Family Control in Listed Corporations: A Review of the Literature

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Contents

Abstract

This monograph reviews 76 published empirical studies in relation to listed family corporations. Existing empirical evidence shows that a substantial proportion of listed corporations around the world are classified as family firms. Family shareholders are characterized as large, undiversified and with long-term investment horizons. These unique attributes are expected to have significant impacts on corporate behaviors. This monograph reviews the impact of family control on firm performance; financing and investment; corporate disclosures; corporate governance; and various socio-economic issues. Limitations of existing empirical studies and future research directions are provided.

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Introduction

Empirical evidence around the world shows that a substantial proportion of listed firms are classified as family firms. For instance, Barontini and Caprio [2006] and Maury [2006] show that more than half of the listed firms across Continental and Western European countries are family firms. The same applies to Asia, with numerous studies [Chau and Gray, 2010, Chen and Jaggi, 2000, Chen and Hsu, 2009, Shyu and Lee, 2009] showing that families control more than half of the listed corporations in Hong Kong and Taiwan, respectively. Even in the United States (US), which is generally perceived to have the most dispersed ownership structure, approximately a third of the largest listed corporations are controlled by families [Anderson and Reeb, 2003a, Villalonga and Amit, 2006]. Given the significant representation of family firms across most major listed exchanges, there have been growing numbers of empirical studies in recent years that examine the impact of family control on corporate behaviour. This monograph aims to synthesise selected published empirical studies in relation to listed family corporations; discusses the empirical findings; evaluates the contribution of existing empirical studies; identifies the limitations of these studies; and provides future research directions.

The primary motivation to identify listed family corporations as a point of study is due to the growing realisation in the family business literature that family firms are heterogeneous [Chua et al., 2012] and one of the sources of heterogeneity is the organisational form of family firms [Carney et al., 2013]. Compared to private family corporations, there are a number of distinctive attributes in relation to listed family corporations.

First, theoretically the sources of agency costs in private family corporations are different from listed family corporations. Chrisman et al. [2004] state that the sources of agency costs in family corporations include conflict of interest between ownership and management; conflict of interest between dominant and minority shareholders; and asymmetric altruism. For private family corporations, because of the highly concentrated family ownership and the often lack of separation between ownership and management, agency costs arise from conflict of interest between ownership and management; the conflict of interest between dominant and minority shareholders is minimal [Fama and Jensen, 1983, Jensen and Meckling, 1976]. However, the lack of external owners and formal governance structure may facilitate family owners to pursue non-economic goals such as family succession [Chrisman and Patel, 2012, Carney, 2005], which subjects private family corporations to adverse selection and moral hazard resulting from altruism [Schulze et al., 2003, 2001]. On the other hand, for listed family corporations, ownership is shared between dominant family shareholders and other minority shareholders, the dominant position of family owners and the dilution of ownership interest may provide incentives for family owners to use their controlling positions to expropriate value from minority shareholders, which lead to conflict of interest between dominant and minority shareholders [Anderson and Reeb, 2003a, Villalonga and Amit, 2006]. Carney et al. [2013] argue that the different sources of agency costs in listed family and private family corporations may result in different patterns of strategic decision making and different source of competitive advantages.

Second, there are significant differences in the legislative environment between listed family and private family corporations. For listed family corporations, equity shares are free floated on a public stock exchange and hence these corporations are subject to stringent regulation such as listing rules, corporate governance codes, *Corporations Law* and accounting standards. The equity shares of private family corporations in contrast are not free floated so these corporations are only obligated to disclose basic company information and performance to regulators. As a result, certain empirical issues arising from legislation are likely to affect listed family corporations to a larger extent. For instance, all listed corporations are required to comply with all accounting standards and prepare a full version of annual reports for financial report users. On the other hand, private corporations in particularly small to medium size corporations may not need to comply with all accounting standards. Consequently, issues such as earnings quality and earnings management are likely to be more prominent in listed corporations [Wang, 2006, Ali et al., 2007].

Third, the source of the data is different for these two organisational forms. The data of listed corporations are mostly publicly available, while the data of some small to medium size private corporations may not be publicly available. Consequently, the different sources of data affect the research methodology adopted. For studies that focus on listed family corporations, the archival method is the most commonly used method whereas studies that focus on private family corporations prefer to use case study, survey or questionnaire methods [Debicki et al., 2009, Salvato and Moores, 2010]. The difference in research methodology leads to different contribution from these two bodies of literature but it also raises limitations of its research findings.

This monograph contributes to the family business literature in two ways. First, it discusses the empirical findings and it evaluates the contribution of existing empirical studies. All identified articles are categorised into five topic areas, which include 'Firm performance', 'Financing and investment', 'Corporate disclosures', 'Corporate governance', and 'Socio-economic issues'. These five topic areas are identified ex post; that is, these five areas emerged as distinctive themes after reviewing all articles. The separation of topic areas aims to provide cohesive discussion of related empirical issues. Each of the empirical studies is listed in the Appendix at the end of the monograph. The Appendix summarises each empirical study, which provides a starting point for researchers for further investigation.

Second, this monograph identifies the limitations of existing empirical studies and it provides future research directions. In order to drive this vibrant research area forward, it is important to identify gaps in existing studies and provides suggestions for future study. In each of the five topic areas, limitations of existing studies and possible future topics are explored. Also in the last section of the monograph, two common themes across all five topic areas are further discussed to provide future research directions. Table 1.1 provides a summary of existing knowledge of each topic areas and suggestions for future research.

Following Salvato and Moores Salvato and Moores [2010], an initial search was conducted in the EBSCOhost, ABI/INFORM, and Business Source Complete databases using certain keywords. The keywords used in the search include 'Family business', 'Family firm', 'Family ownership', 'Family management', 'Family control', 'Founders' and 'Descendants'. In order to maximise the identification of relevant articles, the initial keyword search was conducted in single keywords as well as in multiple keywords with the use of 'and/or' function provided in the database. An article is only included for review if it meets the following criteria: (1) It is published in a peer-reviewed journal. (2) Family firms are the focus of the study. (3) The sample firms used are listed corporations. (4) It is an empirical study. This search resulted in 76 relevant articles between 1999 and 2014, which are listed in the Appendix. As stated, the selected articles are further categorised into five topic areas: firm performance (22 articles), financing and investment (20 articles), corporate disclosures (16 articles), corporate governance (13 articles), and socio-economic issues (5 articles). These articles were published in 40 academic journals including accounting, finance, management, and economics. Although some published studies may be missing, the empirical evidence drawn from different business disciplines should be sufficient to provide a comprehensive review of this body of literature.

The rest of the monograph is organised as follows. Section 2 discusses whether family control affects firm performance. Section 3

Table 1.1

Research topic/issue	Existing knowledge	Possible future research
Firm performance	Listed family firms on average are more likely to outperform listed non-family firms if it is domiciled in a country with strong investor protection; if there is restricted use of control-enhancing mechanisms; and if the founder serves as the CEO.	1. Explore factors that explain the cross-sectional variations of performance in family firms: e.g., for organisational culture, willingness to invest in long term projects, the degree of delegation to non-family employees, etc. 2. Examine the succession process in family firms. What are the determinants of successful family successions? Potential factors that can be examined include the number of descendants that compete for succession, the presence of founders or other senior family members to aid the transition of succession, the effectiveness of board of directors to monitor performance of descendants. 3. Management buyout (MBO) in family firms. What are the determinants of the likelihood of MBO in listed family firms? What are the factors that affect the post MBO performance in family firms?
Financing and investment	Listed family firms do not appear to reduce the risk associated with their large and undiversified holdings through financing and diversification. However, their risk-averse attitude appears to affect their appetite for riskier investments such as M&A and R&D. The identity of the owner has a significant impact on both the willingness and ability of firms to invest with founders shown to be superior to other family members.	1. How and why listed family firms conduct investment activities. What are the moderating and mediating factors that associate with investment behaviour in listed family firms? Potential factors that can be explored include appointments of non-family executives, education and professional backgrounds of family successors, the use of incentive compensation that rewards long term investment, national and organisational culture.

(*Continued*)

Table 1.1: (*Continued*)

Research topic/issue	Existing knowledge	Possible future research
Corporate disclosures	The relation between family ownership and corporate disclosures is contingent on a number of factors, which include the level of ownership concentration, country levels of investor protection and also the types of corporate disclosure. At lower level of family ownership, the interest between controlling families and other shareholders are aligned, which results in better earnings quality and less need for voluntary disclosure. However, at higher levels of ownership, controlling families are more likely to be entrenched, which results in lower earnings quality and greater need for voluntary disclosure. Moreover, the absence of strong investor protection appears to encourage controlling families to engage in earnings management at the expense of other shareholders.	1. Examine disclosure practices in individual accounting policies of listed family firms, which help to identify the sources of earnings management. For instance, new accounting standards International Financial Reporting Standards (IFRS) such as accounting for intangible assets, financial instruments, assets impairment, and share-based payment. 2. Compare the readability of corporate disclosures between listed family and non-family firms. To investigate whether the presence of family ownership affects the incentives of managers to manipulate the readability of annual reports and other corporate disclosures such as corporate announcements; presentation slides and CSR reports.
Corporate governance	Controlling families have strong incentives to monitor management; hence it can be regarded as an effective governance mechanism. On the other hand, controlling families often use different control-enhancing mechanisms to strengthen their position. The use of control-enhancing mechanisms by families comes at a cost, as investors anticipate the potential opportunistic behaviour by the controlling family and hence place a discount on firm values.	1. Explore the link between family firms and shareholder activism. Do shareholder activists such as institutional shareholders and hedge fund managers prefer to avoid investment in poorly performed and/or governed family firms or undertake corporate actions against those firms?

(*Continued*)

Table 1.1: (*Continued*)

Research topic/issue	Existing knowledge	Possible future research
Socio-economic issues	Greater oligarchic family control is associated with worse social economic outcomes. However at the firm level family firms are more socially responsible than non-family firms. Country-level legal protection is the moderating variable between family control and corporate social responsibility.	1. Investigate corporate social responsibility practices of family firms in countries with less developed legal system. For instance, the country-level investor protection indexes developed by La Porta et al. [1998] can be used as a benchmark to examine the relation between country level investor protection and corporate social responsibility practices of family firms.
Research methods	1. Most of the existing studies divide sample firms into two categories: family firms and non-family firms. The analyses of many of these studies reveal a consistent theme; when founder is identified as a separate independent variable, the results show that it is a significant variable that affects various firm behaviours. Future studies should consider separately identifying founder firms and family firms. 2. The lack of diversity in research methodology in this area of research. With a few exceptions, most of the empirical studies reviewed use quantitative methods with publicly available data. The major limitation to the use of publicly available data is that only observable variables are included in the analysis. Essence variables are ignored in this area of research.	1. Empirical evidence in relation to founder firms is restricted to only a few research topics and the samples are predominantly from the United States. Future research should investigate whether founder firms are also common in other countries and whether the corporate behavior of founder firms is significant different from family firms. 2. The use of alternative research methods such as survey and field study to explore essence variables that affect listed family firms such as intention of family control and family commitment.

reviews studies of the preference of family firms for various leverage and financing methods. This section also discusses the investing activities in family firms, which include diversification, merger and acquisition, and research and development. Section 4 examines empirical evidence in relation to the corporate disclosure practices of family firms. Section 5 reviews the empirical studies of various corporate governance issues in family firms, which include the role of independent directors and institutional investors; and the use of control enhancing mechanisms by family shareholders. Section 6 considers the impact of family control on some socio-economic issues such as economic development, tax evasion, and corporate downsizing. Finally, Section 7 discusses the limitations of the existing body of literature and provides suggestions for future research directions.

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