

HOW DOES FAMILY MANAGEMENT AFFECT FIRM PERFORMANCE: EVIDENCE FROM TAIWANESE FIRMS

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Abstract

This study used the panel data of 465 Taiwanese listed companies by applying both accounting and market-value indicators to an examination of family management's influence on firm performances. The empirical results show that family firms in Taiwan have performed better than non-family firms. The combination of equity ownership and management right has helped family firms reduce agency cost and enhance firm value in the long run. As for family management, the empirical results suggest that if the founder serves as the chairman and CEO at the same time, it is most beneficial to the firm's performance. When the position of CEO is passed to a hired manager, it may enhance firm performance in the short-run. On the other hand, when the position is passed down to a descendant, it may be conducive to firm value in the long-run.

Key words: Family management, Firm performance, Founder, Descendant.

INTRODUCTION

The family firm is a common type of organization in advanced economies, such as Europe and the United States, and is even more popular in Taiwan and other Asian emerging countries. Anderson and Reeb (2003, 1301) study 403 companies in the S&P 500 industrials, and find that more than one-third of them are family firms. Barontini and Caprio (2006, 689) examine 675 listed companies in 11 European countries, and find that with a 10% voting right as the control threshold, 53% of the sampled companies are controlled by families. Claessens, Djankov, and Lang (2000) study 2,980 listed companies of 9 countries in East Asia, and find that with a 10% voting right as the control threshold; more than 50% of the companies are controlled by families. Yeh, Lee, and Woitke (2001, 31) examine 208 listed companies in Taiwan, and find that with a 10% voting right as the control threshold, 81% of the listed companies are controlled by families. If a 20% voting right is used as the control threshold, 51% of these subjects would have been considered family firms.

Although the family firm is a popular business model in the world, the issue of whether or not the family firm is an effective business system has not yet yielded a consensus conclusion. Anderson and Reeb (2003, 1301) find that family firms perform better than non-family firms. James (1999) proposes that family firms have a better long-term vision in investments and, hence, yield better returns. Barontini and Caprio (2006, 691) argue that family firms perform better than non-family firms for European companies. Villalonga and Amit (2006, 394) study the Fortune 500 companies, and find that family firms perform better than non-family firms. In contrast to the above findings, Perrow (1972) point out that family firms are inefficient and that if family members account for the majority of the senior management, the operating efficiency declines. The more serious this situation, the worse the firm performance becomes.

In family firms, the ownership is often concentrated in the hands of the family as the major shareholder, and the family firms tend to have both ownership and management rights. Therefore, family firms have the capacity and the incentive to serve the interests of the family at the expense of the firm, which leads to the Entrenchment Hypothesis (Jensen and Ruback, 1983). Fama and Jensen (1983) indicate that shareholders with both ownership and management rights can seek personal benefits by trading on the interests of the firm; as a result, the firm performance deteriorates. Shleifer and Vishney (1997, 760) conduct a study also proving that the controlling shareholders with a relatively high level of ownership and management rights tend to seek personal benefits by jeopardizing the interests of minority shareholders.

On the other hand, it has been argued that ownership concentration is not necessarily an inefficient structure. According to the agency-cost hypothesis, the combination of ownership and management rights of a family firm may mean the strong alignment of family interests and firm performance. In other words, family members have high motivation to enhance firm performance if they are involved in the management.

Dem-setz and Lehn (1985) suggest that the combination of ownership and management rights is advantageous because major shareholders can mitigate the problems associated with agency costs, while family management can reduce the agency problem significantly. Therefore, with the reduction of agency costs, family management

is expected to be beneficial to firm value. Burkart, Panunzi, and Shleifer (2003) demonstrate that management by family members can improve firm performance to a certain degree. However, this benefit may be offset if the management consists of hired managers. Martinez, Stohr, and Quiroga (2007) argue that the active involvement of family in management responsibilities can enhance firm performance.

In Taiwan, the ownership of family firms is concentrated in the hands of family members; hence, family members are usually involved in firm management, and the long-term involvement has strengthened family firm reputation and employee loyalty to family members. The family members can establish good relationships with minority shareholders, employees, and customers. On the other hand, when family members serve in an important position, they can fail to realize the benefits attributable to professional managers or can trade in the goal of maximizing firm profits for personal gains. All these factors may contribute to a worsening of firm performance. Whether the active involvement of a family in firm management would result in benefits or barriers has received scant attention in previous studies. Furthermore, there is little evidence on the influence of family management on firm performances in Taiwan¹. Therefore, this paper aims to gain an understanding of the effects of family management on firm performance in Taiwan, so as to provide references to firms in other Asian emerging markets.

Family firms in Taiwan have been carrying on Chinese tradition, including the importance of personal relationships, a focus on harmony, an extension of patriarchy (succession by the male heir apparent but not necessarily by the capable), authoritative personalities, lack of trust in outsiders, relationships based on trust and loyalty, and family mottos as the firm philosophy. Many companies in traditional industries remain family-run businesses, which is a characteristic in the early agricultural-based society of Taiwan. In this type of family firm, it is common that the founder acts both as the chairman and the CEO in the early stage, and later intentionally passes the position of CEO to his descendant after the firm gradually develops and becomes well-established. Then, the founder remains the chairman to supervise the management by the young generation and to help guide the firm decision-making. Examples of this practice include some famous family groups in Taiwan such as the Far Eastern Group and the Taiwan Formosa Group. However, for high-tech industries that emerged in the 1980s, ownership may be passed down to the second generation whereas the transfer of management rights follows a different path. Because entrepreneurship in a high-tech company requires a high degree of professional knowledge, in general, the company is often established by technical teams with very short and fast product life cycles. As a result, it is difficult for the founders to pass the management rights to the second generation, and they often pass the position of CEO to hired managers. Examples of this practice include the Foxconn Group, the Asus Group, and the Acer Group.

Which model can generate better performances without damaging the value created by the founders? This is an important empirical issue that, faced by family firms in Taiwan and other Asian countries, merits examination. As corporate governance is not well developed in Asia, whether outside directors and unaffiliated blockholders actively play important roles in monitoring remain an essential corporate-governance issue also meriting further investigation. Jara-Bertin, Lopez-Iturriaga, and Lopez-de-Foronda (2008, 146) find that increased contestability over the control of the largest shareholder increases the value of family-owned firms. Their results also show that in

firms in which the largest shareholder is a family, the presence of a second family shareholder reduces firm value. Anderson and Reeb (2003, 1314) discover that outside directors are more prevalent in non-family firms than in family firms, and that the ability of outsiders to monitor family activity is an important attribute in minimizing family manipulations.

In our study, we have used panel data from 2002 to 2006 for 465 family and non-family listed firms on the Taiwan Stock Exchange. The results strongly show that the performances of family firms are better than those of non-family firms in Taiwan. In the analysis of whether differences among family members will affect firm performances, we find that when the founder serves as the CEO, regardless of whether or not accounting performance (ROA) or market-value performance (Tobin's Q) is applied, this type of structure is most beneficial to firm performance. When the CEO is served by a descendant, it is also beneficial to performance. This finding differs from those of Villalonga and Amit (2006, 385), which suggest that U.S. firm performance declines when a descendant acts as the CEO. We also find that the scenario in which the founder serves as both the chairman and the CEO is the best combination for firm performance. When accounting performance (ROA) is used, the second best combination is when the founder acts as chairman and a hired manager acts as the CEO. However, when Tobin's Q is used as the performance measure, the second best combination is when the founder acts as the chairman and a descendant acts as the CEO. This finding suggests that family firms are potentially long-term value maximization advocates and that family management does support family firm's long-term performance. In addition, our study shows that both outside directors and unaffiliated blockholders play an active role in the elimination of information-asymmetry problems, which leads to a better performance for Taiwanese family firms.

LITERATURE REVIEW

Definition of "family firm"

Previous studies have shown that different definitions of 'family firm' may lead to different empirical findings. On the basis of the different definitions, the influence of family ownership on firm value would vary. Hence, the use of an appropriate definition plays an important role in the study of family performance. Mok, Lam, and Cheung (1992) defined 'family firm' as a scenario in which the total ownership holdings of either family members or the companies established by the same family's ownership exceeds 10%, and in which either these family members or these companies hold seats on the board. Burch (1972) indicates that if any individual or family member owns more than 4% in equity and holds a seat on the board, the firm is a family firm. Anderson and Reeb (2003) suggest that family firms should be defined according to the following conditions: (1) continuous ownership by family members; (2) family occupation of seats on the board.

Most of the above literature defines 'family firm' on the basis of two factors: ownership percentages and board-seat occupancy. Many family firms in Taiwan are in fact conglomerates, while spouses and relatives undertake management responsibilities or hold seats on the board. Therefore, this study defines 'family firm' as a firm that meets one of the following two conditions: (1) the total family ownership (including spouses and family members three-times removed) exceeds 10% and involves occu-

pancy of board seats; or (2) more than half of the board seats are held by family members.

The advantages and disadvantages of family firms

In Taiwan, many family-run firms stand in contrast to the firms in advanced economy that operate under ownership diversified among a large number of shareholders and that have relatively concentrated equity ownership. Burkart, Panunzi, and Shleifer (2003) indicate that ownership concentration empowers family members to achieve their goals better than other shareholders can. Silva and Majluf (2008) also find that family ownership adds value to the firm at lower ownership concentration, and this contribution is large when the family becomes highly involved in management. Family control may reduce or even completely eliminate the agent problems between shareholders and managers. Since the wealth of family members is closely linked to firm value, family members have strong incentives to supervise managers and to improve firm performance. Maury (2006, 321) shows that family control can reduce the classical agency problem between owners and management, but can give rise to conflicts between the family and minority shareholders when shareholder protection is low and control is high. In addition, because family members are long-term presences in a given business, they tend to have a longer investment horizon than is the case with other types of investors. In other words, they are more willing to practice long-term investment plans. Casson (1999) and Chami (1997) argue that family firms treat the firm not as wealth, but as an asset for their descendants. The survival of the firm is the main concern of the family, which implies that family members support corporate-value maximization in the long run. James (1999) and Stein (1989) suggest that families tend to have a long-term investment horizon, in contrast to other types of shareholders who focus chiefly on short-term or immediate profits and who lack a long-term vision. With their long-standing presence in their business, families can establish a reputation that creates intangible value for their products and services, as well as a positive image in the eyes of shareholders. Therefore, family reputations are likely to create sustainable economic benefits.

On the other hand, ownership is cash-flow right; this may create a situation where family firms have greater right-based capacity and greater incentives to benefit the family at the expense of firm performance. Demsetz (1983) proposes that family firms may, in choosing non-monetary benefits, remove resources from profitable projects and damage firm performance. Demsetz and Lehn (1985, 1162) point out that the Disney family obtains non-monetary gains by influencing the policies of the firm, in order to satisfy the needs of the family, rather than to maximize the profits of the firm. Family firms that pursue self-serving ends often choose the second-best policies, so that the performances of family firms are worse than those of non-family firms. Cuculelli and Micucci (2008, 18) indicate that inherited management within a family negatively affects the firm's performance, and that this decrease is concentrated among the good performers.

Many studies have also emphasized the complexity of family firms in the past. Davis (1983) and Lansberg (1983) point out that family firms face many unique challenges when family members and other entities share firm value and family characteristics. These challenges include balancing between family ownership and operating efficiency, as well as the problem of succession. The more important problem is the typical predicament that the founder faces; that is, whether to pass the management positions

to descendants or to hired managers. Family firms usually prioritize family members when selecting managers. Hence, a more capable, qualified, and competitive hired manager may be neglected. Gomez-Mejia, Nunez-Nickel, and Gutierrez (2001) propose that, when selecting their managers or directors, family firms would strive to obtain or to strengthen firm control by erecting barriers meant to prevent entry by a third party. This is detrimental to management and firm value. Shleifer and Vishney (1997) argue that even if major shareholders of family members are no longer competitive or qualified, they may still hold key positions in the management. In addition, families tend not to trust others, and tend to be less likely to establish good relationships with other major non-family shareholders. The complicated relationships among the family members may also lead to conflicts, damaging business reputation in both the eyes of consumers and the eyes of shareholders. Andres (2008, 431) show that only family firms in which the founding family is still active either on the executive or the supervisory board have better performance.

To sum up, family firms have certain competitive advantages but also suffer from some disadvantages due to family attributes. Some recent literature has indicated that the performances of family firms in developed countries are superior to the performances of the corresponding non-family firms (Anderson and Reeb, 2003; Villalonga and Amit, 2006; Barontini and Caprio, 2006). In Taiwan, among the top 20 groups in which one half of the group is owned by families, total revenues account for more than 50% of GNP². This statistic raises the important question of whether or not the performance of family firms is better than the performance of non-family firms in Taiwan. Based on the continuous trend of Taiwan's family firms, this paper proposes the following hypothesis:

H-1: In Taiwan, performances of family firms are better than those of non-family firms.

Influence of family members' management involvement on firm performance

If a family member serves as the CEO, the unique contribution of family traits³ is unattainable by non-family members. Morck et al. (1988) suggest that a family member who serves as the CEO would bring innovations to the firm and enhance firm value. Davis, Schoorman, and Donaldson (1997) find that a family member serving as the CEO would have a strong identification with the firm and consider firm performances an extension of personal welfare. Anderson et al. (2003) indicate that family members' long-term service in key management positions could create a powerful positive reputation for companies and could help family members to improve firm performance. Therefore, family members' active involvement in firm management may result in better performances than non-family firms. Burkart, Panunzi, and Shleifer (2003) point out that when family members are more involved in management, firm performance may be enhanced. Maury (2006, 321) argues that active management by family members can bring higher profitability than is the case with non-family firms; whereas passive management by family members does not affect firm profitability.

Families are usually the major shareholders of family firms, and indeed, most of the ownership might fall to just a few family members. If a family member acts as the CEO of the firm, it means that the family has the absolute power in decision making. The firm decision-making may even be in alignment with family interests, and the maximization of firm value may be neglected. If a family member serves in the posi-

tion of CEO owing to limited human capital, to family member insufficient competence, to inappropriate training of family member, to cronyism, or to ignorance of professionalism, a loss of outside talent and a worsening of firm performance may result. Thus, firms need to bear in mind the opportunity cost in association with the loss of hired managers who are more capable, qualified, and competitive than family managers. Hillier and McColgan (2005) show that a family member is less likely than a hired manager to be removed from the office of CEO, even when the family member exhibits a verifiably poor performance. Smith and Amoako-Adu (1999) and Perez-Gonzalez (2001) point out that a family descendant's occupation of a family firm's CEO position can have a negative effect on stock prices. Hillier and McColgan (2005) find that when a family member leaves the position of CEO, and the firm announces that a non-family member will take up the position, both operating performance and stock price will increase.

Many scholars have examined the influence that family-member occupancy of CEO positions has on firm performance, and have compared this influence with the corresponding influence attributable to non-family members' occupancy of CEO positions. Does the positive effect of founders require that they occupy the CEO position in the firm? Anderson and Reeb (2003, 1310) use ROA as the performance indicator, and find that firm performance is the best when the founder acts as the CEO, followed by the situation where a descendant serves as the CEO. If Tobin's Q is used as the performance indicator, the results show that firm performance is the best when the founder acts as the CEO, followed by the situation where a hired manager acts as the CEO. Barontini and Caprio (2006, 694) prove that whether Tobin's Q or ROA is used as the performance measures, the best situation is when family members serve as non-executive directors, and a hired manager serves as the CEO. This is followed by the situation where a family member acts as the CEO. If family members are divided into founders and descendants, it is best when the founder serves as the non-executive director, and a hired manager serves as the CEO. The least desirable situation is where descendants serve as the non-executive directors, and a hired manager serves as the CEO. Villalonga and Amit (2006, 414) confirm that only when the founder is the CEO or when the founder is the chairman but a hired manager is the CEO could family ownership create value for the firm. If a descendant takes up the position of CEO, the firm value would drop.

The above studies in developed countries suggest that only when the founder acts as the CEO could the firm exhibit better performances. When a descendant takes up the position of CEO, the firm performance may deteriorate, and the firm value may also decline. If a hired manager is appointed to the position of CEO, the performances are usually between the aforementioned two extremes. This paper hence proposes a second hypothesis:

H-2: When the founder acts as the CEO, it is the most beneficial situation for firm performances in Taiwan.

In Chinese culture, the tradition is to pass down businesses to descendants instead of to capable outsiders. The positions of chairman and CEO are usually taken by family members. Only when none of the family members is willing to take a vacant position would the firm appoint an outsider to the position of CEO. Therefore, this paper uses 9 combinations of chairman and CEO positions to analyze the influence that family involvement in management has on firm performances in Taiwan, the combinations

being founder, descendant, or a hired manager serving as chairman and CEO, as Table 1 illustrates.

Table 1. The combinations of chairman and CEO positions from founder, descendant, and hired managers

	Founder CEO	Descendant CEO	Hired CEO
Founder Chairman	A	B	C
Descendant Chairman	D	E	F
Hired Chairman	G	H	I

After comparing these 9 combinations, it is expected that Combination A—where the founder acts as both the chairman and the CEO—will have yielded the best performances. This expectation rests on the assumption that the founder is usually diligent, with entrepreneurial spirit, and keen about the needs of the firm, thus, being most capable of taking the firm value to a higher level. Villalonga and Amit (2006, 414) draw the same conclusion for U.S. family firms. The second-best situation is expected to be Combination B, where the founder acts as the chairman but a descendant serves as the CEO. This is because the founder is more inclined and willing to guide his or her descendant, especially in the Chinese society. The third most desirable situation is expected to be Combination C, where the founder acts as the chairman but a hired manager is appointed as the CEO.

This expectation rests on the assumption that a professional manager could avoid the drawbacks of cronyism leading to a loss of non-family talent. However, Villalonga and Amit (2006, 414) have suggested that, in Western countries, if a descendant became the CEO, the firm performance would be worse than if a hired manager served as the CEO. Combinations E and F should yield, according to expectations, worse performances than Combinations B and C owing to a lack of supervision and assistance from the founder. In relative terms, the combination having few family attributes may fail to shoulder responsibilities adequately and may, therefore, worsen firm performance, in the context of Taiwanese business firms. Therefore, this study suggests that Combination E is better than Combination F, and that Combination H is better than Combination I. Hence, the third hypothesis is proposed as follows:

H-3: The positive influence of different combinations of family members or non-family members serving as chairman or CEO on firm performance, from the strongest to the weakest, is ranked as A>C>B>E>F>H>I.⁴

METHODOLOGY

Sample selection and data sources

This study samples the panel data attributable to listed companies on the Taiwan Stock Exchange from 2002 through 2006. Because financial institutions and insurance companies have unique financial structures, and are subject to the control and supervision of government authorities, this study excluded these two industries from the sample pool. The companies with missing data during the sample period were also

eliminated. A total of 465 listed companies are sampled, including 2,325 firm-year observations. The sources of data come from the following sources: (1) the database of the *Taiwan Economic Journal*, which provides information pertaining to financial issues, board-members' background, and family-member relationships; (2) annual reports and prospectuses of listed companies that present information pertaining to direct or indirect family holdings and founders' background; and (3) company websites and telephone inquiries with company spokesman when the companies meet the definition of 'family firm', and information about founders and about founders' relationships with the chairman and the CEO in cases where the founder occupies neither positions.

Table 2 summarizes the number of family firms and non-family firms, as well as the percentage of family firms in different industries. It is worth noting that in the electric-machinery industry, the electrical-and-cable industry, the chemical industry, and the other industries, the percentages of family firms all exceed 50%. There are a total of 465 companies sampled, and 193 are family firms. In other words, over 40% of the sampled companies are family firms. This shows that family firms are rather common in Taiwan.

Table 2. Number and percent of family and non-family firms by industry (N=465firms)

Industry	Non-family firms	Family firms	%
			of family firms
Cement	5	3	37.5%
Food	10	9	47.4%
Plastics	11	9	45.0%
Textiles	28	19	40.4%
Electric Machinery	12	14	53.8%
Electrical and Cable	5	8	61.5%
Chemical	14	14	50.0%
Glass, Ceramics	3	2	40.0%
Paper, Pulp	5	2	28.6%
Iron and Steel	13	11	45.8%
Rubber	5	4	44.4%
Automobile	4	0	0.0%
Electronic	99	63	38.9%
Building Material and Construction	21	10	32.3%
Shipping and Transportation	11	4	26.7%
Tourism	4	2	33.3%
Trading and Consumers' Goods Industry	6	4	40.0%
Oil, Gas and Electricity	4	2	33.3%
Other	12	13	52.0%
Total	272	193	41.5%

Definitions and measurements of variables

This study applies both accounting and market-value indicators as the measure of performances to investigate whether family firms perform better than non-family firms in Taiwan. ROA is the accounting indicator used in this study, and is calculated in two ways: one is to divide net income (NI) by the book value of total assets, and is denoted as ROA (NI); the other method is to divide EBITDA by the book value of total assets, and is denoted as ROA (EBITDA). Although EBITDA is more capable of reflecting the actual profitability of a firm, both ROA (NI) and ROA (EBITDA) may be distorted by accounting treatments. For the above reasons, this study has also used a market indicator, Tobin's Q (firm market value divided by asset replacement value), to evaluate firm performance. Tobin's Q addresses the future growth opportunity of the firm, and avoids the problems associated with accounting treatments. Thus, companies often use Tobin's Q to assess whether their strategies would create long-term value for shareholders⁵.

The family firm, in this study, is defined as a dummy variable. Any firm that meets a criterion of family firm is defined as "1" and others are defined as "0"; the founder is defined as an individual or a few individuals who established the firm and supervised the firm's operations and developments in its early days; a descendant is a descendant of the founder; a hired manager is a non-family-member manager.

In our regression model, we employ the following control variables: the management ownership (%) is the percentage of management holdings relative to the total number of outstanding shares, excluding holdings attributable to family-member managers. If the percentage of management ownership increases, management control right would increase, and thus, the agency cost possibly would increase and would be expected to negatively affect performance (Demsetz, 1983; Demsetz and Lehn, 1985). But Chen, Gou, and Mande (2003, 280) show that managerial ownership positively affects firm valuation, indicating an interest-alignment effect; the unaffiliated blockholdings (%), defined as the total holdings of the individuals or institutional investors who own at least 5%, excluding both the holdings by family members and company holdings controlled by family members. Because unaffiliated blockholders are the biggest monitors, we expect that they will have a positive relationship with performance (Smith, 1976; Shleifer and Vishny, 1986). However, some studies propose that possessors of unaffiliated blockholdings may tend to seek personal benefits by exploiting the interest of minority shareholders, negatively affecting firm performance (La Porta, et al., 1999; Selarkas, 2005); the outside directors (%), defined as the percentage of outside directors among the total number of board seats, are expected to have a positive relationship with performance (Wagner III, Stimpert, and Fubara, 1998).

R&D/sales (%) is the research and development costs divided by company sales, and it represents the importance of sales-related intangible assets; it also serves to control for asset specificity. R&D/sales (%) may positively influence performance, as one would expect intangible assets to enhance performance (Morck et al., 1988; McConnell and Servaes, 1990). However, firms with high research expenditures (asset specificity) will also be more costly for external investors to monitor; this may deteriorate firm performance (Chen and Steiner, 1999); the long-term debt ratio is long-term debt divided by total assets, and is expected to have a negative correlation with firm per-

formance (Chen, Gou, and Mande, 2003, 274; Singh and Davidson, 2003; Demsetz and Villalonga, 2001), since leverage would increase a firm's floating costs and bankruptcy costs. On the other hand, Morck et al. (1988) argue that financial leverage could capture the value of corporate tax shields, thereby increasing the value of Tobin's Q.

The return volatility represents firm operational risk, which is measured by the standard deviations of the historical daily stock returns in each year. We suspect that high firm-specific risk will strengthen managers' conservatism, so that the return volatility will exhibit a negative relationship with performance (Anderson and Reeb, 2003, 1317); the firm size is measured by Ln (total assets), and we expect large firms to exhibit a positive relationship with performance (Singh and Davidson, 2003; Andres, 2008, 439), since larger firms are more efficient in their asset utilization. On the other hand, some studies have discovered that firm size can decrease performance as the given firm becomes larger and more diversified (Lang and Stulz, 1994; Demsetz and Villalonga, 2001); the firm age is calculated by Ln (the number of years since inception), and as expected, older firms are likely prone to inertia and less flexibility in their ability to adapt to competitive pressures. But older firms are also more experienced, receive the benefits of learning, and are associated with first-mover advantages. Therefore, the influence of firm age on firm performance merits further investigation (Douma, George, and Kabir, 2002).

DESCRIPTIVE STATISTICS

Table 3 lists the descriptive statistics of the key variables of the sampled companies. As for the indicators of market-value performance, the maximum value of Tobin's Q is 6.57, the minimum value is 0.28, and the mean (median) is 1.20 (1.04). As far as the accounting-performance indicators are concerned, the maximum value of ROA (EBITDA) is 42.84%, the minimum value is -238.16%, and the mean (median) is 7.14% (7.31%). The maximum value of ROA (NI) is 40.05%, the minimum value is -165.54%, and the mean (median) is 3.07% (3.08%). These numbers indicate that there are significant variations among the performance indicators of the sampled companies. The mean value of management ownership is as low as 0.99%, the average ownership of outside directors is 4.24%, and the mean value of unaffiliated blockholdings is 9.5%. The average of Taiwanese firm age is 29.95 years, younger than the average of 50 years in the United States (Anderson and Reeb, 2003). Other control variables, namely R&D/sales, long-term debt ratio, return volatility, and firm size, are 1.73%, 8.59%, 0.0258, and NT \$ 2,281,433,000 on average, respectively.

Table 3. Descriptive Statistics of Variables

	Mean	Median	Std_Dev	Max	Min
Tobin's Q	1.1993	1.0423	0.5504	6.5670	0.2796
ROA (EBITDA) (%)	7.14	7.31	10.59	42.84	-238.16
ROA (NI) (%)	3.07	3.08	8.53	40.05	-165.54
Management ownership (%)	0.99	0.11	2.06	26.68	0.00
Unaffiliated blockholdings (%)	9.50	6.88	10.61	81.24	0.00
Outside directors (%)	4.24	0.00	10.15	60.00	0.00
R&D/sales (%)	1.73	0.51	4.26	157.22	0.00
Long term debt ratio (%)	8.59	5.35	9.63	55.41	0.00
Return volatility	0.0258	0.0255	0.0082	0.0521	0.0024
Firm size (Unit: NT\$1,000)	22.81433	22.6039	1.338504	27.93585	19.56356
Firm age(years)	29.95	29.65	11.68	61.05	5.08

Table 4 indicates the differences in major variables for family and non-family firms. We conduct T-tests to observe whether the differences are statistically significant. For management ownership, there is no significant difference between family and non-family firms. In terms of unaffiliated blockholdings, non-family firms had more unaffiliated blockholdings than family firms. For outside directors, although non-family firms have more outside directors than family firms, the difference is not significant. The return volatility of family firms is significantly lower than non-family firms, and the total assets of family firms are smaller than for non-family firms. With regard to R&D/Sales, long-term debt ratio, and firm age, there is no significant difference between family and non-family firms. Family firms are significantly superior to non-family firms in all three performance indicators, and the differences all reach the significance level of 1%.

Table 4. Difference of mean tests between family firms and non-family firms

	Family firms	Non-family firms	t-statistic
Number of firms	193	272	
Tobin's Q	1.239	1.175	2.76***
ROA (EBITDA) (%)	8.36	6.40	4.97***
ROA (NI) (%)	4.14	2.43	5.20***
Management ownership (%)	0.99	0.92	0.02
Unaffiliated blockholdings (%)	8.11	10.33	-5.38***
Outside directors (%)	24.03	25	1.25
R&D/sales (%)	1.87	1.65	1.43
Long term debt ratio (%)	8.27	8.78	-1.3
Return Volatility	0.0249	0.0263	-4.37***
Firm size (Unit: NT\$1,000)	14,635	37,497	-7.10***
Firm age(years)	29.69	30.11	-0.89

Table 5 presents, in percentage form, the combinations that arise when the CEO or the chairman is the founder, the descendant, or a hired manager. For example, the combination of Founder Chairman and Descendant CEO, i.e., Combination B, accounts for 5.88% of the family business. Among the business firms in the sample, 40.98% of the firms have Founder Chairman and Founder CEO, comprising the largest group. The second-largest category is the combination of Founder Chairman and Hired CEO, accounting for 21.67%. The third is the combination of Descendant Chairman and Descendant CEO, accounting for 20.29% of the total.

Table 5. The 9 combinations of family members and non-family members acting as CEO or Chairman

	Founder CEO	Descendant CEO	Hired CEO	Total
Founder chairman	40.98%(A)	5.88%(B)	21.67%(C)	68.53%
Descendant chairman	0.49%(D)	20.29%(E)	7.55%(F)	28.33%
Hired chairman	0.39%(G)	1.57%(H)	1.18%(I)	3.14%
Total	41.86%	27.75%	30.39%	100%

EMPIRICAL RESULTS

Family firm performance versus non-family firm performance

This study examines whether family firms perform better than non-family firms⁶ and also examines the influences that types of chairman and CEO have on firm performance in Taiwan. Founder CEO, Descendant CEO, and Hired CEO are the dummy variables: if the founder serves as the CEO, Founder CEO is defined as 1; if not, it is defined as 0. The same definition applies to the other scenarios. The intercept of regression represents the average performances of non-family firms.

According to columns 1, 3, and 5 in Table 6, the coefficients of family firm are all significantly positive, reaching the 1% significance level when ROA (EBITDA) and ROA (NI) are the measurement of performance. The coefficient of family firm is 0.0676, reaching the 5% significance level when Tobin's Q is the measurement of performance. As we have seen, both accounting indicators and market-value indicators demonstrate the better performance of family firms.

Columns 2, 4, and 6 of Table 6 allow for comparisons involving scenarios where the position of CEO is held by a family member or a non-family member. In the calculations involving ROA (EBITDA) and ROA (NI), regardless of whether the position of CEO is held by the founder, a descendant, or a hired manager, the coefficients are all significant and positive. Both of the calculations indicate that the best scenario is when the founder serves as the CEO, followed by when a hired manager serves as the CEO, and when a descendant serves as the CEO. When Tobin's Q as the indicator, the results show that the best scenario is when the founder acts as the CEO, followed by when a descendant serves as the CEO, and when a hired manager serves as the CEO. As can be seen, family members' active involvement in management could enhance both accounting value and market-value performance. In addition, although management ownership is quite small, it still has a positive effect on firm performance.

In terms of unaffiliated blockholdings and outside directors, all three performance indicators are significant and positive. These findings show that stronger external supervision is more helpful to firm performance in Taiwan. Since outside directors (independent) may not feel compelled to contradict the other executives or the CEO, outside directors are in a better position to monitor managerial activities and performance. As the unaffiliated blockholder are the biggest outside monitors, when the blockholders' rights are more centralized, their supervisory power may promote managers' decisions that maximize shareholder wealth. The above finding is not consistent with the study by Thomsen, Pedersen, and Kvist (2006), which showed that blockholder ownership negatively affects firm performance for continental Europe.

R&D/sales have a significant and negative correlation with ROA (NI), which is consistent with the study by Chen, Guo, and Mande (2003, 276), who argued that the findings perhaps stem from one of two factors: (1) a short timeframe makes it impossible for the R&D results to be reflected in net incomes, and thus, the recognition of R&D costs as expenses would lower net income; (2) the marginal productivity of R&D costs would be highly susceptible to the effects of macro economies; when an economy is sluggish, the marginal productivity of R&D costs may be negative.⁷ The influence of return volatility on ROA (EBITDA) and ROA (NI) is significantly negative, but the influence on Tobin's Q is significantly positive. This two-fold finding perhaps reflects the changes that market-value indicators undergo in response to stock-price fluctuations; hence, the calculation of market-based indicators contributes to the positive influence of return volatility. The influence of a long-term debt ratio on the three performance indicators is also significantly negative. This shows that leverage risk negatively affects firm performance. The influence of firm size is significantly positive on the three performance indicators, suggesting that larger firms do have their own advantages. Firm age is negatively correlated with ROA (EBITDA), indicating that a firm's profitability declines with the passage of time.

Table 6. Family firm performance versus non-family firm performance:

$$Performance_{it} = \beta_{1i} + \beta_2 \text{Family firm}_{it} + \beta_3 \text{Management ownership}_{it} + \beta_4 \text{Unaffiliated blockholdings}_{it} + \beta_5 \text{Outside directors}_{it} + \beta_6 \text{R\&D/sales}_{it} + \beta_7 \text{Long-term debt ratio}_{it} + \beta_8 \text{Return volatility}_{it} + \beta_9 \text{Ln (total assets)}_{it} + \beta_{10} \text{Ln(firm age)}_{it} + e_{it}$$

The influence of CEO position on firm performance:

$$Performance_{it} = \beta_{1i} + \beta_2 \text{Founder CEO}_{it} + \beta_3 \text{Descendant CEO}_{it} + \beta_4 \text{Hired CEO}_{it} + \beta_5 \text{Management ownership}_{it} + \beta_6 \text{Unaffiliated blockholdings}_{it} + \beta_7 \text{Outside directors}_{it} + \beta_8 \text{R\&D/sales}_{it} + \beta_9 \text{Long-term debt ratio}_{it} + \beta_{10} \text{Return volatility}_{it} + \beta_{11} \text{Ln (total assets)}_{it} + \beta_{12} \text{Ln(firm age)}_{it} + e_{it}$$

	ROA(EBITDA)		ROA(NI)		Tobin's Q	
	1	2	3	4	5	6
Intercept	0.2446 (3.91)** *	0.2519 (3.98)** *	0.1866 (3.71)** *	0.1962 (3.86)** *	1.5325 (4.12)** *	1.7442 (4.62)** *
Family firm	0.0247 (4.32)** *		0.0187 (4.15)** *		0.0676 (2.45)**	
Founder CEO		0.0296 (3.49)** *		0.0257 (3.78)** *		0.2043 (4.00)** *
Descendant CEO		0.0194 (2.69)** *		0.0163 (2.10)**		0.1132 (2.00)**
Hired CEO		0.0259 (2.83)** *		0.0214 (2.91)** *		0.0898 (1.67)*
Management ownership	0.1091 (0.87)	0.0949 (0.75)	0.2346 (2.37)**	0.2176 (2.19)**	1.7767 (3.08)** *	1.7298 (3.00)** *
Unaffiliated blockholdings	0.0514 (2.28)**	0.0499 (2.21)**	0.0245 (2.02)**	0.0229 (1.91)*	0.539 (5.57)** *	0.5387 (5.58)** *
Outside directors	0.035 (1.79)*	0.0326 (1.67)*	0.0349 (1.88)*	0.0324 (1.74)*	0.2054 (2.01)**	0.1976 (1.93)*
R&D/sales	-0.0301 (-0.64)	-0.0299 (-0.54)	-0.1052 (-0.97)***	-0.1057 (-0.98)***	0.233 (1.26)	0.2267 (1.23)
Long-term debt ratio	-0.1481 (-0.58)***	-0.15 (-0.56)***	-0.1374 (-0.56)***	-0.1384 (-0.61)***	-0.4683 (-1.77)***	-0.4653 (-1.10)***
Return volatility	-1.3366 (-5.00)***	-1.2999 (-4.85)***	-1.5048 (-7.25)***	-1.475 (-7.00)***	3.1324 (2.88)**	3.3642 (3.09)**
Ln(total asset)	0.0173 (7.16)** *	0.0173 (7.16)** *	0.0126 (6.47)** *	0.0127 (6.51)** *	0.1086 (7.42)** *	0.1141 (7.75)** *
Ln(firm age)	-0.0142 (-0.90)***	-0.0134 (-1.86)*	-0.0091 (-1.59)	-0.0077 (-1.32)	0.0328 (0.75)	0.0463 (1.05)
Adj R square	0.1622	0.1732	0.1544	0.2002	0.1313	0.1297

Note: ***, **, and * denote values under the significance levels 1%, 5%, and 10%.

FAMILY MANAGEMENT AND FIRM PERFORMANCE

This study designed 9 combinations with 9 dummy variables, from A to I, to identify the combination (wherein the chairman and the CEO would be the founder, a descendant, or a hired manager) that would be optimal for firm performance. According to Table 7, if ROA (EBITDA) is used to measure performances, the best combination can be found when the founder serves as both the chairman and the CEO, followed by the founder serving as the chairman but a hired manager acting as the CEO; the third-best combination is the one where the founder serves as the chairman and a descendant serves as the CEO. However, if Tobin's Q is used as the measurement of performances, the best combination is when the founder acts as both the chairman and the CEO, followed by when the founder serves as the chairman and a descendant serves as the CEO, and when the founder serves as the chairman and a hired manager serves as the CEO. The influence of the other combinations (D, F, G, H, and I) is not statistically significant. From the above findings, one can conclude that family management indeed has played a positive role in determining firm performance in Taiwan.

Table 7. Performance comparison of family members and non-family members that serving as Chairman and CEO:

Performan-

$$ce_{it} = \beta_{1i} + \beta_{2A_{it}} + \beta_{3B_{it}} + \beta_{4C_{it}} + \beta_{5D_{it}} + \beta_{6E_{it}} + \beta_{7F_{it}} + \beta_{8G_{it}} + \beta_{9H_{it}} + \beta_{10I_{it}} + \beta_{11} \text{Management ownership}_{it} + \beta_{12} \text{Unaffiliated blockholdings}_{it} + \beta_{13} \text{Outside director-s}_{it} + \beta_{14} \text{R\&D/sales}_{it} + \beta_{15} \text{Long-term debt ratio}_{it} + \beta_{16} \text{Return volatility}_{it} + \beta_{17} \text{Ln (total as-sets)}_{it} + \beta_{18} \text{Ln(firm age)}_{it} + e_{it}$$

	ROA(EBITDA)	ROA(NI)	Tobin's Q
Intercept	0.2591 (4.07)***	0.2018 (3.95)***	1.7778 (4.70)***
A	0.0318 (3.07)***	0.0272 (3.30)***	0.2274 (4.38)***
B	0.028 (1.78)*	0.018 (1.45)	0.177 (2.34)**
C	0.0298 (3.47)***	0.0262 (3.81)***	0.1231 (2.09)**
D	0.0895 (1.27)	0.0645 (1.13)	0.4432 (0.95)
E	0.0262 (2.43)**	0.0163 (1.89)*	0.0811 (1.32)
F	0.0132 (0.83)	0.007 (0.56)	-0.0314 (-0.38)
G	0.0283	0.0216	-0.3722

	(0.45)	(0.43)	(-1.26)
H	0.0024	-0.0061	-0.0363
	(0.08)	(-0.25)	(-0.25)
I	0.0003	0.0023	0.0078
	(0.01)	(0.10)	(0.06)
Management ownership	0.0973	0.219	1.7295
	(0.77)	(2.20)**	(3.00)***
Unaffiliated blockholdings	0.0487	0.0217	0.5374
	(2.15)**	(1.82)*	(5.56)***
Outside directors	0.0311	0.0307	0.1921
	(1.30)	(1.64)	(1.88)*
R&D/sales	-0.0312	-0.1068	0.2187
	(-0.66)	(-2.91)***	(1.18)
Long-term debt ratio	-0.1506	-0.1384	-0.4624
	(-5.87)***	(-6.89)***	(-4.17)***
Return volatility	-1.2925	-1.4733	3.2535
	(-4.81)***	(-7.07)***	(2.99)***
Ln(total assets)	0.0175	0.0128	0.1142
	(7.19)***	(6.53)***	(7.74)***
Ln(firm age)	-0.0124	-0.0067	0.0565
	(1.70)*	(-1.15)	(1.27)
R square	0.1793	0.2092	0.1449

Note: ***, **, and * denote values under the significance levels 1%, 5%, and 10%.

CONCLUSIONS

Whether using an accounting performance indicator (ROA) or a market-value performance indicator (Tobin's Q), this study find that the performances of family firms are better than the performances of non-family firms. Family firms in Taiwan usually hold ownership and management rights, a situation that helps negate the agency problem between shareholders and managers. More important, this study interest in the issue of what role the family should play in firm management to enhance firm performance. Should the position of the CEO be assigned to the founder, a descendant, or a hired manager? How does a descendant acting as CEO or chairman affect firm performance? In this study, both accounting and market-value indicators show that situations where the founder serves as the CEO are the most beneficial to firm performance. When a descendant serves as CEO, firm performance benefits, as well. This finding is not consistent with Villalonga and Amit (2006, 414), who suggest that U.S. firm performance declines when a descendant serves as the CEO.

This study also find weak evidence that outside directors are in a better position to monitor managerial activities and enhance firm performance. As the unaffiliated blockholder are the biggest monitors, they can effectively solve information-asymmetry problems, and therefore, unaffiliated blockholders can help promote firm performance (Shleifer and Vishny, 1986).

When ROA is used as the performance measure, this study finds that the best combination for firm performance involved the founder acting as both the chairman and the CEO. Because the founders usually are hardworking people, are great visionaries, or are exceptionally talented, and most important, they are fully aware of the needs of the firm. The founders' service to the firm can best contribute to firm growth and profitability. In Taiwan, the founder usually passes the position of CEO to a descendant or a hired manager after the firm has matured. At this point, the founder usually plays a role of decision maker and supervisor. The second-best combination is when the founder acts as the chairman, and a hired manager acts as the CEO. This combination could enhance the firm's competitiveness because it avoids the loophole where the firm, by hiring from a within-family pool of candidates, runs the high risk of neglecting the firm's need for professionalism. However, ROA is a short-term indicator of profits. Hired managers generally tend to emphasize short-term profit-seeking opportunities to enhance ROA. With Tobin's Q as the performance indicator, the results show that the best combination is when the founder acts as both the chairman and the CEO. The second-best combination is when the founder serves as the chairman and a descendant serves as the CEO, followed by the combination where a hired manager serves as the CEO. This best-combination sequence may reflect the role of Tobin's Q as a market-value indicator emphasizing long-term performance. When the core decision-maker positions are held by one or several members of the same family, the management places considerable attention on the strategies beneficial to the enhancement of long-term value, partly in the hope that the business could be passed down to future generations over the long term. This scenario may explain why previous studies find the long-term performances of family firms to be better than those of non-family firms.

Notes

1. Up to now, the studies addressing this issue in Taiwan include Tsai, Hung, Kuo, and Kuo, (2006) and Yeh, Lee, & Woidtke (2001).
2. According to statistics by China Credit Information Service in 2003, the top 20 conglomerates accounted for 59.78% of GNP in Taiwan.
3. Dyer (2006) indicates that as far as human capital is concerned, families boast unique training, capabilities, adaptation, and aggression. As far as social capital is concerned, families have good relationships with employees, customers, suppliers, and other shareholders.
4. The combinations of D and G demonstrated uncommon situations in Taiwan's business firm; therefore, this paper excludes them from the discussion.
5. $Tobin's\ Q = \frac{\text{book value of total liabilities} + \text{market value of the outstanding ordinary shares} + \text{book value of preference shares}}{\text{book value of total assets}}$.
6. The panel data used in this paper have both fixed and random effects. The results of the Hausman test show that the P-value is close to 0. Therefore, the fixed effect is applied as the empirical method.
7. During the sampling period of 2002-2006, the economic indicators released by the Council for Economic Planning and Development showed that from January to June 2003, from March to July 2005, and from June to December 2006, the economy of Taiwan was in a slowdown.

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