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Board characteristics and firm performance in public founder- and nonfounder-led family businesses

Rebeca García-Ramos *, Myriam García-Olalla

Department of Business Administration, University of Cantabria, Spain

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ABSTRACT

In this study, we examine whether the presence of a founder influences the relationship between the board of directors' characteristics and company performance in a sample of European, publicly traded, family firms. Our findings contradict the widespread belief that smaller and more independent boards as well as nondual leadership structures always lead to better firm performance, suggesting that agency theory is limited in its explanation of the relationship between board characteristics and firm performance. We find a positive effect of board size on business performance in nonfounder-led family firms and a negative effect of board size on founder-led family businesses. The presence of independent directors on the board has a positive effect on performance when a firm is run by its founder. However, when descendants lead the firm, the presence of independent directors has a negative effect on performance. Although the effect of board meetings on firm performance is positive, this relationship is weaker when the family business is run by its founder. Finally, CEO duality improves firm performance when descendants run the business, although CEO duality has no effect on performance when the firm is led by the founder.

1. Introduction

In recent years, several recommendations have been made with regard to board structure for public corporations and have been written into codes of good corporate governance. A common theme in these recommendations is the agency theory perspective, which seeks to strengthen the role of monitoring boards. The emphasis of these codes on the monitoring function of boards is aligned with the focus of agency theory in much of the literature on boards of directors. However, the related empirical evidence is inconclusive and there is limited guidance for policymakers seeking to identify governance practices that result in more effective firm performance (Finegold, Hetch, & Benson, 2007).

A key aspect of firm governance is ownership structure, particularly the typology of the firm's shareholders (Bammens, Voordeckers, & Van Gils, 2010). The governance practices of family businesses (FBs) differ from those of non-FBs (Bartholomeusz & Tanewski, 2006). In recent years, numerous studies have analysed the distinctive features of the governance systems of these types of business (e.g., Anderson & Reeb, 2004; Arosa, Iturralde, & Maseda, 2010; Bartholomeusz & Tanewski, 2006; Corbetta & Montemerlo, 1999; Corbetta & Salvato, 2004; Davis & Pett, 2000; Lane, Astrachan, Keyt, & McMillan, 2006; Miller & Le Breton-Miller, 2006; Schulze, Lubatkin, Dino, & Bucchold, 2001; Van den Heuvel, Van Gils, & Voordeckers, 2006). However, theoretical explanations of expected governance patterns over generations are only beginning to emerge (Lubatkin, Schulze, Ling, & Dino, 2005; Miller, Le Breton-Miller, & Lester, 2011; Mishra, Randoy, & Jensen, 2001; Schulze, Lubatkin, & Dino, 2003) and little is known about the relation between boards of directors and family generations in charge of companies (Bammens, Voordeckers, & Van Gils, 2008; Barontini & Caprio, 2006). Given these limitations in theoretical knowledge, it is important to note that, as companies evolve, different forms of corporate governance may be needed (Filatotchev & Wright, 2005). As Zahra and Pearce (1989) first noted, board composition is contingent upon the current phase in a company's life cycle, so that, in the particular case of a FB, the family generation in charge of the business will be a relevant variable because it determines a FB's need for supervision (Astrachan, Klein, & Smyrnios, 2002; Bammens et al., 2008; Gersick, Davis, Hampton, & Lansberg, 1997; Voordeckers, Van Gils, & Van den Heuvel, 2007). The nature of FB governance changes as ownership is dispersed over time and across generations because needs for supervision change, as does the generation in charge of the firm (Alderfer, 1988; Aronoff & Ward, 1995; Astrachan et al., 2002; Bammens et al., 2008; Habbershon & Williams, 1999;

* Corresponding author at: Department of Business Administration, University of Cantabria, Avenida de los Castros s/n, 39005 Santander, Cantabria, Spain.
Tel.: +34 942 20 39 22; fax: +34 942 20 18 90.
E-mail address: rebeca.garciaramos@unican.es (R. García-Ramos).

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Lubatkin et al., 2005; Voordeckers et al., 2007). A well-formed board can provide a FB with the edge needed to sustain value from one generation to the next.

Considering these prospective connections, the aim of this study is to determine whether there are significant differences in the relationship between a board of directors and firm performance that depend on the generational stage of the FB and, more specifically, on founder involvement in the business. In addition, we examine the extent to which the observed relationships are consistent with general good governance recommendations for listed companies. To explore these questions, we use a sample of European, publicly traded, family firms during the 2001–2007 period and compare those FBs led by their founders (FLFBs) with those not led by their founders but by descendants (NFLFBs). The European business sector enables us to analyse the impact of corporate governance on firm performance in a context characterised by high ownership concentration and the presence of family groups that remain in control of a significant number of firms, in contrast to the less amenable American and Anglo-Saxon markets.

The role of the founder in FBs is relatively underexplored in the corporate governance literature. By exploring the impact of the founder in the relationship between several board characteristics and firm performance, we attempt to expand the knowledge about corporate governance and to shed further light on differences in FBs over generations. The concerns of this study are particularly pertinent for FB owners, their advisors and regulatory bodies of corporate governance, as well as the scientific community in general. The results presented provide an overview of the relationship between a board and the performance of a FB dependent on whether it is led by its founder. The study provides insight into the proper understanding and design of the structures most suitable for boards of directors in order to maximise firm performance.

To pursue our objectives, this article will proceed as follows: in the next section, we adopt an agency theory approach in order to review the monitoring role of boards of directors in the context of FBs, focusing on the influence of founder involvement on agency problems. Hypotheses are subsequently offered. In the third section, we define the sample, variables and methodology used. The results, implications, main conclusions and limitations of the study are discussed in the final sections.

2. Agency problems, boards of directors and firm performance: theoretical background and hypothesis development

The most dominant direction in corporate governance research is that represented by agency theorists. Agency theory addresses the relationship between a principal (such as an owner), an agent and the contract that binds them (Jensen & Meckling, 1976). Economists study the problems that result from asymmetric information and from divergences of interest between the two parties. Such problems include, for example, a limited ability to select a reliable agent and to monitor and censure his/her performance (Fama & Jensen, 1983). From an agency theory perspective, a primary task that the board of directors should perform as an internal administrative body is the monitoring of management on behalf of shareholders, since effective monitoring can improve firm performance by reducing agency costs (Eisenhardt, 1989; Fama & Jensen, 1983; Jensen, 1993; Jensen & Meckling, 1976).

The literature on boards of directors in FBs has primarily focused on agency issues, from which we can infer that FBs need not incur significant owner–manager agency costs (Habbershon & Williams, 1999; Schulze et al., 2001). Families who own businesses do not confine themselves to simple ownership; they tend to manage and to assume a governing role (Corbetta & Tomaselli, 1996). In a general context of concentrated family ownership and nonseparation of ownership and management, the strong alignment of interests between owners and managers reduces the agency costs arising from the need to establish mechanisms for the supervision of the management team. Moreover, in publicly traded FBs, family block holders have strong incentives to monitor management in order to protect family wealth (Anderson & Reeb, 2003; Barontini & Caprio, 2006; McVey, Draho, & Stanley, 2005), thereby mitigating or reducing the classical agency problem between owners and managers (Anderson & Reeb, 2004; Jaggi, Leung, & Gul, 2009; Villalonga & Amit, 2006).

However, agency problems emerge not only from owner–manager conflict but also from the owner–owner conflict stemming from the divergent interests of majority and minority shareholders (La Porta, Lopez-de-Silanes, & Shleifer, 1999; Shleifer & Vishny, 1997). Publicly traded FBs also hold contracts with other, nonfamily shareholders. Major owners may act as de facto agents for minority owners, but because of their superior power and knowledge, they may be able to exploit minority owners (Le Breton-Miller & Miller, 2009). Family interests may dominate over the interests of minority nonfamily shareholders, since the concentration of personal and family wealth in owner-managed firms usually creates a preference for income and wealth preservation over other dimensions of firm performance such as maximisation of dividend payments to outside shareholders (Filatotchev & Wright, 2005). Therefore, family influence needs to be balanced with board structures that limit the family's discretion over firm resources and with the danger of the expropriation of firm wealth (Anderson & Reeb, 2004). With respect to the latter, two sources of agency problems can be identified (Bammens et al., 2010): the owning family's pursuit of its own economic interests and the owning family's pursuit of its own noneconomic interests.

The owning family's pursuit of its own economic interests brings about the risk of power abuse and the extraction of private economic benefits through special dividends, excessive compensation, tunnelling activities and the like (Anderson & Reeb, 2004) at the expense of nonfamily minority shareholders (Villalonga & Amit, 2006). The second concern refers to the threat of owning families pursuing noneconomic family objectives, such as maintaining control of the company, firm survival, financial independence and/or family harmony, to the detriment of nonfamily stakeholders' interests (Jones, Makri, & Gomez-Mejia, 2008; McVey et al., 2005; Sharma, Chrisman, & Chua, 1997; Voordeckers et al., 2007). Compared with the focus on the risk within private FBs that owning families will pursue noneconomic interests that detract from economic firm performance, research on the public setting of FBs shifts its concern to the expropriation of economic benefits (Bammens et al., 2010; Le Breton-Miller & Miller, 2009). This fact reflects the tendency for privately held FBs to be used as vehicles for sustaining a family's transgenerational economic and socioemotional needs. In contrast, in publicly traded FBs, the distance between the family and the business can grow and the family incentive to exploit rather than nurture the business can become quite real (Miller, Le Breton-Miller, & Scholnicket, 2008; Morck & Yeung, 2003).

Considering these agency issues, scholars have emphasised the value of boards that reduce information asymmetries and that set limits on familial decision-makers' discretion (Anderson & Reeb, 2004; Schulze et al., 2001). These agency problems and needs for supervision depend on the generational stage of the family in charge of the business (Bammens et al., 2008; Habbershon & Williams, 1999; Le Breton-Miller & Miller, 2009; Miller et al., 2008). Within the context of publicly traded FBs, over generations, families often obtain control significantly in excess of their cash