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# PROPERTY RIGHTS, OWNER-MANAGEMENT, AND VALUE CREATION

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**Building on property rights theory, we explore the relationship among property rights, owner-management, and value creation in private firms. We suggest that property rights in the hands of owner-managers create strategic, incentive, and commitment benefits that facilitate value creation. However, the self-incentivizing nature of property rights engenders three control hazards—those related to reliability, egocentrism, and succession—that threaten stakeholder welfare. In order to mitigate these hazards, owner-managers must establish credible governance. We discuss four governance mechanisms often found in owner-managed firms: commitment to social control, delegation of authority to managers, submission to the hierarchy of a board, and partial transfer of ownership. Although these mechanisms help mitigate control hazards, they also constrain the value-generating benefits of owner-management. Owner-managers thus face control dilemmas when determining how to best govern their firms. Our theory sheds new light on the relationship between property rights and value creation, and lays a foundation for exploring the benefits and liabilities of owner-management.**

When pursuing an entrepreneurial endeavor, entrepreneurs typically own the required resources and directly oversee their use. Indeed, owner-management is characteristic of entrepreneurial firms and associated with many economic benefits. Agency theory attributes these benefits to reduced governance costs (Jensen & Meckling, 1976). Incomplete contracting theories, in contrast, attribute these benefits to superior decision-making and the reductions in coordination and transaction costs that occur when ownership is assigned to those who contribute most to value creation[1]—namely, the owner-manager (Foss & Klein, 2012; Grossman & Hart, 1986; Hansmann, 2000). Owner-management thus facilitates value creation.

However, a variety of statistics about the size and value of owner-managed firms—firms that are private and are actively managed by the firm's dominant owner[2] (that is, the owner-manager) (McCann & Vroom, 2013)—have suggested that owner-management actually *harms* value creation. For example, Wasserman (2006) found that startups in which founders retain control are significantly less valuable than those in which founders gave up control. Durand and Vargas (2003) documented that private owner-managed firms are significantly less valuable than private professionally managed firms, which are in turn significantly less valuable than public corporations (Bena & Xu, 2017; Fitza & Tihanyi, 2017). Moreover, while the popular press has lionized the leadership, prowess, and success of entrepreneurial superstars such as Mark Zuckerberg (Facebook) and Elon Musk (Tesla), stagnant

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[1] Examples of value creation include the development of novel products and services, and the implementation of strategies that enable the firm to lower the cost of delivering goods and services or to enhance its value to purchasers (Bowman & Ambrosini, 2000; Lepak, Smith, & Taylor, 2007; Peteraf & Barney, 2003).

[2] This definition is broad and accommodates various types of owner-managed firms, ranging from firms organized as sole proprietorships, *S* corps, or LLCs that have few employees, to large, private, professionalized firms that are led by their principal owner(s).



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owner-managed firms are omnipresent (Zahra & Filatotchev, 2004).

This paradox points to an important gap in the literature: existing theory does not explain why owner-management might be a source of both benefits *and* costs with regard to the creation of economic value. To fill this gap, we explore the impact of property rights on value creation in owner-managed firms. Classical property rights theory defines ownership with respect to the type of control that owners exercise over the resources they own (Kim & Mahoney, 2002, 2005), and suggests that control rights fall into three categories: use, appropriation, and transfer (Alchian & Demsetz, 1972; Barzel, 1997; Libecap, 1986). These rights facilitate value creation because (a) use rights make it possible for owner-managers to pursue novel theories of value (Foss, Foss, & Klein, 2007), (b) appropriation rights incentivize owner-managers to create value and to carefully marshal and monitor resource consumption (Barzel, 1997), and (c) secure transfer rights allow owner-managers to make durable commitments to stakeholders (Belenzon, Chatterji, & Daley, 2017). In contrast, modern property rights theory defines ownership with respect to possession of the residual rights of control. Residual rights of control facilitate value creation because they grant owners the right to determine resource use and to appropriate related returns under all circumstances not specified by prior contract (Grossman & Hart, 1986; Hart & Moore, 1990). These rights provide owner-managers with the motivation, ability, and authority needed to both "command the means of production" (Schumpeter, 1934: 413) and exercise choice during the uncertain pursuit of value.

However, property rights also present owner-managers with rights and incentives that reduce their ability to make credible commitments to stakeholders (Baker, Gibbons, & Murphy, 1999). While the related problems of selective intervention (Williamson, 1996) and bounded reliability (Verbeke & Greidanus, 2009) are ubiquitous, they are especially problematic in the case of value creation in owner-managed firms for three reasons. First, because "subordinate decision authority in firms is loaned, and not owned" (Baker et al., 1999: 56), owner-managers have the authority to overturn managerial decisions, revoke prior commitments, and alter resource use. Second, because property rights are exercised in pursuit of owner welfare, owners have incentive to exercise those rights until the marginal benefits gained are offset by their costs (Barzel, 1997). Lastly, because owner-management significantly reduces the cost of exercising property rights, repeated use of those rights is attractive (Barney, 2018; Foss & Foss, 2005). Property rights have thus often been described as self-incentivizing.

We submit that whenever value creation is a collaborative endeavor, the self-incentivizing nature of property rights, along with the authority residual rights of control vested in the owner-manager, intertwine to create three control hazards that motivate selective intervention and thereby threaten the owner-managed firm's capacity to create economic value. First, while property rights make it possible for the owner-manager to pursue private theories about value, the owner's ability to revoke prior commitments and alter resource use threatens stakeholders who must make firm-specific investments if the firm is to create economic value. This materially reduces the owner-manager's ability to make credible commitments, and creates a *reliability hazard* for those stakeholders (Baker et al., 1999; Kano & Verbeke, 2015). Second, an owner's ability to appropriate benefits gives owner-managers persistent incentive to improve their own welfare at the expense of others. Given that stakeholders' willingness to make firm-specific investments is shaped by their expectations for how rents from team production are distributed, *egocentrism* (Schumpeter, 1934) poses a threat to the value-creation process (Barney, 2018; Mahoney & Kor, 2015). Lastly, secure property rights create a *succession hazard* since the durability of the owner-manager's commitment to stakeholders expires upon succession. The temptation to engage in opportunistic end-game strategies thus rises for all parties as succession approaches (Zellweger, Kellermanns, Chrisman, & Chua, 2012). Taken together, we conclude that property rights facilitate value creation in owner-managed firms but also engender a set of pernicious hazards that, if left unmitigated by the adoption of reliable governance mechanisms, increase the threat of selective intervention, reduce stakeholder commitment, and undermine the owner-managed firm's ability to create value.

Accordingly, we submit that the capacity to create value critically depends upon the owner-manager's ability to resolve the stakeholder commitment problem. Owner-managers can do so by installing governance mechanisms that establish and sustain stakeholder commitment (Williamson, 1996), and by exercising self-control (Thaler & Shefrin, 1981), thereby resisting temptations for selective intervention. In the sections that follow, we first develop theory about the relationship among property rights, owner-management, and value creation and discuss

how control benefits and hazards tied to property rights in the hand of the owner-manager alter value creation. We then discuss how self-control along with four governance safeguards—commitment to social control (Belenzon et al., 2017), delegation of authority to managers (Hellmann & Puri, 2002), submission to hierarchy in the form of a board (Blair & Stout, 1999), and partial transfer of ownership to stakeholders (Coff, 1997)—help to overcome the control hazards but also partially impair the control benefits. The challenge of erecting such safeguards, along with the persistent incentive property rights give owner-managers, is thus a critical and particularly vexing problem.

We make three contributions to the emerging conversation about the relationship among property rights, governance, and value creation (Freeland & Zuckerman Sivan, 2018; Van den Steen, 2017). First, we develop a theoretically grounded account in which property rights play a critical role in both the emergence and pursuit of novel theories of value. Property rights are important because they provide owner-managers with both the incentive and the ability to pursue idiosyncratic, even potentially novel, theories of value.[3] While Knight (1921) and others (e.g., Schumpeter, 1934) have identified novelty as a property that has an essential element of value creation, these authors have not explain its emergence. Property rights facilitate both novelty's emergence and its pursuit (Foss & Klein, 2012). Second, while it is clear that value creation in firms is necessarily a joint endeavor,[4] because the entrepreneur cannot accomplish their goal if stakeholders are unwilling to commit their time, energy, and personal genius to that endeavor, it remains that the creative act in most theories of the firm are attributed to a principal—the entrepreneur. Accordingly, prominent theories of the firm largely view the challenge of obtaining stakeholder support and cooperation through an agentic lens, in which contract, oversight, and incentive alignment play a prominent role. Yet, since "creativity cannot be coerced" (Rothschild, 2000: 197), Freeland and Zuckerman-Sivan (2018) argued that the powerful governance remedies prescribed by these theories are likely to be counterproductive. Our focus on value creation as a cooperative act—and hence, the centrality of the credible commitment problem—sheds new light on how governance safeguards contribute to value creation. Lastly, we provide the outline of a theory that helps explain the observed variance in the ability of owner-managed firms in their ability to create value.

## THEORETICAL FOUNDATIONS

Together with transaction cost economics (Williamson, 1979), property rights theory is part of a larger body of literature on incomplete contracting (Alchian & Demsetz, 1972; Grossman & Hart, 1986; Hart & Moore, 1990). Classical property rights theory defines ownership with respect to the type of control owners exercise over the resources they own, via use, appropriation, and transfer rights. Modern property rights theory defines ownership primarily with respect to possession of the residual rights of control (Kim & Mahoney, 2002, 2005). We maintain that both dimensions of property rights—rights of use, appropriation, and transfer, paired with residual rights of control (Milgrom & Roberts, 1992)—provide owner-managers with authority, rights, and incentives that facilitate the creation of economic value.

The convergence of ownership and owner-management is essential to the pursuit of novel theories of value (Felin & Zenger, 2009) for three reasons. First, ownership is important because the decision to pursue novel theories of value often requires that the entrepreneur place existing productive assets (whether financial, human, or physical capital) at the risk of destruction. It follows that "command of the means of production" (Schumpeter, 1934: 413) is not only useful but perhaps essential in the early and highly uncertain stages of the value-creation process. Ownership is also important because outside owners may not only hinder the entrepreneur as they seek the path to value creation but could also hold them hostage once value is created.

[3] While Schumpeter (1934) and others have noted that "command of the means of production" facilitates entrepreneurship, it remains that ownership is crucial for value creation because the control rights tied to ownership grant an individual the capacity to pursue their idiosyncratic theory of value creation. Because of property rights, they can do so even if others have little confidence in their vision. Property rights also make it possible for the entrepreneur to risk the destruction of their property. As the venture capital literature has made clear, obtaining permission to risk the destruction of *someone else's* property when pursuing entrepreneurial rents can be extraordinarily difficult. Ownership, and not mere "command of the means of production," therefore plays an important role in the value-creation process.

[4] Indeed, the mere presence of the firm provides *prima facie* evidence that the cooperation of others is needed because, if not, theory argues that the entrepreneur should rely on the marketplace, and not hierarchy, to create and capture entrepreneurial rents.

Second, because multiple paths to value creation exist, the entrepreneur must exercise judgment, adapt strategy, and reallocate resources as information about the viability of each path emerges. Ownership and, specifically, residual rights of control provide owner-managers with the authority needed to (re)direct the uncertain journey toward value creation (Foss & Klein, 2012). Owner-managed firms thus have the flexibility and agility needed to adapt firm strategy amid changing circumstances.

Third, because owner-managers retain transfer rights and, in most cases, cannot be displaced without their consent, they are able to make durable commitments to stakeholders. Durable commitments are necessary because the creation of economic value often requires stakeholders to commit time, energy, and personal genius to value creation. However, since the paths to value creation will "often evolve in ways that are difficult, if not impossible, to anticipate" (Barney, 2018: 3313), participation in the value-creation process is risky for stakeholders. Stakeholders are therefore quite rightly concerned that time, uncertainty, and changing owner preferences will—and regardless of the benevolence of the owner-manager's intent—expose them to problems of bounded reliability (Kano & Verbeke, 2015). Owner-managers must therefore establish reliable governance and provide stakeholders with safeguards that are sufficiently robust to enroll them in that endeavor.

Another problem for stakeholders is that not only are owner-managers subject to the problems of bounded reliability but also property rights present them with rights and incentives that further weaken their ability to establish credible governance. First, decision authority enables owner-managers to alter firm strategy (Foss & Klein, 2012). Such decisions, however, may not always enhance value for stakeholders. For example, the value of a stakeholder's path-specific investment in the value-creation process may be lost with a change in strategy or with project failure. In other cases, owner-managers may choose to intervene and overturn decisions made by stakeholders should owner-managers view it to be in their interest to do so (Baker et al., 1999; Williamson, 1996). Moreover, property rights give owner-managers incentive to repeatedly make such decisions because doing so is viewed as enhancing the owner-managers' welfare. Owner-managers can implement such decisions at low cost because their organizations are lean and because their involvement reduces coordination costs (Coff, 1997). Owner-managers thus have both the incentive and the ability to selectively intervene in decision-making, and to make decisions that potentially undermine stakeholder incentives to exert effort and to make firm-specific investments (Foss, Foss, & Vázquez, 2006).

Second, owner-managers are powerful. Their decision-making authority is amplified because their firms are private and free from the discipline imposed by capital markets (Fitza & Tihanyi, 2017). They also have privileged access to key information (Wang, He, & Mahoney, 2009) and may, if they wish, monopolize decision-making (Ling, Simsek, Lubatkin, & Veiga, 2008). Stakeholders' willingness to make firm-specific investments is shaped by both the nature of the commitments the owner-manager has made to them and by their expectations of how rents from team production will be distributed in the future (Foss & Foss, 2005; Wang et al., 2009). The owner-manager's ability to alter or shape strategy, along with their incentives and pronounced bargaining power over rent distribution (Coff, 1999), makes it difficult to provide stakeholders with the assurances needed to motivate them to make firm-specific investments in the value-creation process (Hoskisson, Gambeta, Green, & Li, 2018; Klein, Crawford, & Alchian, 1978). Taken together, owner-managers have both the incentive and the power to exercise their property rights of use, appropriation, and transfer, which makes those rights valuable and at the same time contentious for economic value creation. Table 1 provides an overview of our arguments, which we explore in detail below.

## ADVANTAGES OF OWNER-MANAGEMENT FOR VALUE CREATION

We start by exploring the benefits engendered by the property rights of use, appropriation, and transfer.

### Use Rights and Strategic Benefits

Top management team research has provided ample evidence that owner-managers retain great managerial discretion and have significant firmwide influence over resource use (e.g., Ling et al., 2008). Owner-managers' possession of residual control rights empowers them to pursue attractive opportunities (Klein, Mahoney, McGahan, & Pitelis, 2019). Freedom from capital market oversight, combined with the ability to exercise fiat, facilitates the pursuit of innovation and the implementation of strategies that are idiosyncratic and, perhaps, inimitable (Fitza & Tihanyi, 2017). Moreover, owner-managers have

**TABLE 1**
**Benefits and Costs of Owner-Management for Economic Value Creation**

| Property Right | Description of Property Right | ← Control Dilemmas → | |
|---|---|---|---|
| Right to use | Party holding the property right is empowered to define resource use | ***Strategic benefits*** Innovation advantages, strategic agility | ***Reliability hazards*** Misaligned goals between owner-manager and resource providers |
| Right to appropriate | Party holding the property right can appropriate residual rents after fixed claimants are paid | ***Incentive benefits*** Ability to exercise control, assure efficiency, expend effort, invest in firm-specific resources | ***Egocentrism hazards*** Pursuit of narrow self-interests, capacity constraints of owner-manager, muting of initiative-taking by stakeholders |
| Right to transfer | Party holding the property right has the inalienable right to transfer the right to appropriate and right to use | ***Commitment benefits*** Accumulation of firm-specific resources, embeddedness advantages, personalized signaling of dependability | ***Succession hazards*** High cost to replace owner-manager, owner-manager's unwillingness to depart, owner-manager's selection of a value-destroying entrepreneurial exit option |

superior information due to their long association with their firms and their involvement in day-to-day operations (Lubatkin, Simsek, Ling, & Veiga, 2006). Because of their supremacy, owner-managers can base decisions on their personal judgments and monopolize decision-making should they determine it necessary to do so. Use rights thus provide owner-managers with a great deal of discretion when seeking paths to new sources of value (Amabile, Conti, Coon, Lazenby, & Herron, 1996). Secure use rights make it possible for owner-managers to implement their theories of value and provide the strategic agility required for effective pursuit.

### Appropriation Rights and Incentive Benefits

As the sole claimant to the firm's residual income, the owner-manager has a powerful incentive to ensure operational efficiency and maximize economic value. This argument builds on that of Coase (1960), who noted that as long as property rights are protected and transaction costs are minimized, transactions will be done in an economizing way and will lead to highest-valued resource use (Foss & Foss, 2005). Indeed, private firms benefit from cost advantages because owner-management allows firms to avoid agency costs related to incentive alignment and monitoring (Jensen & Meckling, 1976). Demsetz (1983: 377) observed that owner-managed firms are "lean, no-nonsense institutions devoid of managerial amenities." In addition, the ability to appropriate rents incentivizes owner-managers to expend effort (Fehr, Herz, & Wilkening, 2013) and invest in firm-specific capital (Rajan & Zingales, 1998). The ability to pursue intrinsic goals also often triggers high levels of creativity and achievement (Amabile et al., 1996; Freeland & Zuckerman Sivan, 2018). In addition, owner-managers may be motivated by a variety of nonmonetary rewards (McMullen & Shepherd, 2006), such as the opportunity to implement a cherished technology or autonomy (Hamilton, 2000). When so motivated, owner-managers are sometimes willing to forgo or defer compensation (Wasserman, 2006), which creates cost advantages. Overall, owner-managers' ability to appropriate intrinsic and extrinsic benefits from their property promotes value creation in owner-managed firms.

### Transfer Rights and Commitment Benefits

Consistent with the notion that property rights and their concomitant benefits securely bond the owner to the firm, owner-managers exhibit deep commitment to their firms and employees. Abundant anecdotal evidence has corroborated that founder owner-managers are passionate about their firms (Cardon, Wincent, Singh, & Drnovsek, 2009) and often act in a steward-like manner toward firm stakeholders (Wasserman, 2003). With long-term commitment to their firms, owner-managers accumulate specialized experience about their firms and their environment and, over time, learn how to identify valuable opportunities and calibrate the risks they take (Simsek, 2007). Secure transfer rights also make it possible for owner-managers to make durable long-term personal commitments to stakeholders. Such commitments are personal in nature, but they are reinforced by the owner-manager's identity, reputation, and long-term commitment to the firm. As a result of these commitments, owner-managers often come to be known as relational owners (Hoskisson et al., 2018), who are embedded in an ongoing social structure that constrains opportunistic behavior and preserves valuable commitments from stakeholders (Uzzi, 1996). Relational ties foster advantages via access to reliable information, joint problem-solving, and trust—all of which reduce transaction costs in dealing with stakeholders (Uzzi, 1996). These advantages are reflected in owner-managers' willingness to engage in handshake deals. In addition, owner-managers' continued personal involvement in their firms ensures their accountability to stakeholders and has been viewed as a safeguard against potential misconduct (Kreps, 1996). Namely, owner-managers' personal involvement and identification with their firms motivate them to "bring honor" to their firms and to themselves (Belenzon et al., 2017: 1640). Owner-managers' continuing involvement and resolution serves as a signal of their firms' dependability and, for many contractual parties, serves to certify the value of their contracts. Thus, the ability to make durable commitments to stakeholders enhances the value-generating capacity of owner-managed firms.

## DISADVANTAGES OF OWNER-MANAGEMENT FOR VALUE CREATION

We have argued that the property rights of use, appropriation, and transfer grant owner-managers strategic, incentive, and commitment benefits, all of which contribute to economic value creation (for an overview, refer to Table 1). However, we also suggest that property rights concentrated in the hands of owner-managers engender three *control hazards*—namely, those associated with *reliability, egocentrism,* and

*succession*—which can alienate stakeholders and undermine private firms' ability to create economic value.

### Use Rights and Reliability Hazards

Although rights of use play a critical role in value creation, they are accompanied by reliability hazards that make it risky for stakeholders to commit effort and genius to private firms. More specifically, in the absence of the external control imposed by capital markets and the internal controls often found in widely held firms (e.g., independent boards and management hierarchy), the exercise of property rights can create holdup problems in owner-managed firms. These holdup problems arise because owner-managers can monopolize decision-making, exercise great discretion, and implement idiosyncratic strategies, such as limiting production capacity or favoring certain production processes over others. For example, Walt Disney limited attendance at his parks in an effort to reduce wait times for his patrons, and Elon Musk eschewed conventional automobile production technology at Tesla—a decision that has proven problematic for investors, employees, and customers alike (Atkins, 2018). However, because owner-managers are theoretically accountable to no one but themselves, they have great discretion and latitude when determining the best use of their property. This increases both the risk that owner-managers will pursue idiosyncratic strategies (Hambrick & Finkelstein, 1987) and the likelihood that stakeholders will view such conduct as inconsistent or erratic (Zaheer, McEvily, & Perrone, 1998).[5] While the discretion provided by property rights facilitates the emergence of novel strategies, repeated or capricious exercise of these use rights may lessen stakeholder perceptions of owner-managers' reliability. Even though, as outlined above, owner-managers' commitment can help signal dependability, previous studies have shown that simple promises made to those who make firm-specific investments are often unreliable (Kydland & Prescott, 1977; Laffont & Tirole, 1988; Nooteboom, 1996). In the end, low reliability deters firm-specific investment.[6]

Another way in which use rights can become problematic for stakeholders is if owner-managers choose to pursue noneconomic goals. Such decisions may take the form of reduced effort or slower firm growth (Schulze, Lubatkin, Dino, & Buchholtz, 2001), nepotism (Villalonga & Amit, 2006), use of firm resources for political purposes (Fauchart & Gruber, 2011), or excessive consumption of perquisites (e.g., Gimeno, Folta, Cooper, & Woo, 1997). Over time, rights of use can also shape and alter owner-manager preference such that owner-managers overturn prior commitment to employees or engage in strategies that favor one group of stakeholders over another—a phenomenon that Verbeke and Kano (2010, 2012) called benevolent preference reversal. In the end, the pursuit of idiosyncratic strategies and noneconomic goals likely creates a wedge between owner-managers' and stakeholders' interests, which makes firms less competitive (Bena & Xu, 2017; Gimeno et al., 1997; Lehmann & Weigand, 2000; McCann & Vroom, 2010) and less valuable in the marketplace (Wasserman, 2006).

Information asymmetries between the owner-manager and stakeholders about owner welfare can also create reliability problems for stakeholders. The problem is straightforward: because subordinates have at best imperfect knowledge about how a given decision might impact owner-manager welfare, they will sometimes make decisions that compromise it. The wise owner-manager should base the decision about whether to overturn a given decision on an assessment of the benefits of intervention versus the detrimental impact of intervention on agent or stakeholder motivation. Baker et al. (2001) found that the optimal decision outcome is determined by which party (principal or agent) possesses superior information. In cases where the principal is uninformed—that is, they lack or have inferior information about the decision at hand—Baker et al. (2001) showed that principals are better off if they exercise forbearance. However, if the principal is informed, they should intervene. Property rights there-

[5] In his work on the discrepancies between behavior and perceived self-interest, Loewenstein (1996) found that people often act against their self-interests, knowing full well that they are doing so. People themselves and the individuals around them, in particular, then experience a feeling of being "out of control."

[6] We wish to be clear: we are not postulating that owner-managers are systematically erratic or even opportunistic when dealing with stakeholders; rather, we are proposing that there is likely significant idiosyncrasy in private firms' strategic conduct due to the wide managerial discretion owner-managers enjoy and the pernicious incentives they face.

fore exacerbate the problem of selective intervention because owners will always, and necessarily, have superior information about actions that might enhance or harm their welfare. Extended to the case of owner-management, it follows that property rights exacerbate the problems of selective intervention and bounded reliability in owner-managed firms because the information and incentives facing owner-managers and nonowner-managers necessarily differ.

Selective intervention, and the pursuit of idiosyncratic strategies and noneconomic goals, help to explain the persistent labor market problems many private firms experience (Wang et al., 2009). Given that these attributes make it difficult for private firms to signal reliability, it is likely that high-quality employees are less willing to work for them. The result is that reliability hazards expose owner-managed firms to adverse selection and force them to rely on less-qualified employees or those with limited mobility or other constraints (Hellmann, 1998). In the event stakeholders are faced with unreliability *ex post*, they have the incentive to leave or engage in morally hazardous behavior, such as shirking or consuming perquisites (Hart, 2009). Together, these challenges impair the value-generating capacity of owner-managed firms.

Demsetz (1983: 383; see also Miller & Smith, 1993) provided an example of reliability hazards when discussing Ford Motor Company during the era in which it was privately owned and run by Henry Ford Senior:

> The senior Ford, who built the Ford Motor Company into a position of dominance in the automobile industry, is said to have had such a proclivity [to habitually consume on the job, to be erratic]. But also, in his later years, he proved to be stubborn, single minded, and without managerial flexibility. He "consumed" dominance over his fellow workers at the sacrifice of profit to himself. His lieutenants were disgruntled but helpless as they witnessed the decline of the company. Ford survived as the managerial leader of his company only because it was his company. Had the Ford Motor Company been a publicly held corporation, it is unlikely that he would have been allowed to indulge his taste for dominance for so long.[7]

We suggest that Henry Ford's transformation into a malevolent dictator is, at least in part, a product of the hazards that use and residual control rights exacerbate. We conclude that these rights exacerbate reliability hazards in private firms and create a wedge between the goals of the owner-manager and those of resource-providing stakeholders, which in turn detracts from value creation.

### Appropriation Rights and Egocentrism Hazards

The flipside of the incentive benefits that appropriation rights provide is the problem of egocentrism. Egocentrism poses a hazard to stakeholders because it may cause owner-managers to favor self-regarding over other-regarding interests (Thompson & Loewenstein, 1992). The problem of egocentrism for economic value creation is that the owner-manager's pursuit of self-regarding interests can make it difficult for the owner-manager to reach win–win agreements with stakeholders (Drouvelis, Nosenzo, & Sefton, 2017). Barney (2018: 3319) pointed to this hazard when arguing the following:

> Stakeholders always have two self-interests to balance: their narrow self-interest in extracting as much of the profit generated by a firm as possible, and their broader self-interest, which suggests that, without cooperation that leads to co-specialization, there will not be any expected economic profits to distribute.

Therefore, the threat is that owner-managers have both the ability and the incentive to pursue self-regarding interests, but doing so undermines the conditions necessary to support cospecialization by stakeholders, and weakens value generation (Bridoux & Stoelhorst, 2014).

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[7] The case of Theranos, which was ultimately dissolved in 2018, serves as a more recent illustration of reliability hazards. On April 24, 2016, the *New York Times* ran an article titled "Theranos's Fate Rests With a Founder Who Answers Only to Herself," referring to Elizabeth Holmes, majority owner and founder of Theranos, a company that provides blood-testing services. With a valuation of 9 billion USD in 2015, the company's fate depended on the charges against the firm and Elizabeth Holmes' capacity and willingness to keep her promises, especially those with investors. The *New York Times* wrote that "after more than six months of intense questions, change has been limited"; that as the majority owner, "She—not the investors, and not even the board—controls the switches"; and that "What she wants done at the company she can demand." Regarding the future of the company, the article stated, "The intentions, and a strong intention, is that the company is going to be private forever." Finally, on the goals of the founder and the future of the firm, the *New York Times* noted, "This technology is not going to be sold to somebody who just wants to make more profits from it" but that, ultimately, "You have to ask Ms. Holmes what the next steps are" (Abelson, 2016: 1).

One problem that appropriation rights create is that in order to benefit from the value-creation effort, owner-managers must remain closely involved in their firms. For example, owner-managers may decide to perform or closely supervise critical tasks in an effort to limit others' ability to imitate their products (Rajan & Zingales, 2001).[8] However, tight control constrains value creation because the supervisory capacity of even the most heroic entrepreneur is limited (Foss & Weber, 2016). As firms' size and value increase, owner-managers face diminishing returns as information-gathering, monitoring, and other control efforts become excessively costly and inefficient for them to shoulder alone. Put differently, owner-managers' concern about rent appropriation can impede, if not place an upper bound on, value creation (Holmstrom & Milgrom, 1994; Miller & Smith, 1993). Indeed, research on threshold firms has documented the challenges private firms face once they reach a certain level of value, above which more decentralized governance is required (Gedajlovic, Lubatkin, & Schulze, 2004).

Further, the powerful incentive for owner-managers to appropriate rents from team production may dampen stakeholders' initiative, given the tradeoff between monitoring and stakeholders' motivation to engage in team production (Burkart, Gromb, & Panunzi, 1997; Frey & Jegen, 2001). Since monitoring focuses on compliance and the reduction of variance, in particular bad outcomes it may lead employees to shift attention away from risky but value-generating entrepreneurial initiatives. Employees might also interpret monitoring as distrust, or "second guessing," on the part of the supervising party (McDonald & Westphal, 2010). In colloquial terms, owner-managers may start acting like "control freaks" or "micromanagers" and insist that their ideas are always the best. In the end, power asymmetry that favors owner-managers leads to feelings of disempowerment among stakeholders, which undermines incentives and ultimately hampers value creation (Baker et al., 2001; Burgelman, 1983; Holmstrom & Milgrom, 1994).

**Transfer Rights and Succession Hazards**

We further suggest that transfer rights in the hands of the owner-manager make private firms vulnerable to succession hazards. Although the timing may be uncertain, an owner-manager's departure is inevitable and, due to the risk that it may engender opportunistic end-game strategies, often costly. For instance, owner-managers may decide to retain control because of the multifaceted pleasures tied to exercising authority (Fehr et al., 2013), and stay at the helm of their firms beyond the official retirement age (Uhlaner, Wright, & Huse, 2007).[9] In addition, owner-managers may not heed advice about letting go simply because they do not see the need to do so. They may fall prey to overconfidence and complacency fostered by prior success or become risk averse due to gains accumulated over a prolonged tenure (Simsek, 2007). In sum, their continued tenure harms value creation.

Alternatively, owner-managers may make value-destroying succession decisions, such as appointing an unqualified heir (Bennedsen, Nielsen, Perez-Gonzalez, & Wolfenzon, 2007) or transferring ownership to parties who will not honor prior commitments to stakeholders (Sharpe, 1990). Managers who anticipated a long-awaited promotion or the implementation of a favored project may then be disappointed and demotivated. Alternatively, owner-managers may decide to place their shares in "asset-freezing" legal structures, such as trusts or foundations. Doing so reduces estate taxes and has the appearance of perpetuating one's entrepreneurial legacy but often reduces the vitality and value of the enterprise (Zellweger & Kammerlander, 2015). Akhter, Sieger, and Chirico (2016) also documented cases in which owner-managers closed their firms, rather than selling them, because their firms would simply not be the same without them.

Succession hazards might also motivate stakeholders to engage in opportunistic end-game strategies because they realize that the value of their firm-specific investments will expire with the departure of the owner-manager. Valuable employees may choose to exit the firm in anticipation of the owner-manager's exit, or they may start to shirk or adopt morally hazardous behavior. Put simply, in the absence of reliable governance and organizational commitments that will survive the owner-manager,

[8] Examples of such activities range from approving the design of new products and licensing of products to third parties to the close monitoring of product quality and careful cultivation and protection of the firm's reputation.

[9] In a sample of 495 CEOs (most of them sole owners) from small to mid-sized U.S. firms, Simsek (2007) found that mean CEO firm tenure is 19.9 years and mean CEO positional tenure is 13.8 years. In combination with abundant anecdotal evidence, these data suggest that owner-managers' firm tenure often spans from firm foundation to sale or retirement.

succession hazards will threaten the vitality of the firm and undermine value creation.

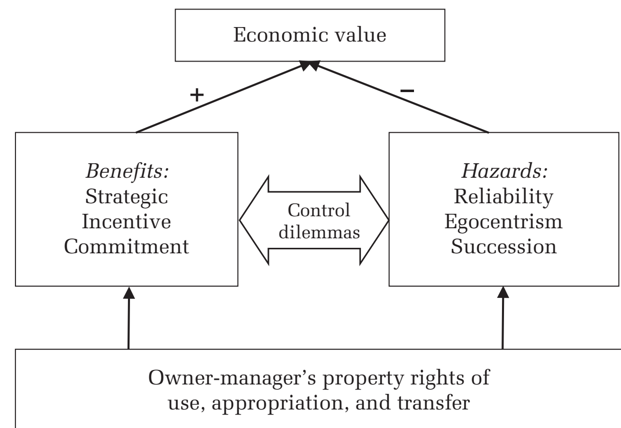
## PRIVATE FIRM GOVERNANCE AS A SELF-CONTROL PROBLEM

We have argued that the property rights of use, appropriation, and transfer are a source of both advantages and disadvantages in value creation. Whereas the advantages come in the form of strategic, incentive, and commitment benefits, the disadvantages materialize as reliability, egocentrism, and succession hazards, which result in control dilemmas for owner-managers (Figure 1).

The problem is that the rights and incentives that accompany owner-management make it difficult for owner-managers to make commitments to stakeholders in a manner that the latter view as credible. The willingness of owner-managers to install credible governance may be limited because property rights tempt owner-managers to minimize governance in an effort to preserve value-creating discretion as well as their ability to enhance their personal welfare. Even if owner-managers recognize the need for governance, the siren call of property rights may tempt owner-managers to intervene and renege on delegation promises. They may, for example, choose to willfully disregard board advice or overrule managerial decisions. While such decisions may, on a case-by-case basis, lead to value-enhancing outcomes (Baker et al., 2001), they inevitably frustrate stakeholders' initiative and willingness to contribute to value creation (Foss, 2003). Because, ultimately, owner-managers retain absolute authority (Baker et al., 1999, 2001), they will struggle to make credible commitments to stakeholders and, in so doing, materially compromise their ability to create economic value.

The crux of the matter is that no one can alleviate the control hazards other than the owner-manager themselves, so both self-control and governance mechanisms are needed for value creation. Sole reliance on self-control will likely be viewed as too unreliable to attract new high-quality stakeholders, such as employees, or to persuade existing stakeholders to fully commit to the proposed path to value creation (Bazerman, Tenbrunsel, & Wade-Benzoni, 1998; Laffont & Tirole, 1988).[10] Governance

**FIGURE 1**
**Control Dilemmas in Economic Value Creation**




safeguards alone are also likely to be ineffective if owner-managers do not exercise self-control, "walk the talk," and refrain from putting rhetoric about shared governance into action; for example, they might install a board of directors but disregard its advice. Therefore, owner-managers face a dilemma: they cannot create value without the cooperation of stakeholders, but making credible commitments to enlist these stakeholders requires them to limit their authority in ways that confines the free exercise of property rights and hence constrains their ability and incentives to create and appropriate value.

Building on the private firm governance literature (e.g., Uhlaner et al., 2007), in the following we discuss the impact of four governance mechanisms often found in private firms on the benefits and hazards of property rights: (a) commitment to social

[10] Self-control refers to an individual's capacity to inhibit responses that are immediately gratifying but ultimately detrimental to longer-term goals. When people exercise self-control, they alter dominant response tendencies and regulate their conduct in a manner that promotes desired behaviors (De Ridder, Lensvelt-Mulders, Finkenauer, Stok, & Baumeister, 2012). Thaler and Shefrin (1981) formalized self-control as an agency problem wherein both the principal and the agent are the self (in our case, the owner-manager), who is faced with two conflicting preferences: immediate consumption (the doer) versus future consumption (the planner). Thaler and Shefrin (1981) found strong evidence indicating that much like in a team production effort, people rationally choose to impose self-constraints on their behavior to overcome the limits of their myopic and ultimately inefficient behavior (Ariely & Wertenbroch, 2002; Vanberg, 2002). A striking description of self-control in combination with binding governance can be found in Homer's (2019) epic *The Odyssey*, wherein Ulysses, the commander of a ship, asks his sailors to tie him to the mast to avoid the enchanting but ultimately deadly songs of the Sirens.

**TABLE 2**
**Impact of Governance Mechanisms on Control Benefits and Control Hazards**

| | | Impact on Control Benefits | | | Impact on Control Hazards | | |
|---|---|---|---|---|---|---|---|
| | | *Strategic benefits* | *Incentive benefits* | *Commitment benefits* | *Reliability hazards* | *Egocentrism hazards* | *Succession hazards* |
| **Commitment to social control** | Community → Owner-manager | Partly reduced | Unchanged | Reduced | Reduced | Reduced | Partly reduced |
| **Delegation of authority to managers** | Owner-manager → Management | Reduced | Reduced | Partly reduced | Reduced | Reduced | Partly reduced |
| **Submission to the hierarchy of a board** | Board → Owner-manager | Reduced | Unchanged | Unchanged | Reduced | Unchanged | Reduced |
| **Partial allocation of ownership to stakeholders** | Owner-manager ← Stakeholders as coowners | Reduced | Reduced | Reduced | Reduced | Reduced | Reduced |

control, (b) delegation of authority to managers, (c) submission to the hierarchy of a board, and (d) partial transfer of ownership to stakeholders. Table 2 summarizes our discussion.

## Commitment to Social Control

One way to curb control hazards is for owner-managers to commit to social control. In line with organizational sociology (Aldrich, 1999; Kanter, 1968), we define commitment to social control as the owner-manager's willingness to commit to a socially legitimized normative order (O'Reilly & Chatman, 1996), such as promotion of the good of the collective (Grimes, 1978; Vanberg, 2002). Under social control, individual discretion is deferred to higher-order normative claims about what is appropriate (Whetten & Mackey, 2002). Social control is a powerful control mechanism given the threats of social stigma, ostracism, and isolation imposed on individuals and organizations that transgress (Kanter, 1968).

Common forms of commitment to social control include publicly committing to communities or causes (e.g., educational, environmental, or religious causes), adopting advertising campaigns in which the identity of the owner-manager or their family is used to signal integrity (e.g., SC Johnson identifies itself as a "family company" [https://www.scjohnson.com/]), and promoting transparency (e.g., disclosing financial statements or salary information). These forms of control help signal reliability and predictability, circumscribe owner-manager behavior, and provide stakeholders with assurance about future firm conduct. Put differently, commitment to social control increases owner-managers' persuasiveness and reputation for trustfulness and reliability (Gans & Ryall, 2017), thus strengthening the ability to establish cooperation and create value (Nooteboom, 1996). However, an owner-manager's commitment to social control may partially constrain the firm's strategic agility (Fombrun, 1996). Put differently, when committing to social control, private firms forgo some strategic options in exchange for improved reliability.

Further, we expect that social control will reduce egocentrism hazards while leaving incentive benefits largely unchanged. When owner-managers commit to social control, they signal a willingness to put aside their narrow self-interests and to make the sacrifices necessary to enhance the long-term welfare of their enterprises. Expressing care and concern about stakeholder welfare, demonstrating loyalty, and

adopting moral principles of business conduct should stimulate commitment, trust, and loyalty among stakeholders, thereby fostering team production and value creation (Hernandez, 2012). In contrast, incentive benefits should not be affected because owner-managers' incentive to exercise effort and create value is not formally altered with the submission to social control.

In addition, we expect that commitment to social control only partially mitigates succession hazards; property rights still incentivize owner-managers to cling to power or transfer ownership to those who promise to generate ongoing benefits for the owner. To the extent that stakeholders anticipate continuity in firms' social commitments upon departure of the owner-manager, the incentives for owners and stakeholders to engage in end-game opportunistic behavior will be reduced. At the same time, we expect commitment to social control to weaken the benefits of prior commitments. Social control should curb embeddedness advantages from personal ties between owner-managers and stakeholders since social missions constrain what firms may or may not do and depersonalize the nature of exchange firms have with stakeholders.

Founders provide a particularly good example of how commitment to social control alters control benefits and hazards. Founders often commit to an authentic set of values and learn that doing so allows their firms to benefit from higher levels of reliability, collaboration, and value (Stinchcombe, 1965). Ultimately, however, founders are reluctant to let go of their firms (Wasserman, 2017), and succession hazards persist. Consider the outdoor clothing and gear producer Patagonia. The firm is highly successful and strongly committed to environmental sustainability. This commitment, along with other espoused beliefs firmly embedded in the firm's employment practices, provides reliable safeguards to stakeholders. Thus, social control firmly binds the owner-manager's hands, guides strategy, and makes Patagonia an attractive employer, especially for those who share its values. The firm is, however, entirely owned by the founder Yvon Chouinard and his wife. The firm will pass to a trust controlled by the founder's two children, who are bound by terms of the trust to uphold the values imbued by their father (Paumgarten, 2016). Establishing a trust helps preserve commitment benefits and mitigate succession hazards, but also limits Patagonia's future strategic agility. In fact, a trust commits the firm to a course of action that may or may not yield the desired environmental benefits, and may constrain the future leader's ability to address other social needs (e.g., hunger or homelessness).

### Delegation of Authority to Managers

The authority granted by property rights greatly facilitates value creation because it gives owner--managers both the ability and the incentive to centralize decision-making, which helps to overcome team-production problems (Arrow, 1963). To generate economic value, however, owner-managers must resist autocratic tendencies since their capacity to manage complexity and acquire and process information is naturally limited (Miller & Smith, 1993). Even the most autocratic owner-managers must depend on subordinates—namely, those who possess knowledge of particular circumstances and time and place—to create value (Hayek, 1945).[11]

We anticipate that managerial hierarchies will mitigate reliability hazards but also weaken the strategic benefits of owner-management. Schulze and colleagues (2001) suggested that a benefit of professionalizing management in private firms is the adoption of a set of practices (e.g., budgets, strategic plans, measurement, and organizational rules) that provide transparency and enhance accountability and reliability (Poppo & Zenger, 1998). Such practices align owners' and managers' interests and impose discipline toward a common goal, one typically defined in economic terms. Even though hiring a marketing vice president or establishing human resource policies that protect employees from holdup is prudent (Hellmann & Puri, 2002), entrepreneurs are often hesitant to do so (Daily & Dollinger, 1992). Indeed, with the appointment of managers, owner-managers forgo some of their discretion and related strategic agility as a result of misaligned interests and information asymmetries between owners and managers (Jensen & Meckling, 1976). In this sense, delegating authority to managers improves reliability but undercuts strategic flexibility.

In a similar vein, decentralized, participative decision-making (Coff, 1997) helps overcome the capacity constraints often found in owner-managed firms. Managerial hierarchies should give organizational members "breathing room," reduce overmonitoring by owner-managers, and alleviate egocentrism hazards. However, the downside of managerial hierarchies is that owner-managers run into agency costs from misaligned interests, which necessitates costly

[11] Regarding his recipes for value creation, Steve Jobs, founder and former CEO of Apple Computer, famously said, "It does not make sense to hire smart people and tell them what to do. We hire smart people so they can tell us what to do" (Schwantes, 2007).

incentive systems. Having to establish incentive systems will likely undercut incentive benefits since owner-managers must then share the rents from team production with managers (Jensen & Meckling, 1976). In this sense, delegating authority to managers curbs egocentrism hazards but at the same time undercuts incentive benefits.

Finally, delegating authority to managers partially alleviates succession hazards but also weakens commitment benefits. By installing a management team, owner-managers make their firms less dependent on their own involvement, reducing the cost of owner-manager replacement and succession. However, installing a management team will not necessarily increase owner-managers' willingness to let go. Delegating unpleasant tasks and instead focusing on favored activities inside the firm may create an organizational context in which owner idiosyncrasy and personal reward flourish. The flipside of professionalization is that firms become depersonalized to some extent such that relational ties with stakeholders are replaced with transactional ties, which likely undermines the embeddedness advantages and hence the commitment benefits that owner-management typically creates.

Empirical research has indeed confirmed that delegating authority to managers is beneficial in private firms. For example, Durand and Vargas (2003) found that owner-controlled flat firms (i.e., firms without a top management team layer) underperform owner-controlled multilayered firms. The authors also showed that owner-managed firms outperform agent-managed firms only when the owner-managed firms are multilayered—that is, when decision-making is decentralized. Durand and Vargas (2003: 67) concluded that "multilayer owner-controlled firms appear to be more efficient than flat agent-led firms, indicating a potential predominance of the 'control dimension' over the 'organization dimension' in driving the private firms' efficiency." Put differently, gains from the alleviation of control hazards by delegating authority to managers appear to be greater than the attendant reduction in control benefits.

### Submission to the Hierarchy of a Board

According to the corporate governance literature, the primary role of the board of directors in widely held firms is to monitor management (Hillman & Dalziel, 2003; Zahra & Pearce, 1989). Because the controlling owner in a private firm serves as chief executive officer (CEO), the monitoring function of the board is assured and has led agency theorists to conclude that board oversight is not theoretically necessary in private firms.

However, a team-production perspective on firm governance suggests that boards can play an important role in value creation in private firms by enhancing stakeholder welfare (Blair & Stout, 1999; Machold, Huse, Minichilli, & Nordqvist, 2011; Rajan & Zingales, 2001). For example, boards can be useful if they enhance owner-managers' sense of accountability. Accountability refers to the expectation that one may be called upon to justify one's behavior and decisions to others (Lerner & Tetlock, 1999). Accountability increases the rationality of decision-making and makes individuals more aware of their own judgment processes (Siegel-Jacobs & Yates, 1996; Tetlock, 1992). The appointment of a board of directors, even in an advisory capacity, might then enhance organizational decision-making processes and reduce the extent to which owner-managers' decisions are biased by the incentives and hazards that attend ownership. Boards might also serve a broad stakeholder base by working as a vehicle through which conflicts between stakeholders are resolved, thereby limiting idiosyncrasy and owner opportunism. The latter outcome is especially important in light of the relationship between self-control problems and the hazards that complicate value creation (Anderson & Reeb, 2004; Chrisman, Chua, & Litz, 2004).

We surmise that private firm boards help mitigate reliability hazards but also limit strategic agility. Even though owner-managers can, in principle, choose to disregard board advice, the act of establishing a board comes with the duty to delegate authority to it (Fiegener, 2005). Because boards approve strategic plans and operating budgets using standardized financial criteria, it should be easier to align owner-managers' and other stakeholders' interests. Further, boards are likely to push for greater transparency and appoint auditors (Desender, Aguilera, Crespi, & Garcia-Cestona, 2013). Boards thus enhance consistency in firm conduct and thereby mitigate reliability hazards. However, the appointment of a board is not costless. Besides the direct costs of appointing board members, the need to seek board approval for strategic decisions may limit owner-managers' discretion and slow private firms' responses to changing market conditions, reducing their strategic agility.

We further propose that boards are less effective in dealing with egocentrism hazards and may have a negligible effect on incentive benefits. Boards often lack the tools needed to alleviate overcontrol by owner-managers and employee demotivation because their

authority is translated into day-to-day business activities by owner-managers themselves, which tempers the effectiveness of board oversight in alleviating egocentrism hazards. Private firm boards also tend to be less independent than public firm boards (Uhlaner et al., 2007), have fewer committees, and be less likely to compensate directors (Minichilli, Zattoni, & Zona, 2009), all of which reduce their capacity for active oversight. In addition, board activity levels and meeting frequency tend to be much lower than what is required to run firms' daily operations and to critically mitigate owner-managers' capacity constraints (Vafeas, 1999). Finally, since compensation in most private firms is not supervised or determined by the board, boards do not materially alter the rent-distribution process inside the firms they oversee (Kapila, 2018). Boards in private firms thus have a negligible effect on incentives for value creation as perceived by owner-managers.

However, we expect that because boards play a role in appointing top managers (Conyon & Peck, 1998), establishing a board should reduce succession hazards. Tasked with advising on the appointment of the CEO and serving as advocates for a multitude of stakeholders who have ongoing interest in the firm, boards should motivate owner-managers to establish structures and processes, such as succession plans, that make their firms less vulnerable to their departure. Boards should be in the position to push owner-managers to groom successors, which in turn helps sustain economic value generation (Schulze et al., 2001). In contrast, we do not expect that submission to the hierarchy of a board will materially alter commitment benefits. Since appointing a board does not necessarily alter the owner-managers' involvement in operations, their commitment to the firm and their capacity to accumulate firm-specific resources and embeddedness advantages remain unaffected.

Empirical evidence from a nationwide study found that, after controlling for endogeneity, private firms with boards had higher returns on assets and were larger than private firms without boards (Villalonga, Trujillo, Guzmán, & Cáceres, 2019). These findings suggest that the mitigated control hazards outweigh the loss of control benefits associated with installing a board.

### Partial Transfer of Ownership

The ultimate safeguard that stakeholders can seek is the partial transfer of ownership, and hence the formal transfer of authority, from the owner-manager (Coff, 1997; Miller & Smith, 1993; Wang et al., 2009). Scholars have viewed these transfers as value enhancing. Hansmann (2000) observed that firm value is greatest when ownership is held by the party whose firm-specific investments have the most influence on the value being generated, and for whom effective contracts cannot be written. Baker et al. (1999) also modeled and found that the formal transfer of authority through asset transfer is, as Grossman and Hart (1986) asserted, an effective solution to the selective intervention problem that attends the concentration of power.

Partial transfer of ownership, we conclude, should reduce reliability hazards but simultaneously undercut strategic benefits. Reliability hazards should decline because allocating ownership to stakeholders reduces the likelihood that owner-managers will behave opportunistically, take stakeholders hostage, or "dispossess them on a whim" (Rajan & Zingales, 2001: 423). For example, shareholders are legally entitled to financial information, which makes it harder for owner-managers to capitalize on private information. In addition, transparency makes it more difficult for owner-managers to pursue nonfinancial goals and extract private benefits. Reallocating ownership should in turn support the development of coherent strategies and the pursuit of economic goals, including value creation (Wang et al., 2009). However, given that partial transfer of ownership implies that additional owners will have voice in determining firm strategy, owner-managers' strategic discretion and agility may suffer.

When partial ownership is transferred to stakeholders, egocentrism hazards should decline because stakeholders have a formal claim on a portion of the rents generated by the firm. To the degree that every party's interests are protected, ownership grants all owners a residual claim on profits and a say in the firm so that stakeholders with shares in the firm are motivated to specialize and exert effort even when it is costly to do so. However, ownership dispersion typically gives rise to collective action problems as individual owners lack the incentive and power to exert effort and engage in monitoring to uphold operational efficiency (Villalonga et al., 2019). Moreover, ownership dispersion may also engender conflicts among majority and minority owners, such as those concerning strategic preferences, dividends, and risk-taking, thus causing minority owners to fear expropriation by the majority owner (Villalonga et al., 2019). In sum, benefits from reduced egocentrism hazards may be offset by costs from reduced incentive benefits.

Finally, partially transferring ownership to stakeholders should also mitigate succession hazards. Dispersed ownership creates a more liquid market for firm shares such that the additional owners may become the natural successors of the owner-manager (Hansmann, 2000). Moreover, stakeholders can push for leadership changes—even the replacement of the owner-manager or CEO)—through their interactions with the board. In turn, reallocating ownership to stakeholders might reduce the owner-manager's inertial tendencies and mitigate end-game behaviors that destroy value. However, the fact that other owners may gain the upper hand will weaken the benefits tied to the owner-manager's continuous involvement in the firm, such as embeddedness advantages and the owner-manager's accumulation of firm-specific know-how. In summary, partial transfer of ownership to stakeholders is a powerful governance mechanism that mitigates all three control hazards but simultaneously undercuts all three control benefits.

## DISCUSSION

In this article, we offer theory about the benefits and costs of owner-management for firms' economic value generation. Drawing on property rights theory (Alchian & Demsetz, 1972; Hart & Moore, 1990; Mahoney & Kor, 2015), we develop an integrated and parsimonious theoretical framework that helps reconcile traditional agency perspectives with recent empirical findings about the detrimental economic impact of owner-management (Belenzon et al., 2017; Bena & Xu, 2017; Durand & Vargas, 2003; Lehmann & Weigand, 2000; McCann & Vroom, 2010; Moskowitz & Vissing-Jørgensen, 2002). Our paper contributes to research by showing that the advantages and disadvantages of owner-management for value creation have a common root cause: concentrated property rights in the hand of the owner-manager. We suggest that property rights exacerbate self-control (Bazerman et al., 1998) and bounded reliability problems (Verbeke & Greidanus, 2009) such that reliable governance safeguards are needed for owner-managed firms to create value (Mahoney & Kor, 2015). We illuminate how self-control, along with four governance safeguards—commitment to social control, delegation of authority, submission to hierarchy, and partial transfer of ownership to stakeholders—enhances owner-managers' ability to make credible commitments to stakeholders. We also discuss how these governance safeguards vary in their capacity to curb the control hazards (reliability, egocentrism, and succession hazards) and, at the same time, partly undermine the control benefits (strategic, incentive, and commitment benefits), which provides a theoretical foundation for the control dilemmas often found in owner-managed firms (Wasserman, 2017).

Our work also contributes to entrepreneurship theory because we describe the crucial role that property rights play in the emergence of novel theories of economic value creation. While transaction cost economics and other formal theories of the firm do not rule out the prospect that managers may pursue novel theories of value or implement idiosyncratic strategies, it is difficult to identify a mechanism in formal theory that explains their emergence because such theories tend to model managers as subject to identical influences. In our account, property rights facilitate value creation because they grant owner-managers the use rights needed to place property at risk of destruction, as well as the control rights needed to alter course, as the value-creation process unfolds.

We also delineate the different roles that control and residual rights play in facilitating the pursuit of new sources of value. Our theory thus sheds shed new light on such diverse phenomena as the emergence of new sources of value and the impact of selective intervention on value creation in private firms. We also offer a theory about how reliability, egocentrism, and succession hazards influence private firm governance. While some of these aspects of firm governance have been addressed in literature on the theory of the firm, their relationship with owner-management has not been adequately explored. We contend that our theory is a steppingstone toward the development of a theory of private firm governance (Audretsch & Lehmann, 2014; Zahra & Filatotchev, 2004). Our paper thus responds to calls for better contextualization of governance theories in light of contingencies related to ownership structure (Desender et al., 2013).

Our discussion of the governance safeguards suggests that they vary in their effectiveness, so a blend of them is likely needed. We thus concur with Schulze et al. (2001) and their observation that for enhanced economic value creation, private firms benefit from adopting the kind of governance mechanisms found in widely held firms. Adopting these mechanisms means that the central advantages of owner-management—that is, the advantages of dictatorship captured by Arrow's theorem—are at risk (Miller & Smith, 1993). As control is decentralized, the ownership and control functions are split, and the strategic, incentive, and commitment benefits of owner-management are weakened. Thus, the

governance safeguards that mitigate control hazards are not only a source of agency costs but they also weaken private firms' capacity to generate value. Further, while the value generation capacity of owner-management can, at least theoretically, be preserved through the heroic exercise of self-control, the agency costs of value creation (i.e., the costs tied to adopting governance mechanisms that help to overcome the control hazards) can only be forgone in cases where team production is not required to create value. For example, in rare cases where the entrepreneur does not need others to develop or test their theory of value, the entrepreneur does not need to incur the agency cost of value creation. Rather, entrepreneurs can then create and capture value through contract—for example, outsourcing.[12] Moreover, the agency costs of value creation that we describe differ from those associated with conventional agency theory because they are positive (i.e., they are aimed at facilitating collaborative benefit) and because they are associated with the *principal's* efforts to increase the productivity of the firm—they are not the product or a cost of agent opportunism. The task of value creation thus requires owner-managers to seek a governance configuration in which the benefits of owner-management exceed its costs. Accordingly, our theorizing provides a positive explanation for the emergence of agency costs in private firms, as well as for private firms' need for governance.

Our theory builds on important previous work on commitment failures and the concept of bounded reliability (Coff, 1997; Lumineau & Verbeke, 2016) by specifically focusing on owner-managed firms. This is the ideal context to study commitment problems and the variegated impact of self-regarding behavior, since the owner-manager cannot not be sanctioned or unseated—a stark contrast to the case of the manager in the widely-held firm. Hence, untangling differences between widely-held and owner-managed firms with respect to the selective commitment and bounded reliability problem is an important prerequisite for refined theorizing on the governance of private firms. We show that commitment problems are particularly salient in owner-managed firms because the owner-manager is the absolute ruler in their firm. By rooting our theorizing in the property rights of use, incentive, and transfer we uncover core problems that are unusually problematic in private owner-managed firms, but less so in nonowner-managed firms. By uncovering the dual-edged nature of property rights in the hands of the owner-manager—that is, by linking control benefits to their hazards—we unearth some of the core strategic strengths and weaknesses of owner-managed firms, and draw attention to the control dilemmas owner-managers face.

Our theorizing also allows for variance in the magnitude of control benefits and control costs across various types of owner-managed firms. For instance, founder-controlled firms may benefit from pronounced strategic advantages by competing on the basis of innovative offerings. Founders can also be inspirational and put their self-interests aside, which limits unreliability and facilitates stakeholder investments (Wasserman, 2006). Founders are also often deeply committed to their enterprises, provide their firms with critical firm-specific resources, and hold deep knowledge about their firms' unique bundle of resources (Mahoney & Kor, 2015), all of which can play an important role in creating value. However, founders often become emotionally attached to their firms and encounter problems in "letting go" (Wasserman, 2006). Together, the interplay of strategic and incentive benefits, on the one hand, and succession hazards, on the other, creates a vexing management dilemma for owner-managers. Variance in founders' capacity to exploit these benefits and mitigate the hazards may shed new light on the inconsistent findings about founder firm success (Jayaraman, Khorana, Nelling, & Covin, 2000; Villalonga & Amit, 2006).

Our theory additionally helps to explain the benefits and costs of family control. With intentions for transgenerational continuity, next-generation leaders' early exposure to the business, and preferences toward refining established business models, family-managed firms should be particularly good at accumulating firm-specific resources (Le Breton-Miller & Miller, 2015; Lee, Lim, & Lim, 2003). Family firms are also able to benefit from embeddedness advantages (Arregle, Hitt, Sirmon, & Very, 2007), which enhances their ability to signal trustworthiness to stakeholders, particularly suppliers, customers, and debt capital providers (Anderson, Mansi, & Reeb, 2003). Together, these factors suggest that family firms profit from commitment benefits. However, transgenerational control often poses a reliability hazard for nonfamily stakeholders, especially for

[12] While these cases are rare, they exist. For example, the youngest "self-made" billionaire, Kylie Jenner, made her fortune by leveraging her celebrity across a line of cosmetic and other beauty products. Kylie Cosmetics had 330 million USD in revenue in 2018 and was 100% owned by Ms. Jenner. It had seven full-time and five part-time employees (Forbes, 2018).

employees and minority owners (Chrisman, Memili, & Misra, 2014; Morck & Yeung, 2003). The preferential treatment of family interests may signal to nonfamily stakeholders that they are "second class citizens" (Neckebrouck, Schulze, & Zellweger, 2018; Verbeke & Kano, 2010). We thus expect that family firms face a management dilemma created by commitment benefits on the one hand, and reliability, egocentrism, and succession hazards on the other, and anticipate that variance in their occurrence should help explain performance differences among family firms (Villalonga & Amit, 2006). More generally, our work speaks to the burgeoning literature on management dilemmas (Coff & Raffiee, 2015) and the paradoxical demands of the entrepreneur's job (Miller & Sardais, 2015). Lastly, we directly address the tension between control and value creation in entrepreneurial firms—that is, the dilemma between the throne and the kingdom that Wasserman (2006, 2017) so eloquently described.

### Limitations and Future Research

In contrast with public firms, where governance is primarily concerned with the separation of ownership and control, our theory positions self-control and forbearance of selective intervention as central issues in the establishment of reliable governance in private firms. In advancing this argument, we make a variety of assumptions that may limit our contribution. First, we assume that owner-managers want to create economic value. However, research has confirmed that this is not always true (Wiklund & Shepherd, 2003); many owner-managers eschew growth in favor of lifestyle and other noneconomic objectives. We emphasize, however, that for stakeholders who join firms with conventional expectations about future firm conduct, owner-managers' decisions to pursue an idiosyncratic strategy or to prioritize noneconomic goals may be problematic. Moreover, when firm-specific investments by stakeholders are not required to sustain performance (e.g., when owner-managers are content to earn a normal rate of return), the governance measures we prescribe may not be necessary.

While owner-management is commonplace, owners have created a wealth of context-specific, and often idiosyncratic, organizational solutions for the control hazards we describe—a discussion of which we cannot fit within the scope of this paper. However, our goal here has been to advance a parsimonious theoretical model that can be tailored to accommodate the variety of distinctive organizational forms found among private firms, such as family or founder firms, as well as the effectiveness of the many alternative governance solutions found in these firms. An advantage of our approach is that we do not need a new or distinctive theory of the family or founder firm to explain those enterprises' governance. Rather, we maintain that family and founder firm governance can be treated as special cases of the more general theory we advance. Similarly, our theory helps to explain why entrepreneurial firms often start as tightly controlled owner-managed firms but often find it advantageous to transfer some formal ownership to stakeholders, and adopt many of the governance mechanisms we discuss as they grow (Filatotchev & Wright, 2005; Greiner, 1972).

We see a series of avenues for future research. To begin, our theory lends itself to empirical testing since the problems and solutions we propose are empirically tractable. For example, we know relatively little about the conditions under which owner-managers adopt these governance mechanisms (alone or in combination) and whether owner-managers alter governance to support different theories of value creation. Put differently, researchers may want to explore the circumstances under which owner-managers voluntarily choose to constrain their own behavior (Vanberg, 2002). In this context, it seems useful to distinguish between the formal adoption, and actual compliance, with self-chosen rules. Moreover, future research could explore alternative mechanisms through which owner-managed firms secure stakeholder commitment (Hampel, Tracey, & Weber, 2019; Kano & Verbeke, 2015). Researchers may also want to measure control benefits and costs, as well as the effectiveness, of the four governance mechanisms we discuss under different institutional regimes (Aguilera & Jackson, 2003). Lastly, the task of integrating our theory of private owner-managed firms with the corporate governance literature is daunting but necessary, since the owner-management of public corporations (i.e., closely held corporations) is commonplace in our economies (e.g., Facebook, Google, or Tesla).

Our paper also holds important insights for practitioners. We identify the strengths and weaknesses of owner-managed firms and show that both are rooted in the concentration of property rights in the owner-managers' hands. We explain how property rights create control dilemmas in owner-managed firms, and explain why reliable governance plays a crucial role in value creation. Such governance, however, typically represents a double-edged sword in that it curbs the control hazards but simultaneously

weakens the control benefits. In sum, we provide owner-managers with a model by which to rethink how they exercise power inside their firms, how their decisions in this area spur value creation, and how to govern effectively.

## CONCLUSION

Our theoretical understanding of private firms' governance is very limited. Traditionally, owner-management has been viewed as the ideal governance form wherein ownership and management functions coincide in a single person. In contrast to received theory, we show that the influence of property rights on owner-managers can lead to multiple problems that make it challenging to enlist stakeholders for value creation. We hope that our study spurs new research about governance and value creation in private firms, the most prominent type of firm in the world.

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