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**FAMILY OWNERSHIP AND CONTROL IN LARGE FIRMS:
THE GOOD, THE BAD, THE IRRELEVANT – AND WHY**

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Abstract

There is a major debate regarding the role of concentrated family ownership and control in large firms, with three positions suggesting that such concentration is (1) good, (2) bad, or (3) irrelevant for firm performance. This article reports two studies to shed further light on this debate. Study 1 uses 744 publicly listed large firms in eight Asian countries to test competing hypotheses on the impact of the combination of family ownership and control on firm performance. On a country-by-country basis, our findings support all three positions. On an aggregate, pooled sample basis, the results support the "irrelevant" position. Study 2, based on a sample of 688 firms from the same eight Asian countries, endeavors to answer why Study 1 obtains different results for different countries. We theorize and document that Study 1 findings may be systematically associated with the level of shareholder protection embodied in legal and regulatory institutions. Study 2 thus sketches the contours of a cross-country, institution-based theory of corporate governance. Overall, our two studies lead to a finer-grained and more cumulative understanding of the crucial debate on family ownership and control in large firms.

Family ownership and control refer to one family (through one or several members) serving as a dominant (controlling) shareholder of a corporation. Are family ownership and control of large firms beneficial for or detrimental to firm performance? Under what conditions do the benefits of family ownership and control of large firms outweigh their costs? Despite the ubiquity of concentrated family ownership and control in large firms around the world, interestingly and somewhat surprisingly, there is no clear answer to these questions. This article, therefore, takes on these important but underexplored questions. Most small firms around the world are owned and managed by families. Theoretically, such a concentration of ownership and control seems to be an uncontroversially optimal arrangement with reasons ranging from more hands-on and less bureaucratic management to reduced principal-agent conflicts (Fama and Jensen, 1983). What is relatively unclear and thus controversial is the impact of concentrated family ownership and control on the performance of *large* firms.

One key reason that there is no clear answer is because of the relative paucity of research on large firms with concentrated family ownership and control (Morck, 2000). Dominated by agency theory, corporate governance research has focused on the separation of ownership and control. More than 70 years ago, Berle and Means (1932) advanced a hypothesis suggesting that as firms grow larger, concentrated family ownership and control will *inevitably* be replaced by a separation of ownership and control. Fama and Jensen (1983: 306) predict that failure to separate ownership and control "tends to penalize the organization in the competition for survival." In other words, concentration of ownership and control in the hands of families may be bad for the performance of large firms.

However, on a worldwide basis, the separation of ownership and control hypothesized by Berle and Means (1932) and articulated by Fama and Jensen (1983) "is actually an exception rather than the rule around the world," and "most corporations around the world [outside the United States and the United Kingdom] are controlled by a family or the state, characterized by concentrated ownership" (La Porta, Lopez-de-Silanes, and Shleifer, 1999: 498).[1] Thus, there is

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[1] For example, in Canada, a country very close to the United States and United Kingdom culturally and geographically, more than 380 of the 400 largest publicly traded corporations have *concentrated*

a significant mismatch between the Berle and Means (1932) hypothesis on the inevitability of the separation of ownership and control for large firms and evidence from most areas of the world.[2]

While it is possible to follow the Fama and Jensen (1983) logic by arguing that these "stubborn" large firms which refuse to separate ownership and control are inefficient, this argument cannot go very far when confronting the evidence that the vast majority of large firms outside the United States and United Kingdom, including those in some of the most prosperous, developed economies such as continental Europe and Japan, have concentrated family ownership and control (Shleifer and Vishny, 1997: 774). Therefore, it seems more sensible to acknowledge the limits of the Berle and Means (1932) hypothesis by conceding that concentrated family ownership and control in large firms may be good for firm performance, at least in some cases.

Thus far, most corporate governance research has focused on stylized U.S. (and to a less extent U.K.) firms which separate ownership and control. Consequently, there is value in investigating firms outside the Anglo-American world when advancing research on large firms which still combine ownership and control (Carney and Gedajlovic, 2002). Specifically, this article reports two studies which focus on a region with extensive concentration of family ownership and control in large firms – Asia (Bruton, Ahlstrom, and Wan, 2003; Claessens, Djankov, and Lang, 2000). Study 1 tests basic competing hypotheses on whether family ownership and control in large firms are good, bad, or irrelevant for firm performance. Study 2 theorizes and documents that the findings in Study 1 may be associated with the level of shareholder protection embodied in legal and regulatory institutions.

Overall, this article departs from the existing literature in four significant ways. First, theoretically, we focus on the concentration of ownership and control in large family firms,

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ownership and control in the hands of a single family (Gedajlovic and Shapiro, 1998: 536).
[2] La Porta et al. (1999) suggest that families and the state are the two major owner groups of corporations around the world. In this article, we choose to focus on family ownership and control. There is a separate literature on state ownership and its spin-off, privatization, which is outside the scope of the present article.

which have a family and/or its identifiable members as the largest owner(s). This contrasts sharply with most existing research based on the separation of ownership and control in professionally managed firms. Second, we draw on multiple theories such as resource-based and institutional theories, whereas most corporate governance research often relies solely on agency theory. Third, especially through Study 2, we endeavor to sketch the contours of a cross-country, institution-based theory of corporate governance. Finally, we empirically take advantage of a large database covering eight Asian countries. While existing studies either focus on a single country or lump data from multiple countries for an "Asian" model, we make and substantiate the case (1) that within Asia, family ownership and control in large firms are good (that is, benefits outweighing costs) in some countries, bad in some other countries, and irrelevant in the remaining countries, and (2) that such differences are systematically correlated with different legal and regulatory frameworks governing shareholder protection.

THE DEBATE

Empirically, there is no dispute that in Asia, (continental) Europe, and Latin America, the vast majority of large, publicly traded firms are family owned and controlled (Carney and Gedajlovic, 2002; Claessens et al., 2000; de Miguel, Pindado, and de la Torre, 2004; Faccio, Lang, and Young, 2001; Gedajlovic and Shapiro, 1998, 2002; La Porta et al., 1999; Thomsen and Pedersen, 2000).[3] Theoretically, there is a major debate regarding the role of family in large firms, with three positions: such concentrated ownership and control are (1) good, (2) bad, or (3) irrelevant for firm performance. To be sure, given the complexity, the debate is not about family ownership and control of large firms being absolutely good or bad. "Good" and "bad" are just short hand descriptions of the benefits outweighing or not outweighing the costs associated with family ownership and control.

Among the three positions, first, some agency theorists (Anderson and Reeb, 2003; Demsetz and Lehn, 1985) and some family business scholars (Habbershon and Williams, 1999) extend their endorsement for the efficiency gains of family owned small firms to the context of

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[3] Even in the United States, "shareholdings are not so diffusely owned as is often supposed" (Demsetz, 1983: 390). In the 1990s, families were present in one-third of the Standard and Poor's 500 firms and accounted for 18% of equity (Anderson and Reeb, 2003).

large firms. Second, other agency theorists (Fama and Jensen, 1983) and other family business researchers (Schulze et al. 2001) argue that large firms which refuse to separate ownership from control would be less efficient than firms with dispersed ownership. In addition, a third group of scholars find no performance difference between founder managed and professionally managed firms (Daily and Dalton, 1992; Willard, Krueger, and Feeser, 1992), implying that family ownership and control are irrelevant for firm performance. Most existing theories on the determinants of firm performance (e.g., the five forces model) are silent on the ownership and control issue, implicitly endorsing the "irrelevant" perspective.

Each side of this debate has a set of valid theoretical logic and empirical evidence in support of its view (de Vries, 1993; Villalonga and Amit, 2005). Our two studies are designed to shed further light on the debate, not by supporting one particular view but by acknowledging the validity of all sides (Study 1) and then endeavoring to address the more interesting question of "why?" (Study 2).

STUDY 1: COMPETING HYPOTHESES

Study 1 directly tests competing hypotheses by focusing on two of the three primary ownership and control mechanisms: (1) appointing a family member as the CEO and (2) pyramiding.[4] While the practice of CEO appointment is straightforward, pyramiding requires some elaboration here. A pyramid occurs when a family controls other firms through a chain of ownership. In other words, a family owns and controls a firm through another firm. Through such pyramiding, it is common for a firm's ultimate shareholders to have formal control rights that are greater than ownership (cash-flow) rights.[5] Pyramid structures are the predominant mode of corporate organization outside the United States (Morck, 2005). This arrangement potentially increases the probability of expropriation of minority shareholders, because the financial benefits from expropriation may disproportionately outweigh the financial costs for

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[4] Another primary mechanism for family ownership and control is shares with superior voting rights – often used in Latin America (Lins, 2003). However, because Asian firms tend not to use this mechanism (La Porta et al., 1999), we do not consider it here.
[5] For example, a family owns 50% of the shares of Company X, which owns 40% of Company B, which in turn owns 30% of Company C. The family ends up with 6% (50% x 40% x 30%) of the ownership (cash-flow) rights of C but 30% of its control rights (Faccio et al., 2001: 56).

the family (Chang, 2003).

Family CEO: The Good

Certain streams of two perspectives, agency theory and resource-based view, suggest that appointing a family member as the CEO may be beneficial. One stream of agency theory argues that there are significant advantages in appointing family members as CEOs (Anderson and Reeb, 2003).[6] This is because "family members have many dimensions of exchange with one another over a long horizon that lead to advantages in monitoring and disciplining" the family CEO (Fama and Jensen, 1983: 306). Because such interest alignment – and family ties – between principals (family owners) and agents (family CEOs) reduces agency costs (Westphal, 1999), firms with family CEOs (as opposed to nonfamily, professional CEOs, who may even be professionally more qualified) may perform better than firms with nonfamily CEOs (Durand and Vargas, 2003; Lee, Lim, and Lim, 2003).

Similarly, the resource-based view, when applied in the context of family firms, yields a converging prediction (Barney, 2001). Although primarily working in the context of small firms, family business researchers have long argued that "familiness" embedded in a kin network such as common interest and identity, goal congruence, trust, and reciprocity provides valuable, unique, and hard-to-imitate sources of competitive advantage (Durand and Vargas, 2003; Habbershon and Williams, 1999; Sirmon and Hitt, 2003; Ireland and Miller, 2004). Compared with professional managers, family CEOs may have competitive advantages in gaining access to unique resources. In emerging economies with weak market-supporting institutional frameworks, access to resources is often not through formal channels (such as banks) but often through informal, private networks (such as business groups) (Peng, 2003). A business group is "a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated action" (Khanna and Rivkin, 2001: 47). Business groups are ubiquitous in emerging economies and often controlled by well-connected families (Morck, 2005). With wide-ranging family connections, a family CEO

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[6] Another stream of agency theory argues for exactly the *opposite* (see the next section)

may have more advantage in accessing resources which otherwise would not be available to the firm. Thus:

Hypothesis 1: The presence of a family CEO is <u>positively</u> related with firm performance.

Family CEO: The Bad

Other streams of agency theory and resource-based view make the case that having a family CEO may be detrimental. Agency theorists argue that despite some benefits such as reduced agency conflicts, family CEOs, as inside shareholders, may have incentives to adopt investment policies that benefit themselves and their families, but reduce the payout to outside shareholders (Fama and Jensen, 1983; McConnell and Servaes, 1990). Even qualified and competent family CEOs, if they are not strictly disciplined, may deviate from shareholder wealth maximization (Carpenter, Pollock, and Leary, 2003; Gomez-Mejia, Larraza-Kintana, and Makri, 2003).

Another branch of resource-based view argues that the appropriate resources – such as family ties – are necessary but insufficient to achieve a competitive advantage, and that "familiness" must be managed effectively (Sirmon and Hitt, 2003). Specifically, altruism commonly found in family firms – the selfless regard for the well-being of other family members – may hurt firm performance (Schulze, Lubatkin, and Dino, 2003). Deeply altruistic, family members subscribe to a curious mix of rationalities, juxtaposing contradictory economic and altruistic (noneconomic) motivations to justify their behavior. As a result, family relations may make agency conflicts "*more* difficult" to resolve (Schulze et al., 2001: 102, original italics), because relations between principals (family owners) and agents (family CEOs) are likely based on emotions, sentiments, and informal linkages, which may result in less effective monitoring and disciplining of family managers.

Sons, daughters, in-laws, and other relatives, who may be incompetent, may be appointed as family CEOs. Once on the job, they may destroy value. Thus, altruism, especially parents' failure to discipline underperforming adult children serving as family managers, creates agency problems. In the imperfect managerial labor market whereby their positions are not

threatened, family CEOs do not have to maximize efforts to keep their jobs. Overall, the higher the level of parents' altruism, the higher the risk that parents may spoil adult children serving as family managers (de Vries, 1993).

In addition, family CEOs themselves often have a hard time dealing with other family members. Altruism can create a sense of entitlement among family members for employment, perquisites, and privileges that these individuals otherwise would not receive (Schulze et al., 2003). Altruism may also make family CEOs loath to adopt and enforce formal rules and procedures.

Finally, family squabbles – the opposite of altruism – may add other complications to make family CEOs ineffective. Family management can incur other costs, such as sibling rivalry, generational envy, non-merit-based compensation, and irrational strategic decisions (Gomez-Mejia, Nunez-Nickel, and Gutierrez, 2001). Family CEOs may enter into power competition with other family members, and have incentives to enhance CEOs' own power and prestige rather than to create profits. In addition, after the founding generation passes away (a very likely scenario given the large size of the firm now), the firm becomes a sibling partnership, in which each sibling partner is likely to be more concerned about his/her own welfare and that of his/her immediate family rather than other siblings' welfare (Stark and Falk, 1998). The family CEO in a sibling partnership usually lacks the authority and influence over other siblings because typically the principal is neither the founder of the firm nor the biological head of the family (Schulze et al., 2003). In comparison, outside CEOs may be more focused on work and less likely to get into family squabbles. In summary:

Hypothesis 2: The presence of a family CEO is <u>negatively</u> related with firm performance.

Pyramid Structure: The Good

Resource-based theory suggests that a pyramid structure may be beneficial for firm performance. With a pyramid structure, a family controls multiple firms, each becoming a member of an informal business group. Other members of such a group in the pyramid may provide useful information, access to finances and technologies, and important social

interactions (Khanna and Rivkin, 2001). If the focal firm suffers from performance problems, other member firms may come to rescue it by injecting resources such as assets and talents (Chang and Hong, 2000; Gedajlovic and Shapiro, 2002).

Relative to independent firms without such pyramid/group affiliations, these affiliations and connections for pyramid firms may add value. Proponents of resource-based view address controlling shareholder's contribution as boundary spanners of the organization and its environment (Hillman, Cannella, and Paetzold, 2000). Specifically, pyramid firms – those with links to their affiliates through a pyramid – can gain access to other pyramid firms' resources (Hoskisson et al., 2003). Thus, according to the resource-based view (Barney, 2001), abilities to do so may become valuable, unique, and hard-to-imitate resources (Guillen, 2000). How pyramid firms derive benefits from their affiliations and connections is not through costly formal contracting, but through relational contracting, social networks, and family ties. This may be especially the case in Asia (Bruton et al., 2003; Chen, 2001). As suggested by the literature on relational contracting and social networks in emerging economies (Peng, 2003, 2004), nonpyramid firms outside these networks may have a hard time accessing these highly idiosyncratic and informal relationship- and family-based assets. Thus:

Hypothesis 3: The presence of a pyramid structure is <u>positively</u> related with firm performance.

Pyramid Structure: The Bad

The primary theory critical of the pyramid structure is agency theory. Some of the intragroup activities described above may be labeled as "expropriation" of minority shareholders. Jensen and Meckling (1976) argue that the tendency of controlling shareholders such as families pursuing their private benefits at the expense of minority shareholders increases when the controlling shareholders own less equity in a pyramid structure. Through pyramiding, one family can control multiple publicly listed firms each with many minority shareholders. When several firms rescue one firm within the pyramid through asset injection, the interests of minority shareholders of the firms which transfer resources may resent these

activities which reduce the value of their shares (Dyck and Zingales, 2004).

In emerging economies where markets for corporate control usually do not operate effectively because of a lack of formal market-supporting institutions, expropriation of minority shareholders can take the form of (1) tunneling (digging a tunnel to sneak out corporate resources – such theft is often illegal) (Bertrand et al., 2002), and (2) related transactions (selling firm assets to another company owned by controlling shareholders at below-market places – this is often legal) (Chang, 2003; Johnson et al., 2000). Because prospective minority shareholders realize that controlling families' interests diverge from theirs, they in response may discount such shares or refuse to invest, leading to a higher cost of capital and a lower level of performance for pyramid firms (Lins, 2003). Therefore:

Hypothesis 4: The presence of a pyramid structure is <u>negatively</u> related with firm performance.

Overall, it seems difficult to tell *a priori* whether the benefits of concentrated family ownership and control in large firms outweigh the costs, or vice versa (de Vries, 1993; Villalonga and Amit, 2005). This debate thus calls for empirical efforts.

STUDY 1: METHODOLOGY

Sample and Variables

For Study 1, we amass a database covering 744 large, publicly listed, family-owned and -controlled corporations in eight countries in East and Southeast Asia: Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, and Thailand.[7] Our data collection efforts are guided by three considerations. First, in the literature, most studies focus on only one country. A smaller number of studies pool data from a number of Asian countries to generate models of "Asian corporate governance" (Lemmon and Lins, 2003), which assume substantial

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[7] Among major Asian economies, only China and Japan are omitted. China is not included because most listed firms there are state-owned and family ownership and control of large listed corporations are very rare (Peng, 2004: 460). Japan is excluded because as the only developed economy in the region, Japan has the highest percentage of professional managers heading its large corporations (Claessens et al., 2000: 92).

homogeneity among these countries. However, "significant cross-country differences exist" (Claessens et al., 2000: 82). We attempt to overcome this limitation by performing analysis both on a country-by-country basis and a pooled basis. Second, we look for a region whereby concentrated family ownership and control are especially profound. Firms in Asia are very appropriate for this purpose (Chen, 2001; Phan, 2001). Finally, we are intrigued by the recent changes in Asia. Prior to the 1997 financial crisis, family ownership and control were widely regarded as embodiment of "family values" which contributed to the Asian economic growth (also known as the "miracle"). However, since the 1997 crisis, this pattern of ownership and control, often in the hands of the *same* families owning and controlling the *same* assets, has often been harshly criticized as evidence of "crony capitalism" (Backman and Butler, 2003) – the "good" somehow becomes the "bad." From a policy standpoint, post-1997 corporate governance reforms aiming at "taming" the leading families,[8] in the absence of concrete empirical evidence, also necessitate our attention. To avoid the potential complications associated with the various post-1997 reforms, we follow Joh (2003) by focusing on the relatively calm year of 1996. This also avoids complications associated with the region-wide collapse of the share prices of virtually all listed firms during the 1997 crisis.

Our primary sources are (1) Asian Corporate Governance Archival Data Center (which primarily draws on Worldscope and World Bank data sources)[9] and (2) Datastream. Since all stock exchanges require firms to be sufficiently large in order to qualify for public listing, a firm whose shares are publicly listed and traded is regarded as a "large firm." A "family-owned and -controlled large firm" is defined as having a family and/or its identifiable members as the largest owner(s). Family ownership of each company is traced to its ultimate owner and is identified by how much control rights share, in percentage of total outstanding shares, the family owner has (Claessens et al., 2000). A 5% family control rights cutoff is used to assure that the largest shareholder has sufficiently concentrated ownership and control. Given our

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[8] In South Korea, a number of leading members of prominent business families have been jailed since 1997.
[9] Previous studies using this data source have appeared in reputable journals such as the *American Economic Review* (Faccio et al., 2001) and *Journal of Financial Economics* (Claessens et al., 2000).

focus, we exclude firms whose largest owner is the state, a financial institution, or a widely held corporation. In other words, only firms with a family (one individual or several members) as the largest identifiable shareholder are included.

The independent variables are (1) family ownership, (2) family CEO, and (3) pyramid structure. Family ownership is measured by cash-flow rights in percentage of total outstanding shares. We use a dummy variable equal to one for firms having a family CEO and zero otherwise. Following Hoskisson et al. (2003), we measure pyramid with a dummy variable.

The dependent variable, firm performance, is measured by the cumulative stock return in 1996 (between January 1 and December 31) reported by Datastream. A stock market-based performance measure is used as the performance indicator for three reasons. First, unlike performance measures based on accounting data, market-based performance measures are not influenced by firm-specific reporting idiosyncrasies and potential managerial manipulation. Second, using stock market data eliminates the problem with accounting data which are distorted by different accounting and tax systems across countries. Third, the use of a market-based measure is consistent with an important principle in agency theory – that is, managers should maximize the *market* value of the firm.

Three commonly used control variables are used. The first is firm size, measured by the logarithm of market capitalization, which is transformed to U.S. dollars using the official exchange rate on December 31, 1996. Second, we control firm age. Third, we also include dummy variables for 12 broad industries to control for industry effects.

Econometric Issues

We estimate the following model using the ordinary least squares (OLS) method:

Stock return = $\alpha + \beta_1$ (family ownership) + β_2 (family CEO) + β_3 (pyramid structure) + β_4 (logarithm of market capitalization) + β_5 (age) + ε (including industry dummies). Data are fit into the model country by country, thus resulting in eight models. When the pooled data are fit into the ninth model, we include dummy variables for the countries to control for country effects.

In terms of econometric issues, multicollinearity does not appear to be a significant problem, because the average variance inflation factor for each country is less than 10. Heteroskedasticity is corrected using robust (Huber-White-Sandwich) standard errors. We have also tested for omitted variables using the Ramsey test of the powers of the independent variables. We fail to reject the null hypothesis that our model has no omitted variables at the 95% confidence level, indicating that there are no significant variables which are omitted.

Another issue is the potential endogeneity of the regressors. If the governance variables are not exogenous, then their estimated coefficients may be inconsistent or unclear. Demsetz and Lehn (1985) show that ownership and firm value can be jointly determined. However, La Porta et al. (1999) report that ownership structures for large Asian firms are relatively stable over time. It seems unlikely that firms can change their ownership structures quickly and frequently in light of temporary over- or under-valuations. Thus, the possibility of endogeneity is less likely to be significant.

STUDY 1: FINDINGS

Table 1 provides the correlation matrix and descriptive statistics. In Table 2, regarding family CEO, Hypothesis 1 (the "good" hypothesis) is supported in Indonesia and Taiwan, and Hypothesis 2 (the "bad" hypothesis) is supported in Hong Kong. The presence of a family CEO has no significant impact in other countries, thereby supporting the default, "irrelevant" perspective. Specifically, holding other things constant, the stock return is 48% *higher* for firms with a family CEO than those with a nonfamily CEO in Indonesia and 34% *higher* in Taiwan. On the other hand, the stock return of Hong Kong firms with a family CEO performs 28% *lower* than firms with a nonfamily CEO.

Table 1.
Study 1: Descriptive Statistics and Correlations

Hong Kong (N = 151)

Variables	Mean	S.D.	1	2	3	4	5
1. Stock return	0.54	0.71					
2. Family ownership	25.76	11.4	-0.03				
3. Family CEO	0.68	0.47	-0.15	0.12			
4. Pyramid structure	0.33	0.47	0.10	-0.46	0.22		
5. Market capitalization (log)	16.85	1.48	0.06	-0.15	-0.32	0.03	
6. Firm age	28.46	21.01	-0.13	0.10	-0.09	-0.06	0.24

Indonesia (N = 95)

Variables	Mean	S.D.	1	2	3	4	5
1. Stock return	0.36	0.9					
2. Family ownership	24.62	11.25	-0.09				
3. Family CEO	0.91	0.29	0.10	0.12			
4. Pyramid structure	0.74	0.44	0.02	-0.36	0.30		
5. Market capitalization (log)	9.53	1.29	0.16	-0.09	-0.1	0.04	
6. Firm age	22.06	13.71	0.14	-0.00	0.14	0.17	0.01

Malaysia (N = 121)

Variables	Mean	S.D.	1	2	3	4	5
1. Stock return	0.41	0.48					
2. Family ownership	25.6	11.06	0.02				
3. Family CEO	0.94	0.23	0.07	-0.06			
4. Pyramid structure	0.43	0.5	0.14	-0.49	0.00		
5. Market capitalization (log)	13	0.86	-0.16	-0.23	0.06	-0.03	
6. Firm age	29.7	18.57	-0.12	0.24	0.03	-0.02	0.15

Philippines (N = 47)

Variables	Mean	S.D.	1	2	3	4	5
1. Stock return	0.16	0.5					
2. Family ownership	22.4	12.29	0.14				
3. Family CEO	0.68	0.47	0.20	0.17			
4. Pyramid structure	0.55	0.5	-0.02	-0.05	-0.25		
5. Market capitalization (log)	12.65	1.27	0.28	0.07	0.27	-0.08	
6. Firm age	32.47	23.11	0.12	-0.46	-0.13	0.14	-0.08

Singapore (N = 71)

Variables	Mean	S.D.	1	2	3	4	5
1. Stock return	-0.05	0.24					
2. Family ownership	22.73	11.87	-0.09				
3. Family CEO	0.89	0.32	-0.14	0.30			
4. Pyramid structure	0.69	0.47	0.23	-0.42	-0.24		

5. Market capitalization (log)	16.76	1.01	0.24	-0.50	-0.33	0.17
6. Firm age	25.83	17.05	0.10	0.06	0.11	0.01	0.04

South Korea (N = 131)

	Mean	SD	1	2	3	4	5
1. Stock return	-0.11	0.61					
2. Family ownership	19.82	9.3	0.19				
3. Family CEO	0.76	0.43	0.03	0.08			
4. Pyramid structure	0.34	0.47	-0.17	-0.22	0.14		
5. Market capitalization (log)	4.99	0.99	-0.22	-0.36	-0.04	0.08	
6. Firm age	32.91	13.07	-0.06	0.10	-0.16	0.05	0.04

Taiwan (N = 60)

	Mean	SD	1	2	3	4	5
1. Stock return	0.29	0.28					
2. Family ownership	18.68	9.75	-0.10				
3. Family CEO	0.97	0.18	0.11	-0.01			
4. Pyramid structure	0.68	0.47	-0.04	-0.14	0.27		
5. Market capitalization (log)	19.65	0.15	0.29	-0.37	-0.00	-0.02	
6. Firm age	27.08	9.91	-0.09	0.27	-0.14	0.21	0.02

Thailand (N = 64)

	Mean	SD	1	2	3	4	5
1. Stock return	-0.28	0.37					
2. Family ownership	34.58	14.4	-0.21				
3. Family CEO	0.75	0.44	-0.03	-0.03			
4. Pyramid structure	0.16	0.37	0.14	-0.26	0.05		
5. Market capitalization (log)	14.2	1.27	-0.14	-0.05	0.04	-0.20	
6. Firm age	21.97	17.32	-0.20	-0.04	-0.03	-0.24	0.06

Whole sample (N = 744)

	Mean	SD	1	2	3	4	5
1. Stock return	0.21	0.65					
2. Family ownership	24.23	11.91	-0.01				
3. Family CEO	0.81	0.39	-0.00	0.06			
4. Pyramid structure	0.46	0.5	0.06	-0.35	0.14		
5. Market capitalization (log)	12.9	4.71	0.18	0.05	-0.01	0.05	
6. Firm age	27.97	17.55	-0.04	0.00	-0.06	-0.01	-0.05

Table 2
Study 1: Direct Effects of Family Ownership and Control Mechanisms on Firm Performance [a]

	Hong Kong	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*South Korea*	*Taiwan*	*Thailand*	*Whole sample*
Family ownership	0.007	-0.002	0.006	0.014	0.002	0.006	0.000	-0.006	0.001
	(0.006)	(0.009)	(0.004)	(0.009)	(0.003)	(0.005)	(0.003)	(0.004)	(0.002)
Family CEO	**-0.278***	**0.484****	0.151	0.128	-0.05	0.05	**0.335****	-0.058	-0.011
	(0.156)	(0.227)	(0.134)	(0.151)	(0.123)	(0.096)	(0.135)	(0.090)	(0.056)
Pyramid	**0.313***	**-0.368****	**0.173***	-0.075	**0.119***	**-0.174****	-0.086	-0.02	0.028
	(0.174)	(0.177)	(0.098)	(0.136)	(0.064)	(0.086)	(0.107)	(0.152)	(0.046)
Market cap (log)	-0.01	0.110*	-0.038	0.06	0.064*	-0.134*	0.558	-0.031	0.008
	(0.044)	(0.065)	(0.046)	(0.048)	(0.034)	(0.072)	(0.275)	(0.035)	(0.020)
Age	-0.005	0.01	-0.003	0.01	0.001	-0.002	-0.002	-0.005**	-0.002
	(0.003)	(0.011)	(0.002)	(0.007)	(0.002)	(0.002)	(0.004)	(0.002)	(0.001)
Constant	0.965	-0.836	0.583	-1.117	-1.149	0.44	-11.051**	0.547	0.178
	(0.898)	(0.896)	(0.645)	(0.687)	(0.672)	(0.294)	(5.495)	(0.610)	(0.295)
N	151	95	125	47	71	131	60	64	744
R^2	0.1366	0.264	0.1792	0.3343	0.2009	0.1262	0.2977	0.2706	0.1992

a. Numbers in parentheses are White's heteroscedasticity-consistent robust standard errors. Industry dummies are included in the models, and country dummies are included in the full sample model but are not reported due to space constraints.
* $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

Also shown in Table 2, regarding the pyramid structure, Hypothesis 3 (the "good" hypothesis) is supported in Hong Kong, Malaysia, and Singapore. Hypothesis 4 (the "bad" hypothesis) is supported in Indonesia and South Korea. Specifically, in Hong Kong, Malaysia, and Singapore, the stock return of firms with a pyramid structure *outperform* their counterparts without such a structure by 31%, 17%, and 12%, respectively. Conversely, in Indonesia and South Korea, the stock return of pyramid firms is 37% and 17% *lower*, respectively, than that of nonpyramid firms. On the other hand, the pyramid structure seems to be irrelevant in other countries.

In the Philippines and Thailand, neither family CEO nor pyramid structure has any effect on firm performance. Interestingly, after controlling for country-specific effects, the

whole, eight-country pooled sample does not show any significant effect of family CEO or pyramid structure either, therefore supporting the "irrelevant" perspective.

In Table 2, family ownership itself does not show significant effect on firm performance. In further exploratory analysis (Tables 3 and 4), we test if the control mechanisms of family CEO and pyramid structure moderate the relationship between family ownership and firm performance. We interact each of the control mechanism variables, family CEO and pyramid structure, with family ownership separately. Generally supporting our previous findings in Table 2, Table 3 shows that family CEO *positively* moderates the effect of family ownership on firm performance in Indonesia and Taiwan, and *negatively* moderates the effect of family ownership on firm performance in Hong Kong. Table 4 illustrates that pyramid structure *negatively* moderates the effect of family ownership on firm performance in Indonesia and South Korea, whereas the moderating effect is *positive* in Malaysia. Relative to the results on the effects of having a pyramid structure in Table 2, the results for Indonesia (negative), South Korea (negative), and Malaysia (positive) are similar, whereas the positive sign for Hong Kong and Singapore in Table 2 becomes insignificant.

Table 3.

Study 1: Moderating Effects of Family CEO on the Family Ownership-Performance Relationship [a]

	Hong Kong	*Indonesia*	*Malaysia*	*Philippines*	*Singapore*	*South Korea*	*Taiwan*	*Thailand*	*Whole sample*
Family ownership	0.015*	-0.016*	0.003	0.010	0.000	0.004	-0.017**	-0.004	0.001
	(0.008)	(0.009)	(0.005)	(0.007)	(0.007)	(0.005)	(0.007)	(0.004)	(0.002)
Ownership×CEO	**-0.010***	**0.017*****	0.004	0.006	0.002	0.003	**0.017*****	-0.003	-0.000
	(0.005)	(0.006)	(0.003)	(0.007)	(0.007)	(0.005)	(.006)	(0.002)	(0.002)
Pyramid	0.316*	-0.298*	0.171*	-0.067	0.127*	-0.174**	-0.083	-0.028	0.027
	(0.176)	(0.167)	(0.098)	(0.148)	(0.064)	(0.085)	(0.105)	(0.152)	(0.046)
Market cap (log)	-0.007	0.110	-0.04	0.056	0.070**	-0.133*	0.545*	-0.031	0.008
	(0.043)	(0.066)	(0.047)	(0.052)	(0.033)	(0.071)	(0.281)	(0.035)	(0.020)
Age	-0.005	0.010	-0.003	0.010	0.001	-0.002	-0.003	-0.006**	-0.002
	(0.003)	(0.010)	(0.002)	(0.007)	(0.002)	(0.002)	(0.004)	(0.002)	(0.001)
Constant	0.705	-0.509	0.757	-0.964	-1.288**	0.477	-10.453*	0.504	0.169
	(0.810)	(0.926)	(0.659)	(0.656)	(0.600)	(0.324)	(5.662)	-0.619	(0.280)
N	151	95	125	47	71	131	60	64	744
R^2	0.1343	0.2604	0.1773	0.3365	0.1983	0.1271	0.2994	0.2792	0.1992

a. Numbers in parentheses are White's heteroscedasticity-consistent robust standard errors. Industry dummies are included in the models, and country dummies are included in the full sample model but are not reported due to space constraints.

* $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

Table 4.

Study 1: Moderating Effects of Pyramid Structure on the Family Ownership-Performance Relationship [a]

	Hong Kong	Indonesia	Malaysia	Philippines	Singapore	South Korea	Taiwan	Thailand	Whole sample
Family ownership	0.002	0.006	0.004	0.015*	0.000	0.009	0.003	-0.005	-0.000
	(0.005)	(0.007)	(0.004)	(0.008)	(0.003)	(0.006)	(0.005)	(0.003)	(0.002)
Ownership×Pyramid	0.01	**-0.010***	**0.008***	-0.002	0.004	**-0.012****	-0.004	-0.000	0.001
	(0.007)	(0.006)	(0.004)	(0.006)	(0.002)	(0.005)	(0.004)	(0.005)	(0.002)
Family CEO	-0.262*	0.381*	0.15	0.133	-0.062	0.045	0.328**	-0.058	-0.004
	(0.156)	(0.194)	(0.135)	(0.162)	(0.126)	(0.092)	(0.132)	(0.089)	(0.057)
Market cap (log)	-0.016	0.120*	-0.044	0.062	0.068*	-0.133*	0.56	-0.03	-0.009
	(0.046)	(0.064)	(0.046)	(0.049)	(0.034)	(0.071)	(0.268)	(0.034)	(0.016)
Age	-0.005*	0.01	-0.004	0.01	0.001	-0.002	-0.002	-0.005**	-0.002
	(0.003)	(0.011)	(0.002)	(0.007)	(0.002)	(0.002)	(0.004)	(0.002)	(0.001)
Constant	1.226	-1.131	0.74	-1.183*	-1.119*	0.453	-11.167**	0.512	0.511**
	(0.932)	(0.855)	(0.622)	(0.668)	(0.662)	(0.293)	(5.334)	(0.585)	(0.234)
N	151	95	125	47	71	131	60	64	744
R^2	0.1268	0.2592	0.1852	0.3313	0.191	0.1377	0.2983	0.2704	0.1957

a. Numbers in parentheses are White's heteroscedasticity-consistent robust standard errors. Industry dummies are included in the models, and country dummies are included in the full sample model but are not reported due to space constraints.
* $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

Overall, the qualitative summary of our findings in Study 1 can be seen in Table 5. Given the support for both the "good" and "bad" hypotheses in different countries and the overall support for the "irrelevant" (default) perspective, at the very least, a "take-home" message is that sweeping statements, such as "Family ownership and control in large corporations are good" or "bad," should be avoided.

Table 5.

Study 1: Summary

(A) Direct effects of family ownership and control mechanisms on firm performance

	Good	Bad	Irrelevant
Family CEO	Indonesia, Taiwan	Hong Kong	Malaysia, Philippines, Singapore, South Korea, Thailand, Pooled sample
Pyramid structure	Hong Kong, Malaysia, Singapore	Indonesia, South Korea	Philippines, Taiwan, Thailand, Pooled sample

(B) Moderating effects of family ownership and control mechanisms on the family ownership-firm performance relationship

	Positive	Negative	Irrelevant
Family CEO x family ownership	Indonesia, Taiwan	Hong Kong	Malaysia, Philippines, Singapore, South Korea, Thailand, Pooled sample
Pyramid structure x family ownership	Malaysia	Indonesia, South Korea	Hong Kong, Philippines, Singapore, Taiwan, Thailand, Pooled sample

STUDY 2: INSTITUTIONS MATTER

The findings of Study 1 raise two interesting but unanswered questions: *Why* are large family-owned and -controlled firms in certain Asian countries able to reap performance advantages while those in other countries are not? Why do the same control mechanisms assert *opposite* influence in different countries? To answer these questions, it seems imperative that we probe into the roots of institutions which underpin corporate governance and then investigate their impact on firm performance (Roe, 2002; Schneper and Guillen, 2004). These endeavors lead to our Study 2.

Institutional Roots of Family Ownership and Control in Large Firms

Like their counterparts elsewhere, most stylized modern U.S. and U.K. corporations started with concentrated family ownership and control (Chandler, 1990). Over time, they evolve to separate ownership and control (Berle and Means, 1932). An interesting puzzle is why this evolution is not observed in the rest of the world (Roe, 2002). While there are many

explanations, a leading explanation is an institutional one (La Porta et al., 1998). In brief, better formal legal protection of investor rights in the United States and the United Kingdom, especially the rights of *minority* shareholders, encourages founding families and their heirs to dilute their equity to attract minority shareholders and delegate day-to-day management to professional managers. Given reasonably effective investor protection, founding families themselves (such as the Rockefellers) may over time feel comfortable becoming minority shareholders of the firms they founded. On the other hand, when formal legal and regulatory institutions are dysfunctional, founding families *must* run their firms directly. In the absence of effective investor protection, bestowing management rights to nonfamily, professional managers may invite abuse and theft – in other words, rampant agency problems. By default, founding families as controlling shareholders are not willing to hire outside managers – unless they allow these managers to marry into the family (Burkart, Panunzi, and Shleifer, 2003). In addition, prospective minority shareholder may be less willing to invest without sufficient protection, thus forcing concentrated ownership to become the default mode.[10] Overall, there is evidence that the weaker the formal legal and regulatory institutions protecting shareholders, the more concentrated ownership and control rights become (La Porta et al., 1998; Young et al., 2002).

In the United States, Anderson and Reeb (2003) recently refute the Fama and Jensen (1983) proposition that "Family ownership and control are bad for large firms," which is consistent with our H2 and H4 in Study 1. However, Anderson and Reeb (2003) are careful in noting that their results may be contingent upon the particular institutional frameworks governing large family firms in the United States. Anderson and Reeb (2003: 1324) specifically suggest that their findings may only hold in "well-regulated and transparent markets" and that in Asia, their results may not hold. While this interpretation is consistent with the generally understood, coarse-grained differences in institutional frameworks between the United States

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[10] "What's the best way to avoid losing out as a minority shareholder in Asia?" two prominent consultants answer in an influential book on Asian business, *Big in Asia*, "Don't be one" (Backman and Butler, 2003: 235).

and Asia, our findings in Study 1 suggest that even within Asia, some "good" results may be found in certain countries. Therefore, it is interesting to engage in a finer-grained exploration *within* Asia, as discussed next.

How Institutions Matter

For large family-owned and -controlled firms, according to La Porta et al. (2002: 1148), "the central agency problem is not the failure of the Berle and Means (1932) professional managers to serve dispersed shareholders, but rather the – often legal – expropriation of minority shareholders by controlling shareholders." These conflicts are labeled as "principal-principal" conflicts – as opposed to principal-agent conflicts – by Young et al. (2002). Given the simultaneous existence of the benefits and costs of having a family CEO and a pyramid structure (see Study 1), the crucial issue boils down to under what conditions the "good" outweigh the "bad" – and vice versa (Villalonga and Amit, 2005). While individual families may vary in their propensity to expropriate minority shareholders (e.g., some may be more "greedy" than others), recent research finds that cross-country differences in the scale and scope of expropriation systematically vary according to the differences in minority shareholder protection afforded by legal and regulatory institutions (Dyck and Zingales, 2004; La Porta et al., 2002). Consequently, Figure 1 divides countries in two groups: those with more developed legal and regulatory institutions protecting shareholders and those with less developed institutions. When plotted together with the two family ownership and control mechanisms used in Study 1, Figure 1 generates a 2 x 2 matrix with four cells. Each leads to a hypothesis for Study 2.

Figure 1. Study 2: How Institutions Matter

	Countries with *less* developed legal and regulatory institutions to protect shareholders (Indonesia, Philippines, South Korea, and Thailand)	Countries with *more* developed legal and regulatory institutions to protect shareholders (Hong Kong, Malaysia, Singapore, and Taiwan)
Family CEO	Cell 1: Good (H5)	Cell 2: Bad (H6)
Pyramid structure	Cell 3: Bad (H7)	Cell 4: Good (H8)

In countries with less developed legal and regulatory institutions to protect investors (Cell 1), having a family CEO may be beneficial. This is because in the absence of effective investor protection, outside, nonfamily managers may significantly deviate from pursuing the interests of both controlling and minority shareholders. Under these circumstances, despite the potential drawbacks associated with having a family CEO (such as those noted in Study 1), having a family CEO, on balance, may still add value. Conversely, in countries with more developed legal and regulatory institutions to protect investors (Cell 2), outside, nonfamily managers may be more effectively monitored and disciplined. Under these circumstances, having a family CEO in order to combat agency problems brought by nonfamily managers may be redundant and even counter-productive.

This line of reasoning is supported by one of the most striking findings from our Study 1: Having a family CEO is *good* for firm performance in Indonesia and *bad* in Hong Kong. In the absence of concrete information that controlling families in Hong Kong are systematically more "greedy" than those in Indonesia, it seems plausible to suggest that the different levels of investor protection in their institutional frameworks may play a role. Table 1 shows that while 91% of the Indonesian firms appoint a family CEO, only two thirds of the Hong Kong firms do that. It seems that controlling families in Indonesia are a lot more reluctant to appoint outsiders as CEOs. Exploring the generalizability of such Study 1 findings, Study 2 tests the following

two hypotheses:

Hypothesis 5: The presence of a family CEO is <u>positively</u> related with firm performance in countries with less developed legal and regulatory institutions to protect shareholders.

Hypothesis 6: The presence of a family CEO is <u>negatively</u> related with firm performance in countries with more developed legal and regulatory institutions to protect shareholders.

Cell 3 in Figure 1 portrays countries with less developed legal and regulatory institutions to protect investors. Under these circumstances, having a pyramid structure, often set up by the controlling family, may increase the amount of expropriation of minority shareholders. This problem may become especially severe, as the number of "tiers" of the pyramid increases and controlling shareholders have lower cash-flow ownership levels (Dyck and Zingales, 2004; La Porta et al., 2002). Further, in such countries with underdeveloped investor protection institutions, controlling families usually have a relatively "free hand" in expropriating minority shareholders (Bertrand et al., 2002; Chang, 2003). Conversely, in Cell 4 which depicts countries with better investor protection, although controlling families, who set up pyramids, may have the same incentive to expropriate minority shareholders, their ability to do so may be constrained by the legal and regulatory frameworks.

We are not arguing that all controlling families will expropriate minority shareholders. Indeed, some controlling shareholders may develop a reputation for treating minority shareholders fairly (Gomes, 2000). Since institutions governing corporate behavior consist of three "pillars" (a formal regulatory pillar and two informal normative and cognitive pillars) (Scott, 1995), what we are arguing is that reputation, based on informal norms and cognitions, may be a poor substitute for formal legal protection of minority shareholder rights. For example, during the 1997 Asian financial crisis, when controlling families themselves suffered huge losses, even some of the most reputable controlling families expropriated minority shareholders in order to "make up" the losses (Johnson et al., 2000). This suggests the vulnerability of relying on informal normative and cognitive institutions such as reputation to police individual, family, and corporate behavior in the absence of formal institutions.

Again, Study 1 findings on the contrast between Indonesia and Hong Kong are indicative of some of these dynamics. While controlling shareholders in Hong Kong are also known to expropriate minority shareholders (Claessens et al., 2000; Faccio et al., 2001), the scale and scope of such expropriation in Indonesia are in a different league (Johnson et al., 2000). In fact, a pyramid structure in Hong Kong is found in Study 1 to be generally beneficial, despite its drawbacks. Therefore:

Hypothesis 7: The presence of a pyramid structure is <ins>negatively</ins> related with firm performance in countries with less developed legal and regulatory institutions to protect shareholders.

Hypothesis 8: The presence of a pyramid structure is <ins>positively</ins> related with firm performance in countries with more developed legal and regulatory institutions to protect shareholders.

Overall, building on the findings of Study 1, Study 2 directly links the "good" and "bad" sides of family ownership and control with one country's institutional frameworks governing corporate governance. It aims to shed light on *how* institutions matter.

STUDY 2: METHODOLOGY

Sample and Variables

Study 2 continues to draw on the same data sources reported in Study 1. We have collected significant additional data to better account for firm characteristics and institutional frameworks. However, the quest for additional data reduces our sample size from 744 to 688 publicly listed, family-owned and -controlled firms in the same eight Asian countries in Study 1. We continue to focus on firm value, measured as the cumulative stock return in 1996. To control for other factors that might affect stock return, we use an additional set of control variables – in addition to firm size, age, and industry used in Study 1. Firm leverage (measured as the ratio of total debt to total assets) and market-to-book ratio (measured as the market value of equity divided by the book value of equity) are obtained from Worldscope. Stock risk (beta) is computed by regressing a firm's monthly stock return on the corresponding country index return in 1996 from Datastream. Because market value in the previous year may also affect

stock return in the current year, we control for firm stock price at the beginning of 1996 in U.S. dollars using the prevailing exchange rate.

We measure institutional variables based on La Porta et al. (1998), whose index has been widely used and validated in recent cross-country studies (Dyck and Zingales, 2004; Johnson et al., 2000; Schneper and Guillen, 2004). Table 6 represents country scores in the index for (1) efficiency of judicial system, (2) rule of law, and (3) corruption, which are three broad institutional measures crucial for the protection of investors (La Porta et al., 1998). Judicial efficiency is the assessment by Business International Corporation of "the efficiency and integrity of the legal environment as it affects business" (La Porta et al., 1998: 1124). Rule of law and corruption are assessments by International Country Risk Services. Rule of law is the law and order tradition the country. Corruption is the extent of corruption in the government – particularly the extent to which businesses have to pay bribes (La Porta et al., 1998). All of these measures are calculated well before the 1997 Asian crisis. Hong Kong, Malaysia, Singapore, and Taiwan, with each score higher than the average, are considered as countries with *more* developed legal and regulatory institutions. Indonesia, Philippines, South Korea, and Thailand, with each score lower than the average, are considered as countries with *less* developed legal and regulatory institutions. A total of 302 and 386 firms are found in countries with less and more developed institutions, respectively.

Table 6.
Study 2: Rankings of Legal and Regulatory Institutions

	Efficiency of judicial system	Rule of law	Corruption
Countries with *more* developed institutions			
Hong Kong	10	8.22	8.52
Malaysia	9	6.78	7.38
Singapore	10	8.57	8.22
Taiwan	6.75	8.52	6.85
Average	6.5	6.3	5.8

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Countries with *less* developed institutions

Indonesia	2.5	3.98	2.15
Philippines	4.75	2.73	2.92
South Korea	6	5.35	5.3
Thailand	3.25	6.25	5.18

Source: La Porta, R., Lopez-de-Silanes, F., Shleifer, A., and Vishny, R. 1998. Law and finance (pp. 1142-1143). *Journal of Political Economy*, 106: 1113-1155.

Table 7 reports mean values of variables of these two groups of firms. The average stock return in countries with less developed institutions is significantly lower than that in countries with more developed institutions. Family ownership averages 24% across the sample. There are no significant differences in family ownership, family CEO, pyramid structure, firm age, and stock risk beta across the sample. Firms in countries with less developed legal and regulatory institutions have significantly lower market capitalization, firm value, and market-to-book ratio as well as higher debt-to-asset ratio.

Table 7.
Study 2: Similarities and Differences Between Firms in Countries
with Less and More Developed Institutions for Shareholder Protection

	Firms in countries with *less* developed institutions (N=302)	Firms in countries with *more* developed institutions (N=386)	Difference
Stock return	2.84%	36.84%	-0.34***
Family ownership (% of total share outstanding)	24.189	24.163	0.03[ns]
Family CEO (1 = having a family CEO)	0.798	0.8316	-0.03[ns]
Pyramid structure (1 = having a pyramid structure)	0.447	0.4793	-0.03[ns]
Market capitalization (log)	11.939	12.564	-0.62***
Firm age	28.626	29.497	-0.87[ns]
Debt-to-asset ratio	37.711	21.904	15.8**
Firm value (start of 1996) (US$)	7.4402	157.54	-150***
Stock risk beta	0.9748	0.916	0.06[ns]
Market-to-book ratio	1.413	2.2082	-0.8***

* $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

Econometric Issues

In Study 2, we estimate the following model again using the OLS method: Stock return = $\alpha + \beta_1$ (family ownership) + β_2 (family CEO) + β_3 (pyramid structure) + β_4 (logarithm of market capitalization) + β_5 (age) + β_6 (debt to asset ratio) + β_7 (starting stock price) + β_8 (stock risk beta) + β_9 (market to book value) + ε (including industry dummies). Firms in more developed legal and regulatory institutions are fit into the model first, then firms in less developed legal and regulatory institutions, and lastly, pooled data. Multicollinearity does not appear to be a significant problem, because the average variance inflation factors for all the models are less than 10. Heteroskedasticity is corrected using robust (Huber-White-Sandwich) standard errors.

STUDY 2: FINDINGS

Table 8 reports the descriptive statistics used in Study 2. Table 9 documents the regression results with three models. Model 1 (302 firms) focuses on countries with less developed legal and regulatory institutions to protect shareholders, Model 2 (386 firms) deals with countries with more developed institutions, and Model 3 (688 firms) pools data from all the countries.

Table 8.
Study 2: Descriptive Statistics and Correlations

*Firms in countries with **less** developed legal and regulatory institutions to protect shareholders (N = 302)*

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9
1. Stock return	0.03	0.75									
2. Family ownership	24.19	12.68	-0.03								
3. Family CEO	0.80	0.40	0.09	0.08							
4. Pyramid structure	0.45	0.50	0.11	-0.22	0.12						
5. Market capitalization (log)	11.94	1.53	0.04	0.07	0.02	0.06					
6. Firm age	28.63	16.89	-0.01	-0.19	-0.10	0.02	0.06				

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Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9
7. Debt-to-asset ratio	37.71	24.22	-0.12	-0.05	0.03	-0.07	-0.16	0.07			
8. Firm value (start of 1996)	7.44	25.45	-0.12	0.27	0.02	-0.14	0.21	-0.05	-0.12		
9. Stock risk beta	0.98	0.92	-0.03	-0.03	0.07	-0.06	0.15	-0.04	0.11	0.01	
10. Market-to-book ratio	1.41	1.33	0.27	0.18	0.00	0.01	0.47	-0.04	-0.19	0.08	-0.01

*Firms in countries with **more** developed legal and regulatory institutions to protect shareholders (N = 386)*

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9
1. Stock return	0.37	0.57									
2. Family ownership	24.16	11.42	-0.03								
3. Family CEO	0.83	0.38	-0.15	0.05							
4. Pyramid structure	0.48	0.50	-0.02	-0.45	0.16						
5. Market capitalization (log)	12.56	1.40	0.17	-0.16	-0.21	-0.00					
6. Firm age	29.58	18.57	0.14	-0.03	-0.02	-0.00	0.23				
7. Debt-to-asset ratio	21.90	15.39	-0.00	-0.07	0.07	0.11	-0.10	-0.13			
8. Firm value (start of 1996)	157.5	342.1	-0.05	-0.08	-0.11	0.04	0.46	0.15	-0.10		
9. Stock risk beta	0.92	0.93	0.26	0.01	-0.02	-0.02	0.21	0.06	-0.01	0.05	
10. Market-to-book ratio	2.21	2.27	0.08	-0.03	0.02	0.03	0.06	-0.04	-0.01	-0.02	0.09

Whole sample (N = 688)

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9
1. Stock return	0.22	0.67									
2. Family ownership	24.17	11.98	-0.00								
3. Family CEO	0.82	0.39	-0.02	0.06							
4. Pyramid structure	0.47	0.50	0.05	-0.3	0.14						

	4										
5. Market capitalization (log)	12.29	1.49	0.15	-0.05	-0.09	0.03					
6. Firm age	29.11	17.85	-0.04	-0.00	-0.06	-0.01	0.15				
7. Debt-to-asset ratio	28.84	21.24	-0.16	-0.05	0.03	-0.00	-0.20	-0.03			
8. Firm value (start of 1996)	91.65	267.2	0.04	-0.04	-0.07	0.03	0.38	0.12	-0.16		
9. Stock risk beta	0.94	0.92	0.10	-0.01	0.02	-0.04	0.18	0.01	0.06	0.02	
10. Market-to-book ratio	1.86	1.95	0.10	0.04	0.02	0.03	0.22	-0.03	-0.14	0.16	0.05

Table 9.

Study 2: Direct Effects of Family Ownership and Control Mechanisms on Firm Performance

	Model 1	Model 2	Model 3
	Less developed countries	More developed countries	Whole Sample
Family ownership	-0.0022	0.0042*	-0.0002
	(0.0027)	(0.0023)	(0.0018)
Family CEO	**0.1167***	**-0.0715**	0.0013
	(0.0691)	(0.0969)	(0.0603)
Pyramid	**-0.1396****	**0.1436****	0.0129
	(0.0685)	(0.0679)	(0.0476)
Market cap (log)	-0.056	0.0863**	0.025
	(0.0385)	(0.0268)	(0.0173)
Age	0.0028	-0.004**	-0.001
	(0.003)	(0.0016)	(0.0015)
Debt-to-asset ratio	-0.0015	0.0004	-0.0009
	(0.002)	(0.0019)	(0.0014)
Firm value (beginning of 1996)	-0.0011*	-0.0002***	-0.0002***
	(0.0007)	(0.0001)	(0.0001)
Stock risk beta	0.0169	0.1022**	0.0663*
	(0.0504)	(0.041)	(0.0352)
Market-to-book ratio	0.1673*	0.0239	0.0493*
	(0.0964)	(0.0164)	(0.0275)
Constant	0.0530	-1.3150***	0.4142***
	(0.3797)	(0.4142)	(0.2466)
N	302	386	688

F	4.6	8.04	12.68
R^2	0.2402	0.253	0.2335

Numbers in parentheses are White's heteroscedasticity-consistent robust standard errors. Industry dummies and country dummies are included in the models but are not reported due to space constraints.
* $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

Model 1 supports both Hypotheses 5 and 7. Specifically, in less developed countries, having a family CEO is value-enhancing (12% *higher* than having a nonfamily CEO), while having a pyramid structure is value-destroying (14% *lower* than nonpyramid firms). Both findings are significant. Model 2 supports Hypothesis 8 in that having a pyramid structure is beneficial for stock return (14% *higher* than nonpyramid firms) in more developed countries. However, Hypothesis 6 is not supported: Although the coefficient sign is in the predicted direction (negative), it does not reach significance. Finally, Model 3 on the whole, eight-country, pooled sample – like Study 1 – does not show any significant impact of family CEO or pyramid structure on firm performance. Therefore, this finding, again, supports the "irrelevant" perspective. Overall, Study 2 is strongly supportive of the view that whether family ownership and control in large firms are good, bad, or irrelevant is systematically correlated with the legal and regulatory institutions governing shareholder protection.

DISCUSSION

Contributions

Overall, three sets of theoretical and empirical contributions emerge. First, theoretically, to the best of our knowledge, ours are among the first studies which address all sides of the debate head-on. Although the agency theory-based Fama and Jensen (1983) prediction that large family firms which do not separate ownership and control will suffer from inefficiency is supported by Study 1 in some countries in Asia, it is refuted in other countries and refuted in the aggregate, pooled sample. Overall, just like the Berle and Means (1932) hypothesis on the inevitable separation of ownership and control at large firms turns out to be supported only in certain parts of the world (La Porta et al., 1999), the Fama and Jensen (1983) prediction has only received partial support in Study 1.

A second theoretical contribution lies in the identification that the benefits and costs of family ownership and control vary systematically according to the level of legal and regulatory protection for shareholders. More specifically, our Study 2 joins the recent work of La Porta et al. (1998, 1999, 2002), Roe (2002), Schneper and Guillen (2004), Young et al. (2002), and others in sketching the contours of a cross-country, institution-based theory of corporate governance. This theory enriches the debate, by suggesting that findings from numerous single-country studies need to be qualified with an explicit discussion on the enabling and constraining forces of the institutional frameworks. For example, this theory can help reconcile Anderson and Reeb's (2003) "good" findings in the United States and Chang's (2003) "bad" findings in South Korea. It is neither controlling families are uniformly "good" or "bad," nor are American families less "greedy" than Korean families. Rather, it is the different institutional frameworks American and Korean families have to face that make a difference. In large U.S. firms, controlling families' tendency to expropriate minority shareholders can be potentially constrained by independent directors whose power is supported by the legal and regulatory frameworks (Anderson and Reeb, 2004), whereas in large Korean firms, this might be difficult. Overall, our studies show that national institutions can be conceptualized in a way that captures variations across countries, which then can be used to explain differences in an outcome variable of interest.

Empirically, perhaps the strongest message out of Study 1 is that given the simultaneous findings of the "good," "bad," and "irrelevant" within Asia, efforts to generate models of "Asian corporate governance" or "Asian family firm" may be counterproductive. Another empirical contribution, out of both Studies 1 and 2, lies in the discovery of the *opposite* effect of the two main mechanisms for family ownership and control — family CEO and pyramid structure. This contrast is especially noteworthy between Hong Kong (a highly developed common law practitioner which was a British colony until 1997) and Indonesia (an underdeveloped civil law country which was a Dutch colony until 1945).[11] Finally, Study 2

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[11] However, this contrast is not as strong in some "mid-range" countries, such as Thailand. Although La Porta et al. (1998: 1130) classify Thailand as a common law country, the *CIA World Factbook* (2005)

empirically answers why such opposite findings are found. Specifically, countries with better developed legal and regulatory institutions enable more of the benefits of family ownership and control to outshine their drawbacks. In contrast, families in countries with less developed institutions may have more opportunities to engage in expropriation.

In summary, this article contributes to the literature by *theoretically* arguing that the net balance of the benefits and costs of family ownership and control in large firms – good, bad, or insignificant – is systematically linked with the legal and regulatory institutions governing investor protection, and *empirically* documenting this case through a large sample of firms throughout Asia.

Limitations and Future Research Directions

The limitations of our two studies suggest a number of avenues for future research. First, while it seems helpful to build a cross-country, institution-based theory of corporate governance, we have barely scratched the surface of institutions affecting corporate governance.[12] Although our focus on the formal legal and regulatory institutions is a useful first step, it is important to note that institutions also include numerous other formal and informal aspects such as competition policies and cultural and societal norms (Aguilera and Jackson, 2003; Scott, 1995). In emerging economies, the formal laws on books may look increasingly like those found in the West, but the actual implementation, driven more significantly by informal norms and cognitions, may remain ineffective (Wright et al., 2005). These dynamics thus necessitate our expansion to capture some of these complexities in future work.

A second limitation is that we may have painted a coarse-grained picture of "family firms," by not differentiating various types of families. Intuitively, it seems plausible that firms owned and controlled by the first generation (parents) may exhibit more altruism among family

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suggests that Thailand has a civil law system, "with influences of common law." Thus, it is not surprising that the findings out of Thailand are not as strong in either direction as those out of Hong Kong or Indonesia.

[12] While the institutional origins variables advocated by La Porta et al. (1998) have been influential, there is some debate regarding their validity. For example, Rajan and Zingales (2003: 14) find the La Porta et al. (1998) measures to be only accurate in the post-World War II era.

members, and that firms owned and controlled by the second or third generations (sibling partnerships) may have more dysfunctional squabbles (Schulze et al., 2003). In the United States, Anderson and Reeb (2003: 1303) document that it is firms with founder CEOs that outperform those with professional CEOs, and that second or third generation family CEOs have no effect on market performance. Also in the United States, Villalonga and Amit (2005) find that second- and third-generation family CEOs destroy value. However, our efforts to control for the different generations in our data have been frustrated by our inability to unambiguously identify these different generations in eight countries with such a large sample. Systematic exploration of this effect has to wait for further research.

A third limitation is our cross-sectional design. Although we have built one of the most comprehensive databases on large Asian firms, given the diversity of these countries and the opposite results we find, it may be useful to longitudinally track the changing role of families over time. It is possible that as legal and regulatory institutions become better developed, the benefits of having a family CEO may decrease, and the risks associated with a pyramid structure may decrease.

Finally, it is important to acknowledge that our exploratory efforts have only reported correlations, which are *not* causations. While our hypotheses are carefully phrased in the language of correlations ("A is related with B," not "A causes B"), it will be important to push this research further. One design may be to conduct event studies by investigating the impact of changes in family ownership and control on abnormal stock returns in future research.

CONCLUSION

Despite the Berle and Means (1932) hypothesis, most large firms outside the Anglo-American world have "stubbornly" continued to concentrate ownership and control in the hands of families. In the eight Asian countries that we study, while some of these large firms indeed suffer from poor performance, many others seem to benefit from concentrated family ownership and control, and still others manage to have their performance unaffected by these ownership and control issues. Overall, there is no concrete evidence documenting that

controlling families in large firms are always "paragons," "parasites," or "irrelevant" – our Study 1 suggests that they are "all of the above." Addressing why this is the case, our Study 2 theorizes and documents that whether controlling families in large firms are "paragons" or "parasites" systematically depends on the differences in the legal and regulatory institutions which protect shareholders in various countries.

From a policy standpoint, our findings have important implications for corporate governance reforms in Asia (and perhaps elsewhere). Calls for reforms in the aftermath of the 1997 Asian financial crisis made by Western advisors and media as well as international organizations such as the International Monetary Fund and the World Bank to reduce family ownership concentration, introduce more outside shareholders, professionalize management, and break pyramid structures need to be embraced with caution.[13] In less developed countries (such as Indonesia), having a family CEO may provide a better internal control mechanism and better access to resources. However, in Indonesia, having a pyramid structure may afford controlling families more opportunities to expropriate minority shareholders. In more developed and less corrupt countries (such as Hong Kong), the benefits of having a family CEO may be outweighed by the potential costs, whereas the opportunities for family firms using a pyramid structure to expropriate minority shareholders may be limited. In conclusion, reforms may be needed, but actions need to be substantiated by an in-depth understanding of the complex dynamics associated with family ownership and control in large firms.

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[13] This is similar to the caution we need to embrace when dealing with other theoretically and intuitively sensible but empirically ambiguous suggestions in reforming corporate governance in emerging economies, such as appointing outside directors to corporate boards (Peng, 2004).

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