Journal of Family Business Strategy 6 (2015) 119–129

Contents lists available at ScienceDirect

Journal of Family Business Strategy

journal homepage: www.elsevier.com/locate/jfbs

Do CEO and board characteristics matter? A study of Thai family firms

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ARTICLE INFO

Article history:
Received 15 November 2012
Received in revised form 7 July 2014
Accepted 8 January 2015

Keywords:
Family firms
CEO characteristics
Board of directors
Firm value
Thailand

ABSTRACT

Family businesses are dominant players in global economies. Using the data of family firms in a setting of weak institutions resulting from a deficiency of market-based management skills, we ask which CEO and board characteristics matter? The involvement by family members as CEOs is a common practice in family businesses. However, we find that family CEOs reduce firm value, indicating higher potential expropriation of minority shareholders or possible lower competency of family CEOs relative to professionals. Our results show that such negative effects could be moderated by certain characteristics of appointed CEOs. Family CEOs who are young, have business expertise, or are in the alumni network lead to higher firm value. Interestingly, the presence of family CEOs with a doctoral degree is negatively associated with firm value, which is possibly caused by their interest in research or innovation-related strategies. In addition, boards of directors could be designed by controlling families to support family CEOs. We find that the value of family CEO-run firms improves if their boards of directors are diverse in ages and have political ties, showing the importance of board roles in providing advice and access to external resources for family CEOs. Our analysis suggests a promising set of CEO and board characteristics of family firms in prolonging the survival of family-run firms.

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Introduction

Family firms play an important role in emerging markets (Claessens, Djankov, & Lang, 2000; Faccio & Lang, 2002; La Porta, Lopez-De-Silanes, & Shleifer, 1999). Given the importance of family businesses to national economies, family firms have received increasing attention in finance, economics and management literature over the last decade. A family is the most prevalent type of largest shareholder in companies with ownership concentration and family controlling shareholders appear to be a solution to firms in countries with weak legal systems to protect investors (Claessens et al., 2000; Faccio & Lang, 2002; La Porta et al., 1999; Peng & Jiang, 2010). Active participation in management by members of controlling families is an outstanding characteristic of family firms (Peng & Jiang, 2010; Villalonga & Amit, 2006; Wiwattanakantang, 2001).

Most research has explored the ownership and control of family firms and their impacts on firm performance and value. As family members often hold top management positions, previous studies have investigated the significance of family CEOs (Morck, Shleifer, & Vishny, 1988; Peng & Jiang, 2010; Villalonga & Amit, 2006). Having family CEOs is beneficial to firms because it reduces and even eliminates the conflicts between shareholders and managers (Jensen & Meckling, 1976). Family CEOs have high commitment and profound firm-specific tacit knowledge (Bertrand & Schoar, 2006). Family CEOs also have extensive kinship networks that extend across politics and businesses (Arregle, Hitt, Sirmon, & Very, 2007).

However, the survival rate of family firms is relatively low (Morris, Williams, Allen, & Avila, 1997). One possible factor in this finding may involve the CEO's leadership role, and whether, in fact, he or she is also a family member. The success or failure of firms is frequently dependent on the capabilities and competency of CEOs in directing firms to compete in the market. Family CEOs could be entrenched and use their power to extract private benefits at the expense of minority shareholders (Bertrand, Johnson, Samphantharak, & Schoar, 2008). Moreover, controlling family shareholders may monitor family CEOs to a lesser degree than professional CEOs because the decline in total shareholders' wealth could be compensated by private benefits exploited by family CEOs. In addition, family CEOs may be appointed even if they are not as capable as professional CEOs (Pérez-González, 2006).

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http://dx.doi.org/10.1016/j.jfbs.2015.01.002
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Our objective is to explore what characteristics of family CEOs could reduce the possibilities of expropriation and managerial incompetency in the context of weak investor protection, thus improving firm value. We construct a comprehensive set of CEO characteristics, which are classified into biography, networks and incentives. Biography includes age, expertise and educational background. Networks are identified as alumni and directorate networks. Incentives are measured by the percentage of CEO ownership. We then examine the impact of these observable family CEO characteristics on firm value. We hypothesize that management by influential families could destroy firm value if there is potential expropriation of minority shareholders and/or family CEOs are less competent and perform more poorly than outside professional CEOs. Nonetheless, such negative effects could be offset by some favorable characteristics of family CEOs.

We also examine governance effects in family firms and ask whether board characteristics could have an impact on the capabilities and behaviors of family CEOs, resulting in an increase in firm value. Boards of directors are important because they play crucial roles in monitoring, advising and linking the organization and providers of external resources (Anderson, Reeb, Upadhyay, & Wanli, 2011; Forbes & Milliken, 1999; Globerman, Peng, & Shapiro, 2011; Kang, Cheng, & Gray, 2007). In our article, the governance effects of a board of directors to the family CEOs are proxied by the age diversity and the political connections of boards. We hypothesize that these board characteristics could complement the limited capabilities of family CEOs. Therefore, any negative relation between family CEOs and firm value may be weakened by the effects of board characteristics.

In this study, the sample firms are non-financial family firms listed on the Stock Exchange of Thailand (SET) between 2001 and 2005. Thai firms are worth investigation for at least three reasons. First, a majority of Thai-listed firms are family-owned and their ownership structure is highly concentrated. Such firms are usually managed by family members (Khanthavit, Polsiri, & Wiwattanakantang, 2004). The institutional characteristics of Thai firms are similar to firms in other emerging markets. Second, during the Asian financial crisis of 1997 and its aftermath, corporate collapses and accounting scandals of firms raised questions about decisions made by top managers and CEOs' qualifications. In Thailand, the involvement of family members in management is found to be detrimental to firm value (Wiwattanakantang, 2001), which is consistent with the findings in other Asian countries (Peng & Jiang, 2010). Third, the data of ownership structure, CEOs and boards of directors of Thai listed firms are publicly available via the 56-1 forms. We are able to construct the data of family ownership and detailed characteristics of CEOs and boards, which enable us to explore the role of CEOs and boards in family firms.

Our research contributes to the literature on family firms in emerging markets in several respects. First, prior studies investigated whether family structure and involvement are associated with the performance of family firms and affect the possibilities to extract resources out of the group firms (Bertrand et al., 2008; Luo & Chung, 2013; O'Boyle Jr, Pollack, & Rutherford, 2012). Our study adds to this literature by investigating the effects of the characteristics of family CEOs as moderators of the family involvement and firm value relation. The findings show favorable impacts of certain attributes of family CEOs and would be beneficial to strategic planning for the survival of family businesses in unstable business environments.

Second, there is a need to understand the implications of resource based theories and to integrate the institutional theory with other theoretical perspectives, in research in emerging countries (Wright, Filatotchev, Hoskisson, & Peng, 2005). We extend the resource dependence perspectives by focusing on the capability and knowledge sharing perspectives of CEOs and boards in the context of weak institutions caused by a lack of market-based management skills. In addition, we integrate family firm literature and corporate governance literature and focus on the governance effects in family-run firms. The roles of boards to incumbent family CEOs are highlighted. We find the importance of the board of directors in providing advice and access to limited resources to be of assistance to family CEOs. Although appointing a family member as a CEO is part of family traditions, controlling families should place stress on the governance structure to support family CEOs, especially when the family CEOs are incompetent and are detrimental to firm value.

Third, networks are found to be one of the key institutional characteristics in emerging markets (Bunkanwanich & Wiwattanakantang, 2009; Espenlaub, Khurshed, & Sitthipongpanich, 2012; Peng, Au, & Wang, 2001; Siegel, 2007). Networks of family CEOs are valuable for firms in many ways. For example, in countries with weak law enforcement, networks overcome market failures and helps strengthen trust and the reliability of CEOs and their firms. Although the effects of CEO social networks depend on the types of network (Luo & Chung, 2005; Rhee, 2008), we find that ties among alumni seem to be stronger than ties among directors in the case of Thai-listed companies. In addition, our findings show that the networks of directors are necessary in providing external information and resources to family CEOs, which improves CEO capabilities.

The study is structured as follows: Development of our hypotheses, Data and methodology used in this study, Empirical results and Discussion and implications.

Development of hypotheses

Family CEOs and firm value

Family-owned firms are commonly found in East Asia (Claessens et al., 2000). Peng and Jiang (2010) argued that in countries where the legal and regulatory institutions are relatively weak, family controlling shareholders intend to appoint a family member to manage their firms because hiring outside managers is likely to create agency problems and increases the possibilities of tunneling. In addition, low investor protection in such a context may decrease the willingness of minority shareholders to invest. As a result, ownership concentration in family firms remains prevalent in countries with weak investor protection.

Similar to other countries in East Asia, a majority of Thai firms are owned and controlled by families (Bertrand et al., 2008; Connelly, Limpaphayom, & Nagarajan, 2012; Wiwattanakantang, 2001). The evolution of capitalism in Thailand has been shown by the business expansion and capital accumulation of several big families (Phipatseritham & Yoshihara, 1983). Suehiro (1989) documented that business expansion in Thailand occurred in the shared ownership of powerful families between the 1930s and the 1940s. After the 1960s, groups that were set up through the interlocking of ownership or directorship and personal ties became under the control of a single family. The family injected capital into firms in order to increase its management control and equity ownership, resulting in an increase in ownership concentration in family firms.

In a country like Thailand where law enforcement is fairly weak, family members are directly involved in the company's management to protect their cash flow rights and prevent potential expropriation by outsiders (Bertrand et al., 2008; Wiwattanakantang, 2001). The founders of family firms usually pass control to the next generation as a result of family traditions and inheritance rules (Bertrand et al., 2008). When CEOs are controlling family members, they have common interests and identities as those of family shareholders (Habbershon & Williams, 1999). In addition,

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