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CEO succession decision in family businesses — A corporate governance perspective

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ABSTRACT

Using a comprehensive database of Taiwanese family-owned business, this study investigates chief executive officer (CEO) selection decisions in family-owned businesses. Our data sample is composed of 129 listed family businesses from 1998 to 2008. By employing theories of family-owned business succession and corporate governance, the study examines the influence of chairman of the board (COB) and CEO duality, current CEO/family relations, and shareholding ratio of outside directors on CEO-selection decisions in family-owned businesses. The results demonstrate that a family-owned business is more likely to select an intra-firm member as the new CEO when the incumbent CEO is a family member. Moreover, a family-owned businesses are prone to selecting new CEOs from external sources when the shareholding ratio of outside directors is greater. Based on the findings, the study can contribute to CEO succession research and family-business research in emerging economies.

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1. Introduction

The objective of business-succession planning aims at a smooth transition in the top management position. Within family-owned businesses, CEO succession planning is complicated due to the intertwining of management and ownership (Sharma, 2004). Benson (1990) also found that only 30 percent of family businesses succeed in subsequent generations. Both the family's needs and business requirements influence the CEO succession decision. A serious conflict arises when the interests of both parties are not compatible. In addition, the business's stakeholders also exert a great influence over succession decisions in which the family business is a listed company. This implies difficulty in smooth succession in family businesses.

Among the transition of top management positions, the CEO succession decision is pivotal in family businesses. In fact, the process and result of CEO selection is a signal to business stakeholders who are concerned about the stability, competitiveness, and growth of the business. The essential issue for CEO selection is related to the decision of whether candidates will be from inside or outside of the family-owned firm. In other words, a family business may confront a dilemma in deciding to choose from family members or non-family members or an employee promotion or recruited outside the firm when choosing the new CEO to meet both the family needs and business requirements.

The reasons for an insider succession decision include an increase in employee loyalty and the board of directors' acquaintance with the candidates. However, the major reason for an outsider succession decision is the employment of a new leadership style that may lead to transformation for the company. For example, Delta Air Lines, the third largest U.S. airline, recruited Leo Mullins, who has no prior experience in the airline business, to revamp Delta Air Lines. The purpose in making such a decision was the consideration of a new mindset and leadership style introduced into the conventional airline business. Friedman and Singh (1989) and Datta and Guthrie (1994) stated that the new strategic planning, organizational structure, and resources required of an organization may also follow the inauguration of a new CEO.

Corporate governance has played an important role in both

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family and non-family businesses. The CEO succession decision is also one of the important research issues in corporate governance. However, research on CEO succession decisions for family businesses is still scarce. A company's board of directors nominates, appoints, and delegates a suitable CEO to manage the company. Thus, the designated CEO has substantial influence over the company's performance by virtue of his or her decision-making in strategic planning and responsibility in the company's strategy implementation. Additionally, the board of directors has the authority to decide the CEO's turnover. The constituents on the board of directors play essential roles in management and control the power of a company. Prior studies on corporate governance have focused more on large companies, especially European and American companies; however, research has not paid much attention to the investigation of small and family businesses located in emerging countries. Due to the growing importance of corporate governance in emerging economies, this study attempts to examine CEO succession decisions for small and family businesses in emerging countries from the perspective of corporate governance to fill the research gap.

The purpose of this study is to investigate CEO succession decisions in family-owned businesses and explore the factors that influence these decisions by employing theories of business-succession planning and corporate governance. Prior studies on family-owned businesses were mostly survey based and used an exploratory approach. The data that we collected are from a comprehensive database of Taiwanese family businesses, providing sufficient family-business data for this study. To fulfill the research purpose, the study aims to answer the following questions. First, does chairman of the board (COB)/CEO duality have an influence on the succession decision in terms of insider-outsider choices? Second, does whether the incumbent CEO is a family member affect the succession decision? Third, is the shareholding ratio of outside directors influential on the CEO succession decision?

The research questions in this study mainly pertain to the CEO succession decisions of family-owned businesses for which data have been collected in Taiwan. The reason that we choose Taiwan as our research context is because Taiwan was ranked in 20th place for global-trade entities by the World Trade Organization (WTO) in 2014. In addition, more than 95 percent of Taiwanese enterprises are small and medium enterprises (SMEs), and 80 percent of Taiwanese enterprises are family businesses. According to statistics from the Ministry of Economic Affairs in Taiwan, the total number of SMEs in Taiwan exceeded 1.38 million in 2015, and 70 percent of the total export value was from SMEs in 2015. As family businesses play an important role in SMEs, they therefore make a substantial contribution to the economic development of Taiwan.

2. Theoretical bases and hypotheses

2.1. Family business and succession-planning strategy

Family business has played a dominant role in the economic development of most countries. From previous research, scholars have made various elaborations regarding the definition of a family business (shown in Table 1) and yet have not reached a consensus. As stated by Beckhard and Dyer (1983), a family business is an organization family members influence decisions regarding its ownership or management. Gallo and Sveen (1991) also stated that a business being a family firm indicates that a family owns business and that family members hold the majority of stocks and exert managerial control over the management team in making important business decisions. Scholars have mostly proposed that dominant shareholding ownership and control power that family members possess in a business define a family business. We thus

Table 1
Definitions of a family business.

Author	Definition
Dyer (1986, p.xiv)	“It is an organization in which decisions regarding its ownership or management are influenced by a relationship with a family”.
Stern (1986, p.xxi)	“A corporate owned and operated by members of one or more families.”
Ward (1987, p. 252, p.252)	“The family business means that passed on for the family's next generation to operate and control.”
Lansberg (1988, p. 2, p.2)	At least one member of a family has control or ownership in a company.
Gallo and Sveen (1991)	A family firm is the business owned by a family, and the family members have majority of stock and enforce managerial control over core of the management team, making important decisions regarding the business.
Litz (1995)	The concept of a family business has two perspectives. One view is in terms of structure, families are involved in firm ownership and management. Another view focuses on management's intention to maintain or increase intra-organizational family involvement.

conclude that a family business is usually governed by two principal components: holding a greater proportion of the firm's equity ownership and involving dominant managerial control power on the business. The dominant equity ownership and managerial control power constitute the difference between family-owned businesses and non-family-owned businesses. In this study, we define a family-owned business as members from the [1]same family holding more than two board director positions in a business, which causes the weight of succession planning to be more essential in a family business.

The exploration of succession planning in family business has drawn scholars' attention for decades. Researchers have highlighted that succession planning plays an important role in the success of a family business, and good succession planning is beneficial to the sustainability of a family business (Brockhaus, 2004; Ward, 1987). However, founders of family businesses tend to ignore planning for business succession. As Kertesz and Atalaya (1999) stated, approximately 70 percent of family business founders are reluctant to plan for succession ahead of time. Studies have shown that less than one third of family businesses passed down the control power to the next generation when the incumbent chairman retired, and only a half of those family businesses conducted succession planning for the third generation (Beckhard & Dyer, 1983; Kets de Vries, 1985; Lansberg, 1988; Ward, 1987).

In addition, different types of successors may have an impact on family businesses. Burkart, Panunzi, and Shleifer (2003) and Perez-Gonzalez (2006) argued that non family-related CEOs perform better than family-related CEOs. In contrast, an empirical study conducted in the US which found that firms with founders from family-related businesses as their CEOs outperform those from non-family-related businesses. Additionally, the performances of these family firms may decline dramatically when someone from the next generation becomes the new CEO (Villalonga & Amit, 2006). Similar empirical studies were also conducted in Canada, France, Germany, and the UK (Morck, Stangeland, & Yeung, 1998; Bloom, Dorgan, Dowdy, & Van Reenen, 2007).

[1] The same family indicates a member of the board of directors with a spouse or within the second relatives between a family hold at least 5 percent of the company's shareholding (Gomez-Mejia, Nunez-Nickel, & Gutierrez, 2001).

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