Family Firms and Good Corporate Governance:

Altruism and Agency Considerations

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Abstract

Do descendants of founders make good monitors and managers (Chairs and CEOs) in publicly traded firms? We use insights from agency theory and the theory of altruism to develop testable propositions; we argue that both economic incentives and positive altruism drive the behavior of descendant Chairs. This may reduce agency costs, and ensure the continuity of the founders' strategic vision and therefore higher firm performance. On the other hand, descendant CEOs, who are responsible for executing a strategic vision, can reflect an inefficient market for managerial labor. This may produce negative altruism and lower firm performance. Furthermore, for descendant Chairs, the presence of takeover defenses reduces the positive performance effect of to a lesser extent than for non-descendant Chairs. Evidence from 141 manufacturing, property, and shipping firms in Norway and Sweden largely support our hypotheses.

Keywords: descendant influence, altruism, family firms, agency costs, corporate governance, performance

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INTRODUCTION

Is family leadership in public firms good or bad, and how does the market for corporate control affect the performance of such leadership? The finance literature admits that "..little is known about how to preserve the powerful incentives of owner-managers, especially in family firms, while strengthening the protection of minority shareholders" (Berglöf and von Thadden, 2000: 279). Furthermore, management scholars argue that the family-controlled public firm provides a unique but under-researched topic (Schulze, Lubatkin, Dino, and Buchholtz, 2001). This lack of research is more striking given the significant number of such firms. In Asia and Europe, family controlled firms represent a significant share of public firms. Recent studies have reported founding family influence in 55% of Swedish firms (La Porta, Lopez-de-Silanes and Shleifer, 1999), and 40% of Norwegian firms (Mishra, Randøy and Jenssen, 2001). Even in the United States, families control as much as 30% of the largest public firms and participate in management of as much as one third of these (Kang, 2000).

The specific research question of this study can be stated as follows: Can descendant-led public firms provide the best of both worlds–the disciplining influence of access to public capital markets combined with the altruism and incentive alignment of a family-influenced private firm? In particular, we focus on the division of duties between the Chair of the public firm and its CEO, and the influence descendant has on incentive alignment and the market for corporate control.

Using insights from both agency theory (Jensen and Meckling, 1976; Eisenhardt, 1989) and the theory of altruism (e.g., Lunati, 1997; De Paola and Scoppa, 2001), we argue that a family-led *public* firm could enjoy the benefits of both lower agency costs (due to altruistic behavior of firm's owner-managers), as well as guard against managerial inefficiencies (due to negative effects of altruism). This implies that the founding family has to choose between *managing* the firm (by taking the role of the CEO and guiding by the strategies and vision of the professional Chair), or on *monitoring* the firm (by focusing on professional managers represented by the CEO and by taking the role of Chair). Based on extant research, we build the argument that the ideal leadership structure for a family influenced public firm would comprise of a Chair who is related to the family (in order to lower agency costs of owner-manager separation) and a CEO who is a professional manager (in order to benefit from the competitive managerial labor markets). Family-led public firms that are able to split these roles are able to mitigate the agency costs associated with hired managers, as well as costs of nepotism and self-control associated with poor access to an efficient labor market for superior managerial talent. This split results in superior firm performance and higher firm value. This split effect should be stronger for family firms that do not deploy takeover defense mechanisms that may further impede the market for corporate control.

Schulze et al. (2001) suggest that the neglect of research on family firms is partly due to the presumption that such firms have low agency costs. Since family controlled firms provide both owners (principals) as well as managers (agents) of the firm, agency theorists (e.g., Jensen and Meckling, 1976) have assumed that they are less susceptible to agency costs that arise in a principal-agent relationship. Furthermore, owner-management of the *private* family firm encourages altruistic behavior, and reduces private consumption of perks, as well as effort

aversion by managers at the expense of owners. On the other hand, however, founding family influence might create costs due to nepotism (reducing access to efficient labor markets), problems of self-control (Jensen, 1998), and insulate the firm from the benefits of the corporate control market (Schulze et al, 2001; Walsh and Seward, 1990; Jensen 1993).

This study expands the theoretical understanding of family influence in *public* firms by introducing a discussion of the contingency of family firm roles (Chair and/or CEO). In addition, we focus on the influence of *descendants* of the founding family. Whereas the issue of *founder* influence (i.e. first-generation family influence) in public firms has been addressed in recent studies (e.g., Jayaraman, Khorana, Nelling and Covin, 2000; Randøy and Goel, 2003), there has been less attention given to the role of *descendant* influence (i.e. influence of the family via second or later generations) in public firms. Following extant research pointing out the differences between founder and descendant influence (Gersick, Davis, Hampton, and Lansberg, 1997; Ward, 1987) we believe that studies investigating descendant influence will advance our understanding of family leadership and performance of the firm. Furthermore, this study goes beyond the tenure of the founder by addressing the question of transferability of founder influence. Thus in this study we suggest that there are two specific factors that moderate the agency cost of the family-influenced public firm: (1) the nature of descendant influence (CEO versus Chair), and (2) access to the market for corporate control.

We empirically test for firm performance and the value effects of division of roles (managing and/or monitoring) by using a sample from Sweden and Norway. Corporate law in Sweden and Norway does not allow for CEO-Chair duality; furthermore, the norms governing public firms in Norway and Sweden discourage a founding family to fill both positions. Thus,

these countries provide a unique environment to separate the effect of descendant influence from CEO and Chair.

LITERATURE REVIEW

We conceptually distinguish four kinds of ownership and governance structures for firms: (1) the private family firm, (2) the closely held public firm *with* family influence, (3) closely held public firm *without* family influence, (4) and the widely held public firm (Table 1). We argue that agency costs of the various ownership and governance structures are particularly affected by: (1) information asymmetries, (2) access to efficient labor markets, (3) access to efficient capital markets, (4) importance of social contract–altruism, and (5) time horizon.

Insert Table 1 about here

Whereas the widely held public firm has historically been the focus of corporate governance research, a number of newer studies are emerging on private family firms (e.g., Schulze et al., 2003) and closely held public firms (e.g., Thomsen and Pedersen, 2000). In this study, we focus our attention on the closely held public firm with family influence, which provides an interesting combination of features of both the public and the private firm.

Advantages of family firms from an agency theory perspective. Dalton and Daily (1992) argue that family firms are one of the most efficient forms of organizations because of little separation between control and management decisions. Fama and Jensen (1983: 306) make the same argument and specifically point out how *"family members . . . have advantages in monitoring and disciplining related decision agents."* The information asymmetry between owners and managers, that is one of the underlying sources of agency costs of the public firm

(Berle and Means, 1932), is mitigated by both private firms and closely held firms. This mitigation has been considered one of the main arguments for the existence of the family firm (Jensen and Meckling, 1976). In addition, because of owner-management alignment in family firms, these firms are patient investors with a long time horizon (Kang, 2000).

Agency advantages of family firms due to altruism. In addition to the possible benefit of reduced agency costs due to incentive alignment, family firms may gain from employment relationships based on altruism and trust. Altruism refers to decisions that are made for selfless reasons to benefit others, rather than decisions made for selfish reasons typically assumed by classical economics literature (Lunati, 1997). Scholars in several fields have long recognized the value of altruism in employment contracts and intra-firm outcomes. For instance, Chami and Fullenkamp (2002) recognize that developing trust via mutual, reciprocal altruism can reduce the necessity of increased monitoring and incentive-based pay. De Paola and Scoppa (2001) suggest that altruism within the family could lead to superior employment contracts by the firm. Family influenced firms can use a credible threat of discipline involving sanctions for all the family members in the case of one member shirking; this may allow family firms to pay lower wages. Interestingly, a recent study on the CEO pay practices among Norwegian and Sweden firms shows that founding family influence helps to curb CEO pay (Randøy and Nielsen, 2002). Moreover, the family firm's link between parents and children allows the firm to follow a strategy that considers an individual's time horizon as well as potential hazards to the family's reputation.

Agency costs of family firms due to altruism. On the other hand, Schulze et al. (2001) and Schulze et al (2003) argue that there are a number of other agency-related costs that do not favor family influence in public firms. These costs result from bias in favoring family interests over

the firm's interests (such as non-family shareholders), because of loyalty toward the family. Indeed, past studies suggest that family influenced firms are more exposed to managerial entrenchment (e.g. Gomez-Mejia, Nunez-Nickel and Gutierrez, 2001; Thomsen and Pedersen, 2000). In fact Schulze, et al. (2001) argue that access to an efficient labor market is one of the major advantages of widely held public firms over private family firms. This access is hampered partly because of a perception of the family firm's natural inclination to favor applicants related to the family. This perception could reduce the quality of applicants for key managerial positions in the firm, and suggests that a challenge for managerial succession of a family firm is to make sure that key employees are not promoted on the basis of family connections, but on merit.

In addition to the specific agency costs of a family firm, the *private* family firm has the disadvantage of lack of liquidity of its equity, in other words the firm is deprived of access to an efficient and liquid capital market. By contrast, the relative transparency of a public firm and the liquidity of its ownership stake provides an efficient market for corporate control, which curbs managerial entrenchment and the resulting loss in firm value due to higher agency costs (Jensen, 1993; Walsh and Seward, 1990). This implies that mechanisms such as takeover defenses, that raise the cost of changing incumbent management, will reduce firm value.

To summarize, we suggest that family influenced public firms can be expected to benefit from a continuity of entrepreneurial vision, if they also choose the best managerial talent, regardless of narrow family interests. Such firms can produce a unique combination of features of both the private family firm and that of the widely held public firm. This implies that the main challenge for the closely held public firm with family influence is to make a good trade-off between the agency costs of the private firm and that of the widely held public firm.

HYPOTHESES

We suggest that there are two specific decisions that determine the extent of agency cost (and loss of firm value) for the family-led public firm: (1) the nature of descendant influence (CEO versus Chair), and (2) access to the market for corporate control. We base our arguments on a division between the duties of the Chair and the CEO. The Chair represents the link between the owners and the management of the corporation. The main task of the Chair is to provide an overall vision, hire key strategic managers, assess the strategy-setting process, audit the overall strategy of the firm, and monitor the firm's management in executing that strategy. On the other hand, the major role of the CEO is to set strategy and to assume the day-to-day responsibility of executing the strategy by, for example, designing an appropriate organizational structure, hiring functional level managers, and leading the employees toward the firm's performance objectives. This division of responsibility between the Chair and CEO results in each position facing different governance contexts. We argue that a prerequisite for an effective Chair is incentive alignment with that of shareholders, which widely held firms need to provide by the means of requiring some stock ownership and/or grants of stock options etc. The day-to-day management skills of the Chair are of secondary importance. The main challenge of a CEO is related to management skills, and since the Chair is able to monitor the CEO directly, the alignment of interests is of secondary importance. This makes it unlikely that the descendant of a founder is the best choice of CEO for the firm's shareholders.

Studies of CEO duality (where the CEO also holds the title of Chair of the board) have largely been inconclusive. In a review of 13 studies that provided statistical evidence regarding the impact of CEO duality on firm performance, Harris and Helfat (1998) found three that report

a negative effect on some accounting performance measures but not on market performance measures, and 10 others that either find positive or no effects of duality on firm performance. Authors of studies finding negative effects (e.g. Pi and Timme, 1993; Berg and Smith, 1993) have cited the results as evidence of reflection of agency costs (CEO duality weakens the monitoring function). Authors of studies with positive effects (e.g. Finkelstein and D'Aveni, 1994; Rechner and Dalton, 1989) have cited unity of command as the reason why CEO duality improves firm performance. A meta-analysis of board leadership structure and financial performance based on 22 independent samples across 5751 companies indicated that independent leadership structure has a significant influence on performance, but the relationship varied depending upon the context of the study (Rhoades, Rechner, and Sundaramurthy, 2001). However, all these studies were conducted on widely held public firms, and not closely held family-led public firms. Because the family-led firm's main challenge is to make a good *trade-off* between the agency costs of the private firm with that of the widely held public firm, we believe that a separation of Chair and CEO roles would be beneficial to family influenced public firms. Furthermore, in this separation, a descendant Chair is likely to effect performance positively, and a descendant CEO is likely to effect performance negatively. This is because a descendant Chair would be better able to preserve and continue the family's overall vision and preserve the long-term goals of the firm–one of the key advantages of a family firm (Ward and Aronoff, 1994; Litz and Kleysen, 2001; Athanassiou, Crittenden, Kelly and Marquez, 2002). Being hierarchically at a higher level than the CEO would also provide opportunities for close monitoring of CEO's behavior and a check on the agency loss due to the agent-CEO (at the extreme by replacing the CEO in the event of poor performance). On the other hand, a market-selected non-descendant CEO is likely to provide the firm with better managerial talent, due to

access to a competitive labor market. Table 3 summarizes the effect of appointing different combinations of descendent versus non-descendent Chairs and CEOs on firm performance.

Insert Table 2 about here

Descendant Influence and Performance

The economic argument for descendant leadership of publicly traded firms relates to reduced information asymmetries and reduced opportunism, leading to higher firm performance. On the other hand, entrepreneurs and founding family firms are more exposed to managerial entrenchment and therefore potentially associated with weaker performance. Past studies suggest that it is important to distinguish between founding family influence from the founding generation, and the influence arising from a descendant of the founding generation (e.g., Gersick et al., 1997). A popular assertion about family firms is that by the third generation the firm is heading for decline (Ward, 1987). Whereas the founding entrepreneur possesses unique managerial skills by being the person to establish the firm in the first place, the same managerial skills may not be possessed by the descendant. By appointing a descendant as the CEO, the shareholders are deprived of the best managerial talent possible. This is a symptom of the general agency problems identified in family contracts (Becker 1974; 1981; Schulze et al., forthcoming). For instance, parents can spoil their children and favor them irrationally. By appointing a descendant as CEO, the firm does not participate in either the external market mechanism, or internal evaluation processes of finding the best CEO for the job, which on

average is likely to reduce firm profitability and firm value. This suggests the following hypotheses:

Hypothesis 1a: A descendant CEO has a negative influence on ***firm profitability****.*

Hypothesis 1b: A descendant CEO has a negative influence on ***firm value****.*

We now explore the effect of the type of Chair (descendant or non-descendant) on performance of the firm. The Chair occupies a unique position in a public firm. On the one hand, the Chair (as agent) has a fiduciary responsibility to the firm's owners (the principals), and in that role is in a practical sense the ultimate monitor of managerial behavior of the CEO and other top management team members. On the other hand, there is no direct and inexpensive monitoring mechanism to evaluate Chair's performance of his or her monitoring duties (short of replacement of the Chair by owners post performance failure, via market for corporate control). This could result in a corruption of the Chair's position from its original intent, where the Chair may shirk in his or her fiduciary duty of monitoring management. The corruption may be reflected in plain incompetence of the Chair which may be detected only in hindsight (Hendry, 2002). In the absence of direct monitoring opportunities, we claim that incentive alignment would be most suited to the Chair's position. Aligning Chair's incentives with those of owners would make them better monitors of CEO's actions before owners' wealth is destroyed. In addition, incentive alignment could ensure that only Chairs who have the skills, competence, and inclination to perform their duties will have any incentive to offer themselves to the market and reduce the sources of mismatches between owners and agents (Hendry, 2002).

Alignment of Chair's incentives with those of the owners may occur via two means: altruism and economic incentives. Altruism involves a selfless adoption of owners' objectives.

It is self-reinforcing and also motivated by self-interest, since it allows individuals to achieve both others' and their own selfish objectives simultaneously (Lunati, 1997). When altruism is involved in incentive alignment, achieving the owners' objectives is considered a reward in and of itself (Becker, 1974; 1981). This selfless service is akin to siblings helping each other, or parents performing duties for their children. Incentive alignment through economic incentive employs achieving firms' objectives as instruments to economic gains which Chairs are assumed to desire. In other words, achievement of a Chair's objectives (financial gain) is made contingent on the Chair performing his/her fiduciary duty toward the owners. However, incentive alignment through economic incentives is susceptible to the usual agency costs of writing a perfect contract such that the agent (Chair) reaps the economic gains only when the owners' objectives have really been met. In particular, because objectives or standards to earn economic incentives must be relatively clear, the Chair's activity can lead to a multitasking problem (Holmstrom and Milgrom, 1991). This kind of problem occurs when a principal's objectives are complex or multifaceted, and thus difficult to capture in an outcome based contract. As Hendry (2002) notes, "In such cases, attempts to specify outcomes can be dysfunctional, as agents perform to the specific terms of the incentives offered, rather than in the more general interests of their principals." The extreme high cost of writing this perfect contract is evident in a number of recent corporate governance scandals – Enron being the ultimate example. In these cases Chairs (typically also CEOs) were able to reap economic benefits because of incentive alignment via stock options by pursuing strategies that inflated short term stock prices while ruining owners' long term wealth. On the other hand, we suggest that aligning incentives for descendant Chair through altruism does not suffer from this malady.

It has been argued that altruism in family relationships can lead to other kinds of agency problems. For instance, parents may favor their children to enhance their own welfare (Schulze et al., forthcoming). However, a descendant Chair may be more likely to be driven by the vision and selfless zeal (with respect to the family business) inherent in the founding conditions of a family founded business. In other words, a descendant Chair is more likely to represent the "brighter view" of altruism (or positive altruism), and preserve the continuity of family vision (Athanassiou et al., 2002, Ward and Aronoff, 1994; Litz and Kleysen, 2001). This is opposed to the "dark view" of altruism (Shulze et al., forthcoming) where by the agent uses altruism to shield incompetence in the family. The bright view of altruism lowers agency costs because the agent adopts the principals' objectives.

The discussion above suggests that positive altruism and economic incentives are relatively non-substitutable mechanisms for incentive alignment. Using economic incentives alone for a complex and multifaceted task could result in a multi-tasking problem. Using altruism alone could lead to shielding incompetence with or without intent. The relative non-substitution of altruism and economic incentives means that among the Chairs, descendant Chairs of closely held public family firms are likely to be more responsible and superior monitors of the firm than non-descendant Chairs. This is because the position of descendant Chair offers a combination of economic incentives and altruistic attachment to a family firm (Steier, 2003). Non-family managers also suffer from a finite time horizon problem. Because their tenure with the firm is finite, it could lead to decisions that improve performance during the manager's tenure with the organization, but could be harmful in the long run. Altruism among family members leads to adoption of strategies that solves the problem of a Chair's finite time horizon. This occurs by linking an individual manager's tenure (time horizon) with that of the

family's tenure with the firm, and to family's reputation to the reputation of the firm (De Paola and Scoppa, 2001). On the other hand, a non-descendant Chair is less likely to be motivated by altruistic motives. As a result, economic incentives, with flaws noted above, would be the primary instruments to align a non-descendant's interests with those of the owners. This will reduce firm value of these firms relative to firms having descendant Chairs.

*Hypothesis 2a: A descendant Chair has a positive influence on **firm profitability**.*

*Hypothesis 2b: A descendant Chair has a positive influence on **firm value**.*

Descendant Influence and the market for corporate control

Agency theory suggests that corporate governance should enable owners to exercise control over management, and if necessary replace poorly performing managers (e.g. Jensen and Meckling, 1976; Fama and Jensen, 1983; Eisenhardt, 1989). As argued above, direct monitoring of the Chair is expensive, which makes incentive alignment a cheaper option. In addition, an efficient market for corporate control could ensure that incompetent or non-performing Chairs are replaced (Walsh and Seward, 1990). Any mechanism that raises the cost of using the market for corporate control is likely to interfere with this process of replacing poor quality Chairs with Chairs of better quality. Takeover defenses of various kinds, that raise the cost of replacing incumbent management and lead to their entrenchment, would therefore tend to reduce firm value (Malatesta and Walkling, 1988). Empirical evidence on the effect of takeover defenses on firm value has been mixed, with the presence of some types of takeover defenses being found to have a modestly negative association with firm value (Ambrose and Megginson, 1992; Ryngaert, 1988). The effect is sensitive to time periods (Lee and Pawlukiewicz, 2000) and type of stakeholders (e.g. stock or bond holders) (Datta and Iskandar-Datta, 1996), or managerial

ownership and quality (Kabir, Cantrijn, and Jeunink, 1997; Malekzadeh and McWilliams, 1995). In Scandinavia, some of the most important takeover defenses take the form of: 1) multiple share classes with unequal voting power resulting in incumbent management holding shares with higher voting power, or 2) a pyramid ownership structure. Consequently, we argue that the potential positive effect of a descendant Chair can be reduced if the firm eliminates the potential to be disciplined by the market for corporate control. However, because a descendant Chair is likely to be partly driven by altruism, any potential negative effect of the entrenchment of an incumbent descendant Chair is likely to be muted compared to that of a non-descendant Chair, who is not driven by altruism.

Hypothesis 3a: The association between a Chair and performance is negatively affected by the presence of take-over defenses, such that loss in ***firm profitability*** *is greater when an incumbent is a non-descendant Chair rather than a descendant Chair.*

Hypothesis 3b: The association between a Chair and performance is negatively affected by the presence of take-over defenses, such that loss in ***firm value*** *is greater when an incumbent is a non-descendant Chair rather than a descendant Chair.*

DATA AND METHODS

Our sample includes companies from three industries (manufacturing, property, and shipping) and two countries (Norway and Sweden). The observations are taken from an initial random sample of 40 shipping, 100 manufacturing, and 30 property firms. We specifically selected these industries based on two criteria—the existence of descendent leadership in the industry and industries with potentially high free cash flow. Our first criterion is important as

certain industries are too young to experience descendent leadership. We make the second criterion related to free cash flow, as we argue that corporate governance monitoring is of particular importance in asset intensive industries. The sample companies were publicly traded for at least two out of the three-year study period (1996-1998). The initial sample of 170 firms was reduced to 141 firms due to non-response and incomplete information (17 firms), companies listed for less than two years (7 firms), and firms with infrequent trading of stock or unusual reporting periods (5 firms). The applied sample represents 423 firm-year observations. This sample represents approximately half of the population of shipping, property and manufacturing firms from the two countries. Table 2 shows the distribution of sample by type of Chair and CEO. Information about descendant influence was collected via telephone interviews to firms' investor relations department. All other variables were accessed through secondary sources.

Insert Table 3 about here

Our first measure of firm performance–our dependent variable–is one-year *lagged return on assets (ROA)*. We used the lagged return figure since the effect of certain leadership or governance structures is not expected to provide an immediate effect on accounting returns (Nickell, 1996). ROA is calculated by using previous year's net profits before interest, tax, and exceptional items divided by the average book value of assets. *Firm value* measures the firm's log transformed q-value at December 31, in 1996, 1997, and 1998. The natural log transformation was performed in order to reduce problems of heteroscedasticity. The q-value is measured as the ratio of market value of the firm to the book value of total assets. The market value of the firm is measured by the sum of the market value of equity and the book value of

total liabilities. The applied q-value measure is an approximation of Tobin's Q (Perfect and Wiles, 1994; Chung and Pruitt, 1994), a firm value measure that is used to compare the future cash flow value of the firm in relation to the replacement value of the firm's assets.

The measure for *Descendant Chair* is a binary variable that equals 1 if a descendant of the original founder(s) holds the position of Chair. The *Descendant CEO* is a binary variable that equals 1 if a descendant of the original founder(s) holds the position of CEO. *Takeover defenses* is a binary variable that equals 1 if the firm has multiple share classes with unequal voting power (commonly refereed to as A and B-shares) or controlled (>25%) by a closed-end investment fund (a pyramid ownership structure). (Note: Angblad et al. (2002) provide a more extensive overview of corporate control mechanisms used in Sweden.) Furthermore, the takeover defense measure is used in interaction variables created with "descendant Chair" and "descendant CEO" variables. The main effect of *takeover defenses* is included as a control variable to isolate the incremental effect of these interactions.

Control variables

Past research indicates that the corporate governance outcome of ROA and Q-ratio is affected by firm size (Dalton, Daily, Johnson, and Ellstrand, 1999), firm age (Mayer, 1997), and firms' industry affiliation (Baysinger and Butler, 1985). Firm size relates to possible scale economy effects, and firm age relates to changes caused by firm life cycle changes (Smith, Mitchell, and Summer, 1985). *Firm size* is measured by taking the logarithm of total revenues of each year, as the size alone was not normally distributed. *Firm age* is measured by the logarithm of the number of years between the observation year and the firm's founding year.

Based on well-established current literature in finance, accounting, economics, and management, we also control for the extent of debt used, blockholder ownership and insider ownership as other forms of governance mechanisms (via monitoring by debt and blockholders and incentive alignment of insiders), as well as the *main effect* of takeover defenses on firm profitability and value. Past research also indicates that a foreign exchange listing, particularly among firms from smaller capital markets, affect the corporate governance of the firm (Miller, 1999; Randøy et al., 2001). *Foreign exchange listing* is given a value of 1 if the firm is listed on and official stock exchange in an Anglo-American capital market, 0 otherwise. In order to isolate any specific effect of our choice of countries and industries on the dependent variables, dummy variables for countries and industries were included.

In summary, we control for debt ratio, firm size, firm age, takeover defenses (main effect), blockholder ownership, insider ownership, foreign exchange listing, and country and industry effects.

Methods

We apply a cross-sectional ordinary least-square (OLS) regression model to test the hypotheses presented in the preceding section. By using only three industries we reduce specification bias in the hypothesis testing, although at the expense of reduced generalizability.

The method of pooling cross-sectional and time series data is susceptible to heteroscedasticity and multicollinearity (Kmenta, 1997). As pointed out, we had to apply the logarithm as the measure of some variables in order to reduce the problem of non-normal distribution. However, the Variance Inflation Factor (VIF) statistics do not indicate any other multicollinearity concerns.

RESULTS

Table 4 reports the means, standard deviations, and correlations among the study variables. The multivariate results displayed in table 5 show the main and interaction effects of our hypothesized variables for the two dependent variables–lagged ROA and firm value (Q-ratio). The full models of lagged ROA as well as firm value report an R^2 of 0.208. Hypothesis 1 predicted a negative relationship between descendant CEO and firm performance measures. In the main effects model, having a descendant CEO had an insignificant negative effect on firm ROA and a significant negative effect on firm value ($p<.05$). In the full model, these effects remain negative for firm value and ROA but the effect is insignificant for firm ROA ($p<.05$). These results partially support hypothesis 1a and fully support hypothesis 1b.

Insert Tables 4 and 5 about here

Hypothesis 2 predicted a positive relationship between descendant Chair and firm performance measures. In the main effects model, having a descendant Chair has a positive effect on lagged ROA ($p<.10$) as well as on firm value ($p<.10$). This effect remains positive and significant in the full model for lagged ROA and for firm value ($p<.05$). These results support hypotheses 2a and 2b.

Hypothesis 3 predicted that the loss in firm performance due to takeover defenses will be greater for firms with non-descendant Chairs than for firms with descendant Chairs. The interaction coefficients offer a direct test of this hypothesis. The interaction between descendant

Chair and takeover defenses is negative and significant ($p<.05$) for lagged ROA, but not significant for firm value. These results support hypothesis 3a but not hypothesis 3b.

DISCUSSION AND CONCLUSION

This study is an attempt to address the specific call for research on the influence of family management in public corporations (Schulze et al., 2001). Our broader theoretical argument has been that family-influenced public firms provide a special kind of governance environment under conditions of division of responsibility at the top.

Grounded in the theory of altruism and its effect on agency costs, we find that descendant influence by the means of a descendant Chair has a significant and positive effect on performance. The presence of a descendant Chair may be critical in maintaining and articulating continuity in an entrepreneurial vision and mission, and reducing the finite time horizon problem of non-descendant Chairs. Descendant Chairs add value to the firm by being driven both by economic incentives, as well as positive altruism toward other owners of the firm. Furthermore, the positive effect of such chairmanship is contingent on a transparent market for corporate control, that is to say, a descendant Chair person is only advantageous when the firm does not use takeover defenses such as share duality with different voting power, or a pyramid ownership structure.

On the other hand, we find that descendant influence by the means of a CEO has a significant and negative effect on firm performance. The advantage of using a competitive managerial labor market in the area of strategy execution and operational control apparently outweighs the agency cost advantages stemming from having a CEO with family ties. Except for the original entrepreneurs, we argue that having a CEO with family ties may reflect a poorly

functioning managerial labor market, which deprives the firm of one of the main advantages of the public firm.

The results of this study have several major implications. Research from the US suggests that CEO duality reduces firm performance on average (e.g. Worrell, Nemec, and Davidson, 1997; Berg and Smith, 1978; Rechner and Dalton, 1991). This study takes this conclusion further and provides evidence that the specific affiliation of people occupying the Chair and CEO positions is critical to improving performance. In other words, it may not be enough to separate the two positions. It is also important to have the positions occupied by people with specific affiliations, especially in a family-influenced firm.

This study is not without limitations. A sample of 141 publicly traded Norwegian and Swedish firms is used in this study, which limits the extent to which interactions between governance variables can be tested. In addition, the firms in this sample are well established firms, and therefore the results only apply to firms which have survived for a long time. This restricts the range of phenomenon studied. The results may not apply to young, start-up firms using private equity only. Furthermore, to the extent that the growth objectives, legal framework, and motivations of principal actors are unique to Norway and Sweden, the generalizability of this study may be suspect. On the other hand, our findings are in line with other studies on the general effect of founding family influence, such as in the US (e.g. McConaughy, Matthews, and Fialko, 2001), and may therefore support the generalizability of our results.

This study also offers several directions for future research. In a promising area of research, distinction can be made between public family firms that trade in intangible and intellectual goods and services as opposed to tangible goods and services. It is expected that the

former will benefit even more from descendant Chair control, as external monitoring costs of intangible capital are higher (Goel and Randøy, 2002). In addition, while this study explores differences in firm value and performance between firms led by descendant Chair and non-descendant Chairs, future studies may wish to explore within-group differences–especially within the descendant-led group. These studies can model family firm-specific independent variables, such as social, demographic and educational background of the Chair, his or her age, size and composition of the founding family, number of family members involved in the firm, as well as the extent of their involvement. In addition, within-group studies of the strength of altruism-based relationships, and the degree of substitution they offer from agency costs could be other useful areas of research.

We also suggest that implications of combining altruism and agency should be explored beyond the current study's context of public family firms. In particular, the crisis of corporate governance in some public firms in the US, despite high levels of incentive alignments through compensation and stock options, calls for developing trust and confidence in corporate leadership. We believe that processes that lead to development of altruism and trust outside family relationships are worth exploring (e.g. Eshel, Sansone, and Shaked, 1999), in order to develop more general prescriptions of value-added governance models for public corporations. For instance, study of processes that lead to development of altruism and trust outside family relationships can better inform the debate in the US about separation of Chair and CEO positions.

In summary, this paper extends our understanding of corporate governance of family firms, ownership structure and firm performance, with implications for corporate leadership in these firms. With an appropriate division of leadership responsibility, the family influenced

public firm may be able to combine the advantages of corporate governance based on altruism, providing multi-generational continuity, and access to efficient managerial labor and capital markets. Our results support the proposed model of firm performance. Based on the main findings of this study, several useful areas of future research are outlined.

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Table 1

Factors that affect agency cost of private and public firms

	Private family firms	**Closely held public firm with family influence**	**Closely held public firm without family influence**	**Widely held public firm**
Information asymmetries: owners versus managers	Small	Small	Medium	Large
Access to efficient labor markets	Limited	Potentially limited	Unlimited	Unlimited
Access to efficient capital markets	Limited	Potentially limited	Potentially limited	Unlimited
Importance of social contracts – altruism	Important	Important	Unimportant	Unimportant
Time Horizon	Long-term	Long-term	Potentially long-term	Short-term

Table 2

Firm performance effects of different combinations of descendent and non-descendent Chairs and CEOs

	Non-descendant Chair	Descendant Chair
Non-descendant CEO	Firm performance reduced by significant agency costs due to hired managers at the top	High firm performance due to low overall governance costs due to monitoring of CEO by significant insider (Chair) and intangible benefits due to continuity of family vision
Descendant CEO	Firm performance reduced by ineffective monitoring of an entrenched CEO by a less powerful Chair, as well as agency costs of a non-descendant Chair, offsetting intangible benefits from continuity of vision	Firm performance reduced by significant costs due to nepotism and lack of access to competitive labor markets and negative effects of altruism (e.g. overindulgence by parents), offsetting intangible benefits from continuity of vision

TABLE 3

Distribution of firms in the sample by nature of descendant influence

	Descendant Chair	Non-descendant Chair
Descendant CEO	6 cases (2 firms)	15 cases (5 firms)
Non-descendant CEO	27 cases (9 firms)	375 cases (125 firms)

TABLE 4

Pearson Correlation Matrix

Variables	Mean	S.D.	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1. Q-ratio (ln)	.267	.449											
2. Return on assets lagged (ROA)	.032	.117	.177(**)										
3. Debt of total assets (%)	.595	.182	-.158(**)	-.016									
4. Firm age (ln)	3.808	.967	-.034	.199(**)	-.004								
5. Firm size (ln)	7.215	1.869	-.070	.347(**)	.203(**)	.373(**)							
6. Takeover defenses	.510	.5004	-.064	.226(**)	.081	.216(**)	.396(**)						
7. Blockholder ownership (%)	46.642	19.768	-.164(**)	.051	-.004	-.199(**)	-.146(**)	.004					
8. Insider ownership (%)	22.631	24.997	-.213(**)	-.173(**)	-.016	-.266(**)	-.310(**)	-.147(**)	.435(**)				
9. Country (Sweden=1)	.475	.499	-.015	.222(**)	.057	.209(**)	.261(**)	.619(**)	-.033	-.281(**)			
10. International exchange listing	.104	.305	.089	.063	-.031	.120(*)	.436(**)	.179(**)	-.225(**)	-.198(**)	.048		
11. Descendent CEO	.036	.185	-.103(*)	-.003	.048	.081	-.038	.111(*)	.065	.042	.125(*)	-.065	
12. Descendent Chair	.064	.245	-.044	.018	.042	.038	-.017	.023	-.007	.104(*)	-.132(**)	-.089	.264(**)

* p< .05 (two-tailed)
** p< .01 (two-tailed)

TABLE 5

The effect of descendant leadership (CEO or Chair) on firm performance

	Predicted sign	Dependent variable: ROA lagged			Dependent variable: Q-ratio (Ln transformed)		
		Controls only	Controls and main effects	Controls, main and interaction effects	Controls only	Controls and main effects	Controls, main and interaction effects
Controls							
Debt of total assets (%)		-.110 (-2.276)*	-.114 (-2.359)*	-.100 (-2.065)*	-.080 (-1.641)	-.083 (-1.707)†	-.079 (-1.608)
Firm age (ln)		.051 (1.024)	.051 (1.024)	.064 (1.265)	-.095 (-1.889)†	-.090 (-1.785)†	-.087 (-1.727)†
Firm size (ln)		.365 (5.905)***	.359 (5.807)***	.345 (5.564)***	-.213 (-3.415)**	-.223 (-3.581)***	-.232 (-3.712)***
Takeover defenses		.052 (.857)	.044 (.716)	.080 (1.277)	.015 (.244)	.011 (.187)	.022 (.351)
Blockholder ownership (%)		.110 (2.112)*	.115 (2.206)*	.110 (2.105)*	-.069 (-1.299)	-.062 (-1.184)	-.075 (-1.424)
Insider ownership (%)		-.074 (-1.313)	-.067 (-1.175)	-.062 (-1.087)	-.158 (-2.746)*	-.146 (-2.529)*	-.149 (-2.581)*
Country (Sweden=1)		.049 (.788)	.065 (1.016)	.058 (.933)	-.033 (-.527)	-.015 (-.239)	-.024 (-.382)
International exchange listing		-.135 (-2.384)*	-.127 (-2.247)*	-.132 (-2.474)*	.117 (2.037)*	.124 (2.159)*	.119 (2.078)*
Main effects							
Descendent CEO	-		-.057 (-1.193)	-.113 (-.982)		-.101 (-2.107)*	-.330 (-2.532)*
Descendent Chair	+		.095 (1.889)†	.221 (2.854)*		.091 (1.811)†	.171 (2.229)*
Interaction effects							
Descendent CEO x Takeover defenses				.053 (.468)			.245 (1.884)†
Descendent Chair x Takeover defenses	-			-.172 (-2.286)*			-.084 (-1.104)
Number of observations (Firm-years)		423	423	423	414	414	414
R-square		.190	.198	.208	.188	.200	.208
F-Statistics (Significance)		9.636***	8.398***	7.648***	9.330***	8.358***	7.466***
Change F-Statistics (model over model to the left)			1.980	2.725†		3.029*	1.882

Industry controls are not reported. Beta values reported, and t-statistics in parentheses.

† p< .10 (two-tailed)
* p< .05 (two-tailed)
** p< .01 (two-tailed)
*** p< .001 (two-tailed)