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Family firm research – A review☆

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ABSTRACT

This article reviews family firm studies in the finance and accounting literature, primarily those conducted using data from the United States and China. Family owners have unique features such as concentrated ownership, long investment horizon, and reputation concerns. Given the distinguishing features of family ownership and control, family firms face unique agency conflicts. We discuss the agency problems in family firms and review the findings of recent family firm studies. We call for more research to understand the unique family effects and encourage more research on Chinese family firms.

Part I of the article discusses the fundaments of family firms: the prevalence of and the agency conflicts within family firms. Part II summarizes the findings of recent U.S. family firm studies. It reviews the evidence on the family firm premium (how, which, and when family firms are associated with a valuation premium), the manifestation of the agency conflict between majority and minority shareholders in family firms, earnings quality and corporate disclosure, and the determinants of family ownership and control. Part III discusses the prevalence and characteristics of Chinese family firms and reviews the findings of related studies. The article concludes with some suggestions for future research.

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1. Fundamentals of family firms

1.1. The prevalence and uniqueness of family firms

A family firm is a firm in which the founders or descendants of the founding family continue to hold positions in the top management, serve on the board, or are blockholders.[1] As an important organizational form, family firms account for 44% of large firms in Western Europe (Faccio and Lang, 2002), over two-thirds of firms in East Asian countries (Claessens et al., 2000), and 33% and 46% of the Standard and Poor (S&P) 500 and 1500 index companies, respectively (e.g., Anderson and Reeb, 2003; Chen et al., 2008a). Family firms also operate in a broad range of industries. Among the S&P 1500 companies, family firms account for two-thirds of firms in the high-tech industries (e.g., pharmaceutical products, electronic equipment), wholesale and retail, transportation, and printing and publishing. Even among capital-intensive industries (steel works, machinery, automobile, petroleum, and natural gas), regulated industries (banking and insurance companies), and the business supplies industry, which are the least likely to be family controlled, over 30% are family firms (Chen et al., 2008a).

Compared to nonfamily owners and other blockholders, family owners have some unique characteristics. First, founding families hold poorly diversified portfolios due to their concentrated ownership in family firms. Within family firms in the S&P 1500 index, founding families hold 17% of the shares in their firms on average. Moreover, 69.5% of founding families hold more than 5% ownership in their firms, and 24.7% of them hold more than 25%. Due to their high ownership and low diversification, founding families enjoy the benefit of good corporate decisions and at the same time bear the consequences of bad corporate decisions, and thus family owners have strong incentives to increase firm value.

Second, family owners have longer investment horizons than other shareholders. They generally regard their ownership as an asset to pass on to future generations. For example, when William Lauder, grandson of the founder of Estee Lauder, stepped down, he made the following comment: “I am committed to the company. It’s the vast majority of my personal wealth and my family’s personal wealth – and we fully expect to be actively involved with this company going forward” (The *Wall Street Journal* Nov 9, 2007, ‘Lauder Scion Way Out, P&G Executive Way In’). Such long-term commitment implies that family owners care about the long-term value of the firm, rather than the short-term gain.

Third, family members are actively involved in the management of their firms, either as top executives or as directors. On average, founding families hold the CEO position in 62% of family firms within the S&P 1500. Moreover, 98.4% of founding families appoint at least one family member to their boards, 54.6% of them appoint two family members, and 22.9% of them appoint three or more family members. Founding families’ substantial involvement in their firms’ management teams ensures that their preferences are reflected.

Not all family firms are the same. The most important classification within family firms is the identity of the CEO. Depending on the identity of the CEO, family firms can be classified as (1) founder CEO firms, (2) descendant CEO firms, and (3) other family firms, usually referred to as professional, or hired, CEO family firms.[2] Founder CEOs are usually charismatic and visionary leaders with great management skills. They also tend to have a strong will and an undisputed and powerful status in their firms. In contrast, descendants are often criticized for being spoiled brats and less skilled. This classification is critical to the understanding of the agency problems in family firms, as discussed in the next section.

[1] This definition is widely used in family firm studies conducted using U.S. data (e.g., Anderson and Reeb, 2003; Villalonga and Amit, 2006; Ali et al., 2007). Using this commonly used definition is important for several reasons. First, it facilitates comparison of the results across studies. Second, it is less subject to researchers’ discretion in the classification of family. Third, to the extent that the family owners in some of the classified family firms have weak influence in the firms, it would introduce a conservative bias to the results. A more restrictive definition (e.g., requiring multiple generations to be involved in the firm) makes the results less generalizable. One should keep in mind the tradeoff between using a more restrictive versus a more lenient definition and the most appropriate definition is likely to be country specific. See Villalonga and Amit (2010, pp. 866–867) for a further discussion of family firm definition.

[2] The name of the third category does not imply that founder CEOs or descendant CEOs are not professional; nor does it imply that founder CEOs and descendant CEOs are not hired.

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