Family Firms and the Professional Manager Market

Hokuto Dazai, Takuji Saito, Zenichi Shishido and Noriyuki Yanagawa

1. Introduction

A family firm is a firm in which the founding family has an influence over firm policy, corporate strategy, personnel issues, and so on, through ownership and participation in management even after the founder retires.[1] Such family firms are prevalent in publicly traded firms not only in emerging countries, but also in developed countries. However, the prevalence and control mechanisms vary by country.

In the United States, when the founders step down, they tend to hire professional managers and sell out their shares. Thus, the prevalence of family firms is relatively low. Still, for those US heir-run family firms that do exist, many use control-enhancing mechanisms such as dual class shares (Villalonga and Amit, 2009). In Western Europe, significant ownership typically remains with the founding family even after the founder retires. Their children either hire a manager, as with BMW or Fiat, or run the firm themselves, as with Peugeot. In emerging markets, both management and ownership tend to remain with the family when the founder retires.

Burkart, Panunzi and Shleifer (2003) suggested that the varying levels of family ownership and management among countries can be explained by the degree of investor protection. Presenting a model of succession in a firm owned and managed by its founder, they show that when legal protection of outside investors is very strong (e.g., Anglo-Saxon countries), there is no need for monitoring in equilibrium, and the best arrangement is a widely held, professionally managed firm. When legal protection of outside investors is moderate (e.g., Western Europe), the benefits of professional

[1] We define family firm as a listed company in which the founder or founder's heir is a senior manager (president or chairman) and/or the founding family is a top ten shareholder.

managers are still high enough for the entrepreneur to surrender control, but the founder or his family may benefit from remaining as large shareholders and monitoring the manager. In contrast, where shareholder protection is weak (e.g., emerging countries), the founder's ability to control expropriation is limited, and the management role remains within his family even when someone else can run the firm more effectively.

However, Burkart, Panunzi and Shleifer (2003) could not explain the situation of Japanese family firms. Djankov, La Porta, Lopez-de-Silanes and Shleifer (2008) found that Japanese investor protection is relatively strong. When the founders step down, founding family ownership tends to decrease, yet the management role tends to stay within the founding family. For example, Toyota Motor Corporation was founded by Kiichiro Toyoda in 1926. Today, the Toyoda family maintains only a two percent ownership stake. However, the Toyoda family continues to hold management positions in the company; for instance, the current CEO of Toyota is Akio Toyoda. Saito (2008) shows that the founding family is not the largest shareholder in about 44 percent of heir-managed firms.

In addition, Burkart, Panunzi and Shleifer (2003) could not explain the differences in the performance of family firms. Recently, several papers have analyzed the performance of family firms relative to non-family firms. The results vary by country. Villalonga and Amit (2006) determined that heir-managed family firms perform inferior to non-family firms in the US. However, heir-managed family firms exhibit superior performance compared to non-family firms in France (Sraer and Thesmar, 2007) and Japan (Morck, Mehtra, Wiwattanakantag and Shim, 2013) (See Appendix).

The aim of this paper is to explain the differences in the prevalent patterns of family ownership, management and performance across countries, and complement the research of Burkart, Panunzi and Shleifer (2003). Burkart, Panunzi and Shleifer (2003) assumed that a professional is a better manager than an heir. However, we believe that this assumption is not always reasonable, because the size of the professional manager

market varies by country. In the US, hiring a professional manager outside the firm is common practice. On the contrary, most top managers in Japan are selected from an internal labor market. We hypothesize that the size of the professional manager market should affect the decision of founders. When the professional manager market is large, founders can easily find better managers than their heirs. In those situations, founders would tend to hire professional managers. However, when the professional manager market is small, it is difficult for founders to find better managers than their heirs. In these situations, heirs tend to be better managers because they have strong incentives. Thus, founders tend to pass their management positions on to their heirs.

To test our hypothesis preliminary, we present a comparative analysis of family firms in Japan, the US and France.

2. Background and Hypothesis

2.1. Family Firms

In recent times, the costs and benefits of family firms have been widely discussed, based on the classic owner-manager agency problem (Berle and Means, 1932; Jensen and Mechling, 1976) and the agency issues between large and small shareholders. In many family firms, the founding families hold a large equity stake and also occupy senior management positions. A potential benefit of managers having large ownership stakes is that it provides them with strong financial incentives to improve firm performance. In addition, as suggested by Leland and Pyle (1977), high levels of management ownership can help to signal the firm's quality when information asymmetries exist between managers and outside shareholders.

A potential cost of having large concentrated shareholders is that they may pursue actions for private benefits at the expense of other shareholders and firm performance (Shleifer and Vishny, 1997). Several papers have suggested that founding families seek

private benefits from the management of their family firms. Perez-Gonzalez (2006) and Bennedsen et al. (2007) showed that nepotism within a family firm hurts firm performance. Perez-Gonzalez (2006) examined 500 US firms and finds that when the current family CEO announces their resignation, the share price rises sharply if the incoming CEO is an external manager and falls if they are another family member. Bennedsen et al. (2007) found that in Denmark, family succession lowers firm performance. Bertland et al. (2005) suggested that in Thailand, greater involvement of family members in family firms lowers firm performance. The private benefits of control are strongly affected by the level of legal protection provided to minority shareholders (Dyck and Zingales, 2004). Burkart et al. (2003) modeled the control succession decisions of family firms and argued that founding families choose to preserve control within the family if the level of protection provided to minority shareholders is weak. Consistent with this prediction, Claessens et al. (2000) and Faccio and Lang (2002) have found that the family firm is the dominant form of ownership structure in Asia and continental Europe, where the protection of minority shareholders is generally weak.

Several studies have found a relationship between family firms and firm performance. Anderson and Reeb (2003) investigated the relationship between family firms and firm performance in the US. They found that family firms performed better than non-family firms and concluded that family firms have an effective organizational structure. Moreover, McConnaughy et al. (1998) found that in the US, family firms are also more efficient and valuable than non-family firms. Maury (2006) demonstrated that in Western Europe, family firms managed by the founding family are more profitable than non-family firms. In contrast, Claessens et al. (2002) suggested that in Southeast Asian countries, family firms underperform relative to non-family firms. Cronqvist and Nilsson (2003) determined that in Sweden, the value of family firms is largely discounted. Barth et al. (2005) have shown that in Norway, family firms owned and managed by the founding family are less productive than non-family firms.

More recent studies have indicated the importance of the generation of family management and the family structure in family firms. Villalonga and Amit (2006) examined the relationship between family firms and Tobin's Q Ratio in the US. They concluded that founder-CEO firms outperformed non-family firms; however, when descendants served as CEOs, firm value was destroyed. Morck et al. (2000) found that in Canada, family firms controlled by an heir exhibited poor financial performance. Bloom and Van Reenen (2007) found that in France, Germany, the UK, and the US, poor management practices were more prevalent in family firms managed by a founder's descendant. A notable exception is the research by Sraer and Thesmar (2007), who found a premium for family firms in France, even if they were managed by descendants of founders.

Table 1. Prevalence of family firms

		Family firm			Non-family firm
Country	Sample	Founder CEO	Descendant CEO	Professional CEO	Professional CEO
Japan	2165 firms	12%	27%	12%	49%
US	About 2000 firms	18%	13%	16%	52%
France	425 firms	31%	24%	16%	29%

Data Source
Japan: Our data
US: Anderson, Duru and Reeb (2008JFE)
France: Sraer and Thesmar (2007JEEA)

Table 1 shows the prevalence of public family firms in Japan, the US and France. The ratio of descendant CEOs to all CEOs is highest in Japan and lowest in the US. This result might show that founders tend to leave management to their heirs in Japan, while founders tend to hire professional managers in the US.

2.2. The Professional Manager Market

The size of the professional manager market varies by country. Table 2 shows the ratio of CEOs who are picked from an internal labor market to CEOs who are recruited from outside firms. In the US, about 23 percent of new CEOs are outsiders. In contrast, only three percent of new CEOs in Japan are outsiders. This result might show that the

market for professional managers in the US is larger than that in Japan.

Table 2. Characteristics of New CEO in 2013

	Insider	Outsider
US/Canada	77%	23%
Europe	75%	25%
Japan	97%	3%
Brazil/Russia/India	31%	69%

Source
Strategy& 2013 Chief Executive Study

The size of the professional manager market should be strongly affected by employee mobility.[2] Table 3 shows the level of employee protection and average male worker (age 45 to 54) tenure by country. The table shows that the level of employee protection is the highest in France and lowest in the US. Average male worker tenure is the longest in Japan and shortest in the US. These results show that labor mobility is higher in the US than in France and Japan.

Table 3. Country characteristics

Country	Employee protection	Average male worker tenure (age: 45-54)
Japan	2.09	19.15
US	1.17	8.2
France	2.82	16.9

Data Source
*Employee protection: OECD

2.3. Hypothesis

When the professional manager market is large, founders can easily find better

[2] In countries with low labor mobility, outsider CEOs find it difficult to be accepted by employees because outsider CEOs tend to exploit the rent of insiders.

manager than their heirs. Thus, founders tend to hire professional managers. When the professional manager market is small, it is difficult for founders to find better managers than their heirs. In these situations, heirs tend to be better managers because they have strong incentives. Thus, founders tend to pass their management positions to their heirs. In general, a negative relationship should exist between the size of the professional manager market and the prevalence of family management. In other words, we predict that there is a positive relationship between the level of labor protection or average worker tenure and the ratio of descendant CEOs.

3. Preliminary Analysis

Figure 1 plots the level of employee protection and the ratio of descendant CEOs. Figure 2 plots average male worker tenure and the ratio of descendant CEOs. In general, these figures are consistent with our hypothesis. Figure 1 shows a positive relationship between the level of labor protection and the ratio of descendant CEOs, and Figure 2 shows a positive relationship between average tenure of male employees and the ratio of descendant CEOs. These results might indicate that the size of the professional manager market affect the decisions of founders.

Figure 1. Relationship between employee protection and the ratio of descendant CEO

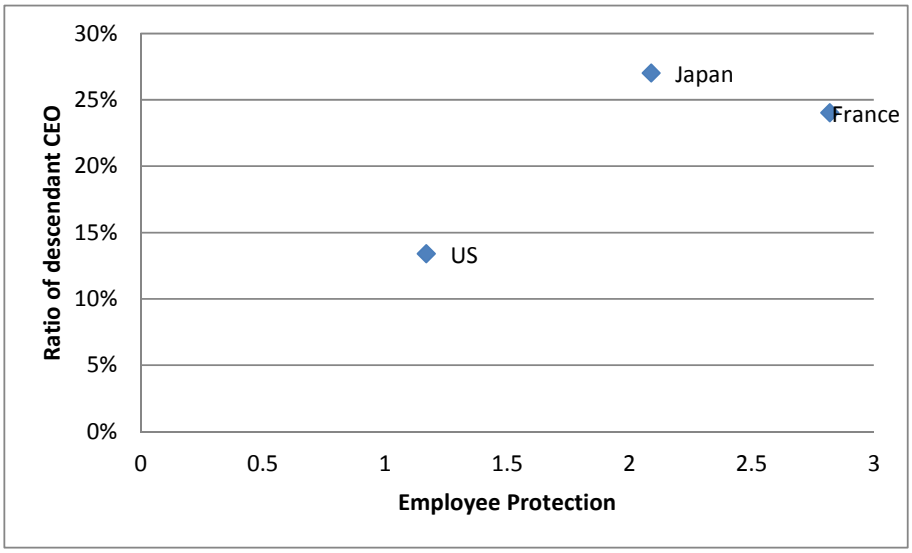
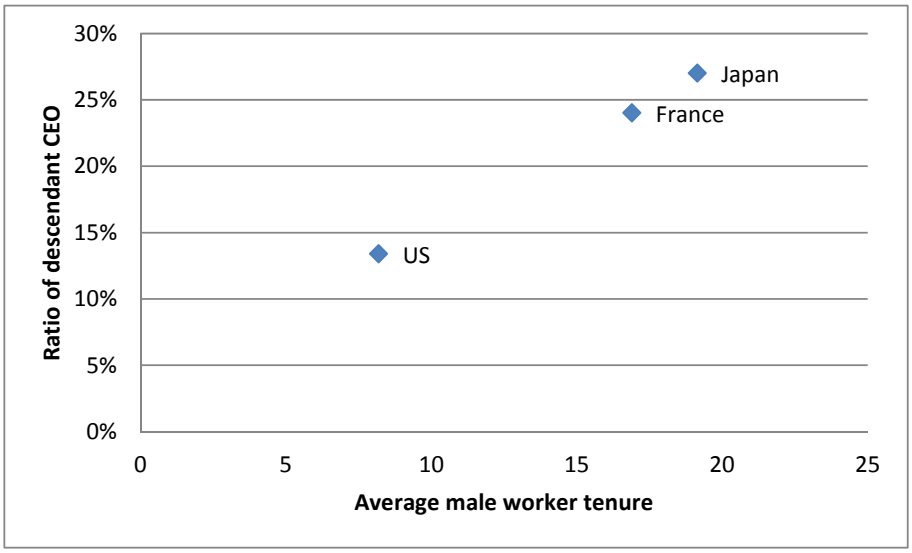


Figure 2. Relationship between average male worker tenure and the ratio of descendant CEO



Although the original investor protection index by La Port, Lopez-de-Silanes, and Shleifer (1999) is fairly consistent with the prediction of Burkart, Panunzi and Shleifer (2003) that, in a regime with strong legal protections for minority shareholders, the optimal solution for the founder is to hire professional managers (Figure 3), the revised investor protection index by Djankof, La Porta, Lopez-de-Silanes, and Shleifer (2008) is inconsistent with the prediction of Burkart, et al. (Figure 4).

Figure 3. Relationship between investor protection and the ratio of descendant CEO (La Port, Lopez-de-Silanes, and Shleifer (1999))

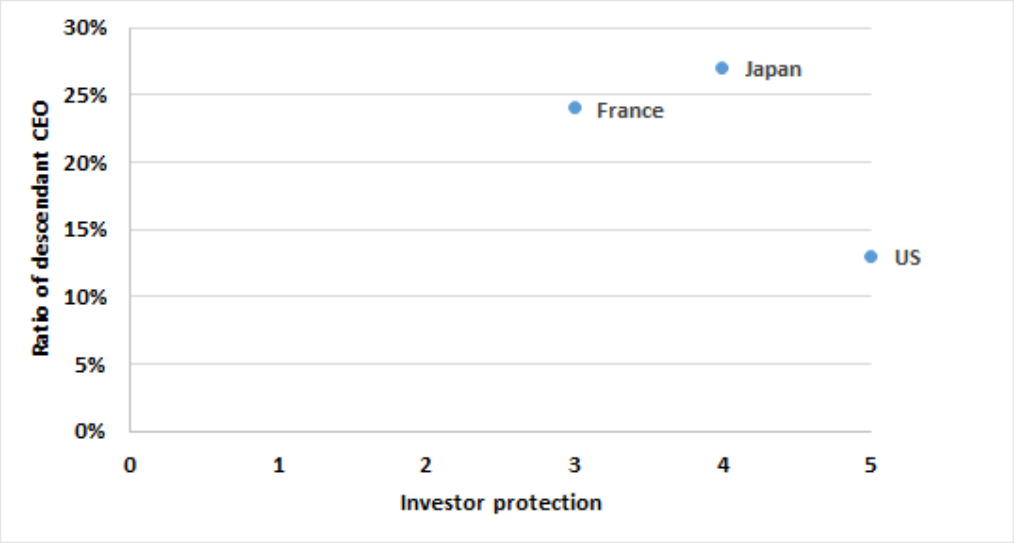
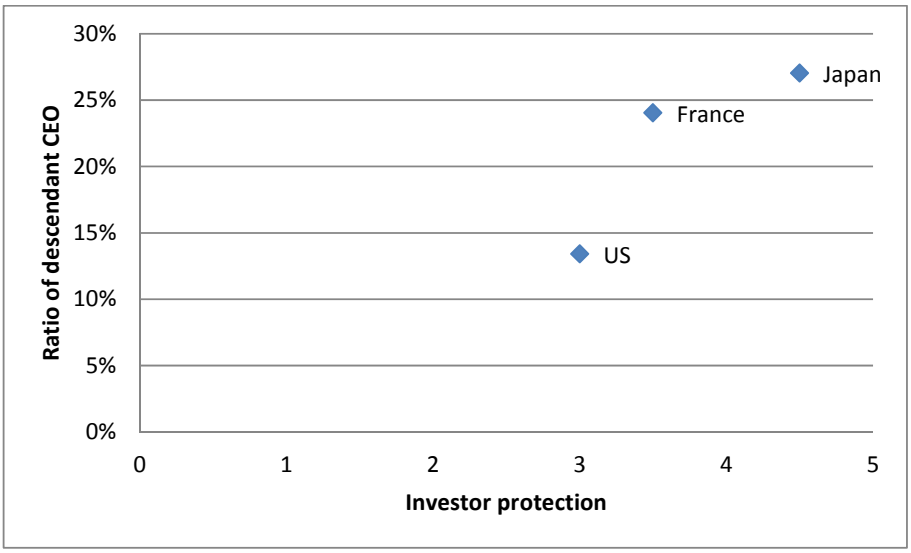


Figure 4. Relationship between investor protection and the ratio of descendant CEO (Djankof, La Porta, Lopez-de-Silanes, and Shleifer (2008))



4. Conclusion

An influential theory of finance suggests that differing levels of investor protection can explain the different corporate governance arrangements in countries, based on the premise that the separation of ownership and management is ideal. The level of investor protection, however, cannot explain the situation of Japanese family firms particularly when comparing across countries such as the US, France, and Japan.

In this paper, we suggest that the size of the professional manager market can explain the difference in the prevalent patterns of family ownership, management, and performance across countries including Japan, in complement with the level of investor protection.

One implication of our findings is that the separation between ownership and management is not always ideal. Even in a country with strong investor protection, the optimal degree of separation between ownership and management depends on the size of the professional manager market. In a country with a small manager market, the benefits of saving on agency costs resulting from the non-separation of ownership and management may overwhelm the benefits of choosing good managers from an external market.

Appendix

J-Family Firms and ROA

Dependent variable=	ROA				
Model=	pooled OLS				
	'62-10	'62-85	'86-92	'93-00	'01-10
	(1)	(2)	(3)	(4)	(5)
FOUNDER	0.016***	0.009***	0.011***	0.021***	0.026***
	(0.001)	(0.002)	(0.002)	(0.002)	(0.003)
BLOOD	0.003***	0.000	0.004***	0.006***	0.004**
	(0.001)	(0.002)	(0.001)	(0.001)	(0.002)
NON-BLOOD	0.004*	0.004	0.001	0.003	0.007*
	(0.002)	(0.003)	(0.003)	(0.003)	(0.004)
SALARYMAN	0.002	-0.002	0.003	0.005**	0.004
	(0.001)	(0.002)	(0.003)	(0.002)	(0.002)
Control Variables	Yes	Yes	Yes	Yes	Yes
Industry dummy	Yes	Yes	Yes	Yes	Yes
Year dummy	Yes	Yes	Yes	Yes	Yes
Sample Size	86,724	32,349	12,987	18,173	23,215
Adj. R^2	0.349	0.306	0.286	0.296	0.248

References

Anderson, R., and Reeb, D., 2003, Founding Family Ownership and Performance. Evidence from the S&P 500. Journal of Finance 58, 1301–1327.

Bennedsen, M., Nielsen, K., Perez-Gonzalez, F., and Wolfenzon, D., 2007, Inside the Family Firm: the Role of Families in Succession Decisions and Performance, Quarterly Journal of Economics 122, 647-691.

Barth, E., Gulbrandsen, T., and Schonea, P., 2005, Family Ownership and Productivity: the Role of Owner-management, Journal of Corporate Finance 11, 107–127.

Berle, A., and Means, G., 1932, The Modern Corporation and Private Property, New York: Macmillan.

Bertland, M., Johnson, S., Samphantharak, K., and Schoar, A., 2005, Mixing Family With Business: A Study of Thai Business Groups and the Families Behind Them, Working Paper, University of Chicago.

Burkart, M., Panunzi, F., and Shleifer, A., 2003, Family Firms. Journal of Finance 58, 2167–2202.

Claessens, S., Djankov, S., and Lang, L. P. H., 2000, The Separation of Ownership and Control in East Asian Corporations, Journal of Financial Economics 58, 81–112.

Claessens, S., Djankov, S., Fan, J., and Lang, L., 2002, Disentangling the Incentives and Entrenchment Effects of Large Shareholdings, Journal of Finance 57, 2741–2471.

Cronqvist, H., and Nilsson, M., 2003, Agency Costs of Controlling Minority Shareholders, Journal of Financial and Quantitative Analysis 38, 695–719.

Djankov, S., La Porta, R., Lopez-de-Silanes, F., and Shleifer, A., 2008, The Law and Economics of Self-Dealing, Journal of Financial Economics 88, 430-465.

Dyck, A., and Zingales, L., 2004, Private Benefits of Control: An International Comparison, Journal of Finance 59, 537–600.

Faccio, M., and Lang, L., 2002, The Ultimate Ownership of Western European Corporations, Journal of Financial Economics 65, 365–395.

Jensen, M., and Mechling, W., 1976, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, Journal of Financial Economics 3, 305–360.

La Porta, R., Lopez-de-Silanes, F., and Shleifer, A., 1999, Corporate Ownership Around the World, Journal of Finance 54, 471–517.

Leland, H., and Pyle, D., 1977, Informational Asymmetries, Financial Structure, and Financial Intermediation, Journal of Finance 32, 371–387.

Maury, B., 2006, Family Ownership and Firm Performance: Empirical Evidence from Western European Corporations, Journal of Corporate Finance 12, 321–341.

Mehrotra, V., Morck, R., Wiwattanakantang, Y., and Shim, J., 2013, Adoptive Expectations: Rising Son in Japanese Family Firms, Journal of Financial Economics 108, 840–854.

Morck, R., Strangeland, D., and Yeung, B., 2000, Inherited Wealth, Corporate Control, and Economic Growth, in Morck, R., ed: Concentrated Corporate Ownership (University of Chicago Press, Chicago).

Perez-Gonzalez, F., 2006, Inherited Control and Firm Performance, American Economic Review 96, 1559–1588.

Saito, T., 2008. Family Firms and Firm Performance: Evidence from Japan, Journal of The Japanese and International Economies 22,620–646.

Shleifer, A., and Vishny, R., 1997, A Survey of Corporate Governance, Journal of Finance 52, 737–783.

Smith, B., and Amoako-Adu, B., 1999, Management Succession and Financial Performance of Family Controlled Firms, Journal of Corporate Finance 5, 341–368.

Sraer, D., and Thesmar, D., 2007, Performance and Behavior of Family Firms: Evidence from the French Stock Market, Journal of the European Economic Association 5, 709–751.

Villalonga, B., and Amit, R., 2006, How Do Family Ownership, Control and Management Affect Firm Value?, Journal of Financial Economics 80, 385–417.