Journal of Corporate Finance xxx (2015) xxx–xxx

Contents lists available at ScienceDirect

Journal of Corporate Finance

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

One-child policy and family firms in China ☆

Jerry Cao [a], Douglas Cumming [b], Xiaoming Wang [c,*]

[a] Singapore Management University, 50 Stamford Road, #04-01, Singapore 178899, Singapore
[b] Economics and Public Policy, York University, Canada
[c] Shanghai University of Finance and Economics, 777, Guoding Rd, Yangpu, Shanghai, China

ARTICLE INFO

Available online xxxx

JEL classification:
G32
J12
Z19

Keywords:
One-child policy
Family firms
Control
Dynastic management
Succession

ABSTRACT

Family business plays important roles to fuel economic growth in China. Due to the one-child policy, family firms are increasingly facing human capital constraints for within-family succession. Having only one heir decreases the probability of continuing family management by over 3%, reduces the probability of adult children working in family firms by 14%, and significantly decreases founders' expectations of having young heirs for succession. Having fewer children negatively affects founder's expectation to go public, reduces family firm's reinvestment rate and R&D. Overall, the evidence suggests that the human capital constraints due to the one-child policy impose significant negative impacts on within-family succession. Dynastic management of family firms remains an important challenge for first-generation entrepreneurs in China.
© 2015 Elsevier B.V. All rights reserved.

1. Introduction

Fertility choice and demographic changes are important factors that can foster economic growth (Barro and Becker, 1989; Becker et al., 1990). The one-child policy successfully implemented in China in 1979 has resulted in a significant drop in China's population growth rate during the last three decades, which has been credited for stabilizing China's rapidly growing population and contributing to its tremendous economic growth (Bloom and Canning, 2003; Cai and Wang, 2005). Conversely, the policy has been widely criticized internationally for violating fundamental human rights through forced sterilizations and abortions, as well as for reducing family stability and accelerating aging populations. Regardless of its controversial nature, the one-child policy was extended through a new legislation in 2001 as the nation's demographic strategy for the future and will continue to cast a long-lasting impact on Chinese family planning and populations.

In this paper, instead of holistically examining the policy's overall economic impact, we take family firms as our study context to examine its impact on within-family succession. Within-family succession is important since most family businesses are mainly controlled and managed by their founders or founder's family members. The advantage of studying family firms is that the outcomes associated with the constraints of human capital or lack of talented heirs are easily measurable by firm governance, performance, and corporate decisions. Several theoretical papers show that family firms remain prevalent in economies with weak legal investor protections or under-developed external markets for managers. For example, Burkart et al. (2003) show that family firms by and

☆ Xiaoming Wang acknowledges a grant supported by the Program for Innovative Research Team of Shanghai University of Finance and Economics. Jerry Cao acknowledges a research grant from the Office of Research, Singapore Management University. We appreciate the helpful comments from David Thesmar, Per Stromberg, Joseph Fan and Morten Bennedsen as well as the discussants at the Conference on Family Firm Governance in Beijing.
* Corresponding author.
E-mail addresses: Jerrycao@smu.edu.sg (J. Cao), dcumming@schulich.yorku.ca (D. Cumming), Wang.xiaoming@shufe.edu.cn (X. Wang).

http://dx.doi.org/10.1016/j.jcorpfin.2015.01.005
0929-1199/© 2015 Elsevier B.V. All rights reserved.

Please cite this article as: Cao, J., et al., One-child policy and family firms in China, J. Corp. Finance (2015), http://dx.doi.org/10.1016/j.jcorpfin.2015.01.005

large pass ownership/control and management to family members such as heirs in countries with weak legal environments. Bhattacharya and Ravikumar (2003) show in their model that family firms will face a higher threshold of management professionalization in weak financial markets due to the under-development of external markets for CEOs and managers. China, with its weak institutional environment and poor external managerial market, offers a perfect setting to examine family firm succession from the perspectives of governance and corporate finance. Within-family succession is a crucial issue for Chinese family firms, which are characterized by credit constraints, poorly developed financial markets, and high agency costs of external managers. Dynastic management of within-family succession remains the key issue that first-generation founders have to address as they get older. In most family firms, founders expect to pass their businesses to heirs or within-family members but at the same time want to maintain tight control of such corporations.

Within-family succession includes identifying and developing internal heirs who have the potential to fill leadership and controlling positions in the family owned businesses. Hence, succession management remains the top priority because family businesses that fail to negotiate this transition must often face discontinuity — either being sold for lack of a family member willing or able to take over. Yet because many prior studies treat a founder CEO's family as a monolithic whole with a large pool of heirs who automatically wish to participate in family control of the business, emerging research has yet to identify individual family members' incentives for such dynastic management. Caselli and Gennaioli (2011) argue that if the heir to the family firm has no talent for managerial decision making, dynastic management as a failure of meritocracy will reduce a firm's productivity. Empirically, Bennedson et al. (2007) show that family succession results in value reduction in developed countries due to lack of talented heirs. Bertrand et al. (2008) analyze the allocation of control, management, and ownership to different family members in large family business groups in Thailand and find that such optimal allocation choices explain firm-level performance. Pérez-González (2006) finds that in Mexico family internal succession leads to underperformance. In East Asian nations, Fan et al. (2012) show that the entrepreneurial firm's accounting system is more likely to shift to a less insider-based system after succession when family firms possess more specialized assets. In another study, Fan et al. (2013) find that within-family succession is chosen over outside succession when a firm has been co-managed by multiple family members and when its business depends on relationships with stakeholders such as employees and banks.

In this paper, we focus on family firms' succession as the main research question. In particular, we utilize the constraints on the family firm's human capital pool caused by the one-child policy as a natural experiment. We believe that our study is the first empirical study to understand how succession decisions are affected by a decreasing number of children or potential heirs and how such constraints affect family firms in China. The literature recognizes that human capital is important for family firms and that heirs are often not equally likely to participate in (and thus succeed to) control of the family business. There exist multiple forces underlying within-family succession. First, the management of a family-owned firm is only one of several job options available to an heir. In the Chinese culture, the first-born child is often the default choice for succession. However, if another child would be a better match (both in terms of skills and his/her interests) to run the firm, the chance for the first born heir to succeed will drop. Secondly, there is tournament effect among multiple children for within-family succession. In the tournament, the pressure of competition can make children invest more in developing their skills. As a result, only the most skilled children will be picked to succeed to family businesses.

In China, the one-child policy exogenously imposes constraints[1] on talent/heir availability for family firm's succession. One direct undesired consequence of the one-child policy is that family firms face a lack of multiple heirs for tournament. Chinese family firms hence provide us a close-to-natural experiment to examine the decision of family succession. If there are cross-sectional variations among the number of available children in family firms, succession decisions will differ correspondingly. We hypothesize that the lack of multiple children imposed by the one-child policy will negatively affect family succession decisions. Empirically we can compare the succession decisions in the families with one child to the succession in the families with multiple children. If founders of family firms only consider passing the control of businesses to the first-born child, the number of children will not affect family succession decisions. If founders implicitly consider multiple children for succession, number of children or a dummy of having one child will have significant impact on family management or founders' expectation to pass their businesses to the next generation heirs.

Our research contribution is that we have a clear natural setting where family firms have a constrained talent pool of heirs due to the binding effect of the one-child policy. In contrast, most prior studies assume that there is a large pool of heirs for succession to family firms so that family control can continue with few constraints. In the real world, however, family firms may face the problem of discontinuity when their pool of candidates for succession is limited or restricted. Such limitation will impose a great cost on dynastic management and firms according to Bertrand et al. (2008). Although the succession problem can be partially solved by alternative arrangements, e.g., adopting sons[2] or hiring external managers, internal succession remains the prevalent norm for family business in emerging markets. Unlike the United States (U.S.) or Europe, many emerging countries, tend to have underdeveloped external job markets for talented managers. Bhattacharya and Ravikumar (2003) suggest that family firms face a higher threshold of management professionalization, external succession by hiring outside managers is often considered as the last resort. Extant research also suggests that family control or internal heir succession tends to carry with it the great benefit of private control. Hence Davis, Schoorman, and Donaldson (1997) and Anderson and Reeb (2003) propose that high-performing family businesses

[1] Evans and Jovanovic (1989) show that financial constraints such as the lack of credit are bad for talented but poor entrepreneurs. Chami and IMF Institute (2001) examine family firms in terms of principal–agent relationships between parent/owner and child/employee and finds that in family firms, trust, altruism, and the prospect of succession mitigate the agency problem relative to the parents' hiring of outside employees.

[2] Mehrotra et al. (2011) examine the effect on firm performance of the Japanese practice of adopting male heirs into the family business from outside if the family's own heir is not fit for or interested in succession. Such a practice, however, is not common in China.

Please cite this article as: Cao, J., et al., One-child policy and family firms in China, J. Corp. Finance (2015), http://dx.doi.org/10.1016/j.jcorpfin.2015.01.005

Download English Version:

https://daneshyari.com/en/article/5093279

Download Persian Version:

https://daneshyari.com/article/5093279

Daneshyari.com