the other hand, the less able kid will not accept the offer because, for $S_k V^*$, the less able kid is only willing to deliver a work level equal to $Z_{k2}^* < Z_{k1}^*$ which the external employer demands. To work at $Z_{k1}^*$ the less able kid demands a much higher pay. Thus, the family firm suffers from adverse selection – the more able kid leaves while the less able kid stays. This assumes implicitly that the family business will be able to find someone to replace the more able kid with the same package paid to the more able kid by the family firm. Without this assumption, the production of the firm will drop and both the parent and the less able kid will have to revise their optimal work efforts.

**Proposition 7.** In the family firm that distributes shares equally to the kids, if the external labour market value of the more able kid is higher than the value of the shares he has been given and he is egoistic, then the more able kid is likely to leave and the less able kid will stay.

As shown previously, the optimal work effort strategy of the egoistic more able kid plots above that of the egoistic less able kid across the entire range of feasible share distribution. It can be shown that

$$\frac{\partial Z_{k1}^*}{\partial (S_k V^*)} > 0 \text{ and } \frac{\partial Z_{k2}^*}{\partial (S_k V^*)} > 0$$

These results are represented in Figure 1 with the optimal work strategy of the more able kid labeled as $Z_{k1}^*(S_k V)$ and that of the less able kid as $Z_{k2}^*(S_k V)$. The curves are drawn concave but convex curves lead to the same results. If the external labour market offers a compensation marginally above $S_k V^*$, the less able kid will not accept the offer because he is only willing to work at the level $Z_{k2}^*$. To work at $Z_{k1}^*$, the less able kid will demand $S_k V^*$. 
Adverse Selection with Egoistic Kids

As shown previously, altruism creates two different ownership ranges within which the more able kid works harder and beyond which the less able kid works harder. For example, when $S_{k1}^* < S_{k2}^*$, the more able kid works harder than the less able kid. Thus, given $S_{k1}^*$, the more able kid works $Z_{k1}^*$ and the less able kid works $Z_{k2}^*$ where $Z_{k1}^* < Z_{k2}^*$. If $\overline{W}_{k1}(Z_{k1}^*) > S_{k}^*V^*$ and the external market offers a compensation marginally above $S_{k}^*V^*$ demanding work effort $Z_{k1}^*$, the more able kid will accept this because the pay is higher than what he gets from the family firm and the work effort demanded is the same. But this compensation package is even more attractive to the less able kid because the pay would be higher than what he is getting from the family firm and the work effort demanded lower. Thus, there is no adverse selection problem when the ownership distributed by the parent to the kids is within this particular range $(0, S_{min2}^*)$.

**Proposition 8.** When $0 \leq S_k^* < S_{min2}^*$, the kids' equal ownership will not create an adverse selection problem.

On the other hand, $Z_{k1}^* > Z_{k2}^*$ when $S_{min2}^* < S_k^* \leq \frac{1}{2}$. If $\overline{W}_{k1}(Z_{k1}^*) > S_{k}^*V^*$ and the external labour market opportunity offers a payment marginally above $S_{k}^*V^*$ expecting $Z_{k1}^*$, the
altruistic more able kid will potentially leave and the less able kid will stay. But the external market will end up overpaying because once the more able kid leaves the family firm, he will no longer work at $Z'_{k1}$; he works at that level only because of altruism. Without altruism, he would work at a lower level as shown previously. Therefore, the external labour market has to pay significantly more than what the more able kid is getting from the family firm to get the same work effort. This could make the more able kid too expensive or the external market wary about the work effort it will get. This gives us the following proposition.

**Proposition 9.** Altruism has the potential to mitigate the adverse selection problem by either making it necessary for the external market to offer a higher pay to entice the more able kid to leave the family firm or making the external market wary about receiving a much lower level of work effort from the family member.

This situation is shown in Figure 2. Assuming that the ownership distribution is within the range $(S^{*}_{min}, \frac{1}{2})$, then $Z''_{k1}$, the work effort of the more able kid with altruism, will be higher than $Z'_{k1}$, the optimal work effort without altruism. If the external market offers a payment marginally above $S^*_k V^*$ expecting work effort $Z''_{k1}$, it will be disappointed because the more able kid will only deliver $Z'_{k1}$. To make the more able kid deliver $Z''_{k1}$, the external market must offer $S''_k V^*$.

**Figure 2**

Adverse Selection with Altruistic More Able Kid

In summary, altruism affects adverse selection differently; it has the potential to mitigate the adverse selection problem in two ways. First, if the external market expects the same work
effort from the more able kid, it cannot entice the more able kid to leave the family firm with a pay that is only marginally above what he is paid by the family firm; the pay needed to obtain the same work effort has to be significantly higher. Second, if the external market offers a pay only marginally above what the more able kid is paid by the family firm, then the external market would end up overpaying because it would get a work effort that is much lower than that delivered by the more able kid to the family firm. Depending on how the external market learns and the productivities of the kids, it is conceivable that if the kids’ ownership is high enough, there may not exist any external market for the kids.

Conclusions

The financial economics literature believes that agency problems are minimal if not zero in the owner-managed firm. We show that although ownership and management are not separated in the family firm, agency problems in the form of shirking and adverse selection could still exist, even in the absence of risk. To put these results in the context of the agency literature, we note that empirical studies of owner-managed firms do not differentiate between single and multiple owner managers. We have shown that this differentiation is important because, with multiple owner-managers, agency problems do exist. Our results are also separate from those in the literature related to the majority-minority shareholder conflicts because in that literature, the minority shareholders do not participate in management. Aside from the existence of agency problems, the most interesting findings are that family members' altruism toward each other may exacerbate the shirking problem but can mitigate the adverse selection problem.

Reference


