Corporate governance and family succession: New evidence from Taiwan

Yin-Hua Yeh
Graduate Institute of Finance, National Chiao Tung University, 1001 Ta-Hsueh Rd., Hsinchu City 30010, Taiwan

ARTICLE INFO

Keywords:
Succession
Corporate governance
Laws and regulations

ABSTRACT

Succession in family firms has historically been associated with risk. However, improvements in laws and regulations along with the consequent improvements in corporate governance can greatly mitigate the potentially negative impacts on succession performance. This study utilizes a comprehensive data set of 280 cases of succession from Taiwan between the years 1997 and 2012, a period which coincides with the introduction of a big bang of new domestic laws and regulations. The results indicate that improvements in the regulatory environment along with the consequent strengthening of corporate governance reduces the probability of family succession while at the same time increases firm performance during the succession period. In many cases the impact of improved corporate governance outweighs the influence of improved laws and regulations. The implications of these findings underscore the importance of the government’s role in establishing robust internal and external mechanisms to enhance corporate governance, so that in significant events such as firm succession, the attendant risks are reduced.

1. Introduction

The prevalence and importance of family firms, as well as their impact on local economies, are by now well recognized around the world. While there are many corporate governance and finance issues that have an important bearing on family owned firms, among the most critical of these is succession.

Burkart et al. (2003) and Franks et al. (2012) found that the level legal protection for investors is an important influence on succession decisions. Moreover changes in laws and regulations will influence the quality of corporate governance. The impact of enhanced laws and regulations and improved corporate governance on family succession raises important questions, namely: 1) whether the probability of family succession decreases when laws and regulations, as well as the quality of corporate governance, improve over the succession period; and 2) whether stronger laws, regulations, and improved corporate governance reduce the risks of succession, or enhance stock performance over the succession period.

This paper takes a closer examination of these questions on succession in Taiwanese family firms. There are several reasons for this. First, as in many countries around the globe, family ownership and succession is highly prevalent in Taiwanese listed firms. Second, as in other countries in the wake of the Enron collapse, key amendments to laws and regulations introduced in 2002 and 2007 significantly improved the level of investor protection in Taiwan which in turn had a profound impact on the succession patterns of family firms. Third, as a succession event is generally associated with transferring control from a family controller to another related family member (i.e. an offspring or close relative) or to an unrelated outsider in the case of a resignation, Taiwan can provide a very detailed and rich source of family succession and corporate governance data. The analysis of this data can provide theoretical implications that can be extended to other countries that have undergone similar reforms.

E-mail address: yhyeh@nctu.edu.tw.

http://dx.doi.org/10.1016/j.pacfin.2017.09.011
Received 11 November 2016; Received in revised form 15 September 2017; Accepted 25 September 2017
0927-538X/ © 2017 Elsevier B.V. All rights reserved.

Please cite this article as: Yeh, Y.-H., Pacific-Basin Finance Journal (2017), http://dx.doi.org/10.1016/j.pacfin.2017.09.011
The probability of a controlling family to choose a family member as the successor showed a steady decline between 2002 and 2012. This was primarily a result of the significant external and internal governance reforms in Taiwan during this period. In 2002 new IPO companies were required to appoint independent directors to their boards. The government also issued corporate governance best practices for all listed firms, and also passed the Investor Protection Act amid new regulations on internal control systems. Cumulatively these measures provided protection to investors in the event of any illegal trade activities. In 2003 the government also eased regulations related to foreign institutional investors. In addition, 2007 saw an important amendment to the Security Act which introduced the option to adopt an audit committee in lieu of a supervisory system. Another reform saw increased responsibility placed on insiders in the event of fraudulent reporting or other illegal corporate activities. In sum these new regulations forced listed companies in Taiwan to adopt enhanced corporate governance practices. The resulting change in operating environment gives occasion to reinvestigate and extend previous studies on succession.

This study provides new evidence and insights into the effects of succession, and in particular the roles of enhanced laws, regulations and corporate governance in influencing succession decisions, as well as the effect these have in maintaining firm value during the succession period. The findings support the conclusions of Burkart et al. (2003) and Franks et al. (2012) in the importance of establishing robust investor protection. While Bennedsen et al. (2015) provides a detailed account of the risks associated with succession events, and highlights the role of specialized assets as explanatory factors, this study provides evidence of the importance of both external and internal governance mechanisms which will mitigate the effects of specialized assets as well as reduce the risks associated with succession.

The remainder of the paper is structured as follows: Section 2 reviews the literature of family succession and provides an overview of the institutional environment in Taiwan by describing the so called big bang of laws and regulations that occurred in Taiwan in 2002 and 2007, as well as the resulting improvements in corporate governance. Following this the two hypotheses that underpin this study are presented. Section 3 provides our methodology, including our definition of succession, our sample, as well as the definition of the empirical variables. Section 4 provides the empirical results and our robustness checks. Section 5 summarizes our findings and discusses future implications.

2. Literature review and institutional environment

2.1. Family firm succession and performance

Succession is an inevitable process that virtually every successful family firm must undergo at some point in time. Successful succession, particularly between the first and second generation of management, is crucial to the survival and future prosperity of a successful family-owned business. In most instances, choosing between a family heir and a family-external professional is a complicated decision (Gomez-Mejia et al., 2001). This is because several competing concerns may require balancing, including internal conflicts between family members, competing personal objectives about the firm's organization and governance (Bertrand et al., 2008; Bertrand and Schoar, 2006), managerial ability (Pérez-González, 2006) and management philosophy (Mullins and Schoar, 2016).

There are many pros and cons associated with choosing a family member as a successor. For example, family successors are often associated with longer investment horizons, reputational concerns and diminished agency conflicts, which may therefore lead to superior performance (Anderson and Reeb, 2003; Andres, 2008; Sraer and Thesmar, 2007). In contrast, non-family successors tend to exhibit superior executive skills (Bennedsen et al., 2007; Pérez-González, 2006) and are often better equipped to deliver superior growth opportunities after the transition. Moreover, family heirs might enjoy the private benefits of control and therefore make inferior decisions in terms of managerial talent (Pérez-González, 2006), which may in turn result in lower performance (Villalonga and Amit, 2006).

Succession therefore presents significant challenges, particularly in maintaining firm value. For instance, Smith and Amosako-Adu (1999) document a negative stock market reaction to family successor appointments in US firms, while Morck et al. (2000) report a lower return on sales and assets for heir controlled firms than comparable firms in Canada.

According to Villalonga and Amit (2006), drawing on a sample of Fortune 500 firms, family ownership creates value only when the family firms' founders serve as the CEO or as the chairman with an externally hired CEO. An event study in the United States was used by Pérez-González (2006) to determine that only promotions of external CEOs are associated with positive abnormal returns. In a different study examining Danish firms Bennedsen et al. (2007) took the unique approach of using the gender of the founder's first child as an instrument variable, and reported that family successors, as opposed to successors by external professional managers, caused a 4% average decline in return on assets, with firm performance failing to meet pre-succession levels. The extent of a founder's involvement in the succession process was found in Bertrand et al. (2008) to negatively correlate with the performance of family firms, and in some cases detrimental instances of tunneling resources out of the group's firms into pockets of family members was documented.

In a study on succession cases in Hong Kong, Singapore, and Taiwan, Bennedsen et al. (2015) document a 56% drop in market-adjusted stock prices during the five-year period following family succession, and propose a hypothesis based on the transfer cost of specialized assets to explain their findings.

While the literature does report that management transitions in family firms to family heirs can be detrimental to firm value, there are other studies indicating that this may not always be the case. The particular characteristics of a given firm may have the biggest influence on firm performance. Miller et al. (2007) find that lone founder firms in which no other family members are involved in management perform better than family firms run by multiple family relatives. However, this pattern may not hold for firms that are
دریافت فوری متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات