



# **The SAGE Handbook of Family Business**

## **Financial Performance of Family Firms**

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## Financial Performance of Family Firms

Raphael Amit and Belén Villalonga

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### Introduction

Family business is one of the fastest growing areas of research within management and related fields such as finance. The main reason for this growth is the increased realization among the academic community that most companies around the world are family controlled, that they are systematically different from other firms, and that those differences are manifested in the relative performance of both groups of firms. In other words, family businesses matter – very much, and to very many people.

Until recently, however, family business research was perceived as a niche topic affecting a small group of companies, published by a small group of researchers in an even smaller set of specialized outlets, and therefore of limited interest to the academic community at large. It wasn't until a few studies put family businesses in the broader business context by presenting rigorous empirical evidence about the prevalence and performance of family businesses relative to non-family businesses that top academic journals opened their doors to family business research, giving it the visibility it deserves.

In this chapter we review the evolution of this research, from its antecedents to its current state. Based on our review, we identify what we see as the main drivers of variation in the cumulative evidence about family business financial performance. We then proceed to analyze the challenges associated with the measurement of performance in family businesses, and propose feasible ways to address some of those challenges.

### How Prevalent Are Family Businesses?

Villalonga and Amit (2006) find that the empirical relation between family ownership, control, or management and firm performance is entirely contingent on the definition of family business used, not just in the magnitude of this relation but even in its sign, which switches from positive to negative if founder-led firms are excluded from the definition. Before discussing family business performance, it is therefore important to discuss the relative prevalence of family and non-family businesses in the economy under different definitions.

Many family business articles begin with the assertion – sometimes even a statistic – that most businesses around the world are family owned or controlled. Until recently, however, there was little empirical evidence to substantiate these assertions or numbers, for the simple reason that no corporate census or database keeps track of whether businesses are family-owned or not for a large and representative sample of companies.<sup>1</sup> Moreover, most businesses around the world are either privately held or owned indirectly through investment vehicles that are themselves privately held. Thus it is typically very difficult, when not impossible, to determine who the ultimate owners of a firm are – let alone whether those owners are family related. Shanker and As-trachan (1996) carefully survey the existing research on this question and reach the same conclusion.

The earliest reliable estimates of the prevalence of family businesses are those provided for Fortune 500 firms by Sheehan (1967) and Burch (1972), who respectively reported 30 per cent and 42 per cent of the largest publicly listed firms as family businesses, based on a definition of family business as one where an affluent individual or a family or group of families owns 4–5 per cent or more of the voting stock or has board representation. Burch also reported an additional 17 per cent in the 'possibly family-owned category'.

Several later studies have added to the body of evidence about the prevalence of family ownership or control among large US firms. In 1986, Shleifer and Vishny examined the identity of the largest shareholders in the 1980 Fortune 500 and found that 33 per cent of them were families represented on the boards of directors; an additional 22 per cent included other corporations or family holding companies not represented on the board

– i.e., possibly family owned as well. McConaughy (1994) reports that 21 per cent of the companies on the Business Week 100 list had a direct descendant of the founding family as CEO, president or chairman. Jetha (1993) found that 37 per cent of the 1992 Fortune 500 firms had a descendant of the founding family as a key officer, director, or owner. Anderson and Reeb (2003) found that founders or their families were key officers, directors, or owners in one-third of the S&P 500 corporations during 1992 to 1999. Closer to Anderson and Reeb's estimate, in Villalonga and Amit (2006) we found that 37 per cent of the Fortune 500 firms between 1994 and 2000 had founders or their families as key officers, directors, or owners. We also found that these estimates are highly sensitive to the definition used; [Table 9.1](#), which is based on the results in that paper, reports estimates of the prevalence of family businesses under nine alternative definitions. Under the most restrictive one, which incorporates the additional conditions that the family be the largest vote holder, have at least 20 per cent of the votes, have family officers *and* family directors, and be in the second or later generation, the percentage goes down to 7 per cent.

### **Table 9.1 Effect of the definition of ‘family firm’ on the relative prevalence and value of family firms**

Definition of family firm	Proportion of family firms in the sample	Regression-adjusted difference in Tobin's $q$ between family and non-family firms	
1. One or more family members are officers, directors, or blockholders	37%	0.23	*
2. There is at least one family officer and one family director	26%	0.29	*
3. The family is the largest voteholder	20%	0.29	
4. The family is the largest shareholder	19%	0.32	*
5. One or more family members from the 2nd or later generation are officers, directors, or blockholders	19%	-0.13	
6. The family is the largest voteholder and has at least one family officer and one family director	14%	0.33	
7. The family is the largest shareholder and has at least 20% of the votes	12%	0.15	
8. One or more family members are directors or blockholders, but there are no family officers	8%	0.06	
9. The family is the largest voteholder, has at least 20% of the votes, one family officer and one family director, and is in 2nd or later generation	7%	-0.28	**

*Note:* This table is based on the results in Villalonga and Amit (2006) and reports, for different definitions of a family firm, the coefficient of a family firm dummy variable in multivariate OLS regressions of Tobin's  $q$  on that dummy and on several control variables. The family refers to the founder or a member of his/her family by either blood or marriage. Blockholders are owners of 5% or more of the firm's equity, either individually or as a group. Tobin's  $q$  is measured as the ratio of the firm's market value to total assets. For firms with non-tradable share classes, the non-tradable shares are valued at the same price as the publicly traded shares.

The control variables are: governance index (number of charter provisions that reduce shareholder rights); non-family blockholder ownership; proportion of non-family outside directors, market risk (beta); diversification; R&D/sales; CAPX/PPE; dividends/book value of equity; debt/market value of equity; log of assets; log of age; sales growth; and year and Fama-French industry dummies.

The sample comprises 2,808 firm-year observations from 508 Fortune 500 firms listed in US stock markets during 1994–2000.

Asterisks denote statistical significance at the 1% (\*\*\*), 5% (\*\*), or 10% (\*) level, respectively.

It is important to emphasize that Fortune 500 or S&P 500 firms are the largest firms in the USA and, as such, not a representative sample of companies around the world or even within the USA. In fact, they are not even a representative sample of US *publicly listed* firms. In Villalonga and Amit (2010) we assembled a random sample of public US firms and found that, using the same definition of a family business as Anderson and Reeb (2003) and Villalonga and Amit's (2006) primary definition, 55 per cent of the sample are family businesses. If non-founding families are also counted in, the percentage rises to 71 per cent. These findings confirm that, as can be expected, family businesses are significantly more prevalent among smaller firms, and suggest that these percentages would be even higher if the entire population of US firms – public and private – were considered.

Unfortunately, there is no equally reliable evidence about the prevalence of family businesses in such a population. Nevertheless, Shanker and Astrachan (1996) develop a careful methodology to come up with estimates of the impact of family businesses on the US economy based on the legal form of organization of

business taxpayers. They conclude that, using a broad definition of family business which, similar to the one used most widely for public businesses, calls for family involvement in either ownership or management, 100 per cent of all sole proprietorships and about 60 per cent of all partnerships and private corporations can be deemed family businesses. Aggregating across all businesses in the economy, the resulting estimate is that 92 per cent of all US businesses can be considered family businesses. Astrachan and Shanker (2003) provide an updated figure of 89 per cent based on year 2000 data. The empirical evidence about the prevalence of family businesses around the world remains limited to public company data, with the exception of a few isolated countries like Denmark for which there is evidence from private companies as well (Bennedson et al., 2007). La Porta et al. (1999) examine the ownership and control structures of the 20 largest publicly traded firms in each of the 27 richest economies, as well as ten smaller firms in some of these countries. To establish who controls the firms, they look at the identities of the ultimate owners of capital and voting rights. They find that 30 per cent are controlled by families or individuals. For the smaller firms and using a less restrictive definition of control (a 10 per cent threshold as opposed to 20 per cent), the fraction of family-controlled firms in their sample rises to 53 per cent. Claessens et al. (2000) examine 2,980 public corporations in nine East Asian countries and find that over two-thirds of the firms are controlled by families or individuals. Faccio and Lang (2002) analyze the ultimate ownership and control of 5,232 public corporations in 13 Western European countries and find that 44 per cent of the firms are family controlled, and 34 per cent are widely held. There have been many subsequent studies reporting on the prevalence of family businesses in individual countries, but these three remain the most comprehensive (even within individual countries, in the case of the latter two). In the introduction to this book, Sharma et al. (2014) review some of the possible explanations to the varying prevalence of family businesses around the world.

## **Do Family Businesses Perform Better or Worse Than Non-Family Businesses?**

Having empirically confirmed that family businesses matter (a great deal) in terms of their prevalence, a natural question arises about whether the distinction between family and non-family businesses matters for firm performance.

### **Theoretical Frameworks**

From a theoretical standpoint, the answer to this question is not clear, even within a given theoretical framework or disciplinary approach. One such approach is provided by agency theory in financial economics. On the one hand, the classic agency theory of Berle and Means (1932) and Jensen and Meckling (1976) suggests that ownership concentration alleviates the conflicts of interest between owners and managers. In particular, higher managerial ownership should align the incentives of owners and managers, while ownership concentration in the hands of outside blockholders should increase owners' incentives to monitor managers. Either way, the prediction is that ownership concentration should lead to increased corporate performance. This prediction particularly applies to family owners, who often not just hold large stakes in their companies but also occupy top management positions in them. The family business literature, as reviewed elsewhere in this book, has also offered a number of arguments that would lead us to expect family businesses to perform better than non-family businesses.

On the other hand, several counterarguments to this point have been made, even within an agency-theoretic perspective. Demsetz (1983) argues that ownership concentration is the endogenous outcome of profit-maximizing decisions by current and potential shareholders, and should thus have no effect on firm value. Stulz (1988) argues that managers can become entrenched if their ownership is too high. Shleifer and Vishny (1997) argue that high degrees of ownership concentration in the hands of outside blockholders can create a new agency problem, between large (controlling) shareholders and small (minority) shareholders. Either way, ownership concentration facilitates the appropriation of what Grossman and Hart (1986) label 'private ben-

efits of control' by managers or large shareholders, at the expense of minority shareholders, and can lead to reduced firm value. This argument once again applies particularly well to family shareholders, who unlike the ultimate owners behind a large institutional shareholder, are the ones who directly enjoy these benefits. Burkart et al. (2003) propose a theoretical model of family business that trades off these agency benefits and costs of family control.

In addition to using agency theory to explain performance differences between family and non-family firms, Chrisman et al. (2005) indicate that the resource-based view is another theoretical perspective that is useful in explaining these performance differences (see Sabine Rau's chapter in this book as well; Rau, 2014). Their central argument is that family involvement enables the firm to accumulate unique resources and capabilities that allow them to develop family-based competitive advantages. Family firms enjoy long-term relationships with external stakeholders and using these external relationships enhances the performance of family firms (Carney, 2005; Chrisman et al., 2009). In addition, Chrisman et al. (2008) suggest that family and non-family firms differ from each other with respect to strategic behaviors, such as strategic response to the threat of imitation or strategic flexibility, and such differences create variation in firm performance.

The chapters in [Part II](#) of this book review other theoretical perspectives in family business studies that are rooted on a variety of disciplines, including psychology, sociology, and anthropology. A review of these different streams of literature further supports the view that the relationship between family involvement and performance remains somewhat ambiguous from a theoretical standpoint.

## Empirical Studies of Family Business Performance

Whether family businesses perform better or worse than non-family businesses is thus an empirical question, and one that remained unresolved when we began our research on this subject, which would ultimately be published as Villalonga and Amit (2006).

At the time, the empirical evidence about this question was scant and conflicting, even within a single country – the United States. Holderness and Sheehan (1988) had found that firms that were majority-owned by individuals or families had a lower Tobin's  $q$  (the ratio of a firm's market value to the replacement cost of its assets, which is often used as a size-adjusted measure of firm value). Morck et al. (1988) had found that the effect of having the founding family among the top two officers was contingent on the firm's age: the effect was positive for firms incorporated after 1950, but negative for older firms. The findings of Smith and Amoako-Adu (1999) and Pérez-González (2006, first draft 2001) that CEO successions by family members had a negative impact on performance were consistent with Morck et al.'s result. On the other hand, McConaughy et al. (1998) and Anderson and Reeb (2003) found that family businesses outperformed non-family businesses, especially when family members served as CEOs.

McConaughy et al. (1998), who define family businesses as family-managed businesses (those with a founding family member as CEO), also found significant differences between founder-managed and descendant-managed family businesses, although the sign of the differences they found was contingent on the methodology they used. When they analyzed separately the subsamples of founder-managed and descendant-managed family businesses using a matched-pairs univariate comparison to non-family businesses, they found that descendant-managed firms outperformed founder-managed firms in terms of market-to-book equity value, sales growth, and cash flow per employee. However, when they pooled together the two groups of family-managed businesses and compared them to non-family businesses in a multivariate regression framework, they found that founder-managed firms outperformed non-family managed businesses by a wider margin than descendant-managed businesses (which also outperformed non-family businesses, however).



Besides this direct evidence about our research question, several streams of literature provided related evidence.

First, there were many empirical studies about the relation between ownership and performance. Demsetz and Lehn (1985) had found a significant linear relation between ownership concentration and profitability but, more importantly, they also found that, in support of Demsetz's (1983) argument, the relation disappeared after controlling for the endogeneity of ownership concentration. Later, Morck et al. (1988) examined the association between managerial ownership and Tobin's  $q$ , and found a non-monotonic relation between the two:  $q$  increased with managerial ownership up to a certain point, beyond which it began to decline. This result is consistent with Stulz's (1988) argument that managerial entrenchment limits the incentive-alignment benefits of managerial ownership. McConnell and Servaes (1990) found similar results using a different regression specification (quadratic instead of piece-wise), as did many subsequent studies (for a review see Demsetz and Villalonga, 2001). However, none of those studies controlled for the endogeneity of ownership like Demsetz and Lehn (1985) had done. Himmelberg et al. (1999) and Demsetz and Villalonga (2001) did, replicating Demsetz and Lehn's (1985) original two-stage analysis on the measures of ownership and performance that were used in the later studies, and found that the relation (monotonic or not) between managerial ownership and Tobin's  $q$  also disappeared.

Second, several working papers had picked up on Morck et al.'s (1988) less-publicized finding that young firms managed by their founding families had a higher  $q$ , and confirmed that founder-CEO firms traded at a premium relative to all other firms: Palia and Ravid (2002), Adams et al. (2009), and Fahlenbrach (2009). The latter two studies also showed that the 'founder-CEO premium' was robust to endogeneity concerns.

Third, there was an ongoing debate about the performance of business groups around the world. Khanna and Palepu (2000) had found that group affiliation was associated with superior performance, whereas Bertrand et al. (2002), using the same Indian data, had found evidence of what Johnson et al. (2000) refer to as 'tunneling' – the transfer of assets and profits out of firms for the benefit of their controlling shareholders. Although the debate had originally been framed as a comparison between group-affiliated firms and stand-alone firms, or between diversified and focused firms (given the parallel debate about the conglomerate discount), the evidence provided by La Porta et al. (1999), Claessens et al. (2000), and Faccio and Lang (2002) that most firms around the world are controlled by large shareholders soon shifted attention to the ultimate ownership and control issues in business groups.

A fourth stream of empirical research that bridged the first and third thus emerged showing that the 'wedge' between cash-flow and control rights created by control-enhancing mechanisms such as pyramids and dual-class stock has a negative impact on firm performance: La Porta et al. (2002) first found this result in their global sample, as did Claessens et al. (2002) in East Asia, and Lins (2003) in 18 emerging markets. Morck et al. (2005) reviewed this literature and concluded that, in countries where a few families end up controlling considerable proportions of their countries' economies through these means, the resulting corporate governance problems can attain macroeconomic importance – affecting rates of innovation, economy-wide resource allocation, and economic growth.

A fifth stream of research that we considered relevant was the literature about dual-class stock. Although dual-class firms had a long history in the United States, a change in regulation in the mid-1980s triggered a flurry of dual-class recapitalizations and, with them, a flurry of academic research, mostly in the form of event studies. Most of these studies, such as Jarrell and Poulsen (1988), found a negative stock market reaction to announcements of such recapitalizations. Others like Partch (1987) found a positive reaction. More recently, some countries have experienced the opposite trend – dual-class unifications – and several studies provided evidence of a positive market reaction to those unifications: Amoako-Adu and Smith (2001) for Canada; Hauser and Lauterbach (2004) for Israel; and Pajuste (2005) for seven European countries. Other studies of

dual-class stock had focused on the voting premium at which superior voting shares typically trade relative to the inferior voting shares in the same company. These included Levy (1982), Lease et al. (1983, 1984), and Zingales (1995) for the United States; Zingales (1994) for Italy; and Nenova (2003) for 18 countries.

In Villalonga and Amit (2006), we brought these five literature streams to bear on our research question, which we framed in terms of firm value: 'Are family businesses more or less valuable than non-family businesses?' The first two were directly related to our question. The third and fourth did not specifically focus on family businesses; however, La Porta et al. (1999), Claessens et al. (2000), and Faccio and Lang (2002) had shown that most controlling shareholders around the world were individuals and families (with much greater prevalence than the State, financial firms, or other owner types), which suggested that family businesses might have driven many of these results. Likewise, the fifth stream of research, about dual-class stock, had traditionally been studied in the context of insider holdings, not of family ownership. However, DeAngelo and DeAngelo (1985) and Nenova (2001) had looked into the identity of those insiders and shown that the primary beneficiaries of dual-class stock were in fact founding families: Nenova reported that this was the case for 79 per cent of the dual-class firms in her comprehensive international sample, and for 95 per cent of US dual-class firms. Their results implied that the separation of ownership and control enabled by dual-class stock was in fact a manifestation of the agency problem between large (family) shareholders and small (non-family) shareholders, rather than of the agency problem between owners and managers, as the dual-class literature had typically been framed.

To bridge these different streams of research and bring them to bear on our research question, we concluded it was important to distinguish among three elements in the definition of a family business: ownership, control (in excess of ownership), and management. We used this approach to test our research question empirically using all non-financial firms that were in the Fortune 500 at any point between 1994 and 2000 as our sample. Consistent with several of the research results described above, we found that family ownership per se on average created value, and that family control in excess of ownership (achieved through mechanisms such as dual-class stock) destroyed value, although not enough to offset the positive effect of ownership. On the other hand, the performance effects of family management were large enough to overpower those of the other two elements, but their sign was entirely contingent on the CEO or chairman's generation: relative to non-family businesses, founder-led firms outperformed, while descendant-led firms underperformed. These results were robust to the inclusion of multiple control variables (including age, sales growth, and a number of financial characteristics and corporate governance measures), and remained significant after controlling for the endogeneity of family ownership, control, and management.

As a result of these effects, we found that the answer to the question 'are family businesses more or less valuable than non-family businesses?' was contingent on the definition of family firm used. We considered nine alternative definitions, as we did when we examined the question of family business prevalence. [Table 9.1](#), which is based on the results in our 2006 article and cited earlier in this chapter, also shows the multivariate  $q$  results under the nine definitions. When family businesses were broadly defined, as in Anderson and Reeb (2003), to include all those firms in which the founder or a member of his or her family by either blood or marriage was an officer, director, or blockholder, we found that family businesses traded at a significant premium relative to non-family businesses. However, results changed significantly when we restricted our definition by requiring minimum thresholds for family control (e.g., 20 per cent of all shares or votes), that the family be the largest shareholder or voteholder, that there be family officers or directors, or that the firm be in second or later generation. Using our most restrictive definition, which incorporated all of those conditions, we found that family businesses traded at a significant discount relative to non-family businesses. As suggested above, the 'deal-breaker' – the factor that turned the premium into a discount – was whether or not founder-controlled firms were included in the sample.

Miller et al. (2007) replicated some of the analyses and findings of Villalonga and Amit (2006) on a broader



cross-section of US firms (the Fortune 1000 and a random sample of 100 smaller public firms). Specifically, they found confirmation for Villalonga and Amit's finding that the estimated value of family businesses relative to non-family businesses is contingent on the definition used, and particularly on whether or not founder-controlled firms are included among family businesses.

While Miller et al. (2007) suggest that Villalonga and Amit (2006) did not distinguish between founder-led and descendant-led firms, we note that the distinction between founder-led and descendant-led firms is one of the main findings of Villalonga and Amit (2006), which is also articulated in the abstract, and is substantiated by five tables which depict rigorous empirical analyses. Miller et al. also highlight the concept of 'lone founder firms' as distinct from first-generation family firms (the difference being that in first-generation family firms there can be more than one member of the founder's generation; there are no subsequent generation members in either case). They find that, in their sample, only lone founder firms significantly outperform non-family firms. (Other) first-generation family firms also outperform, but not significantly so. It is unclear whether the lack of statistical significance of the latter result is driven by economic reasons or by the scarcity of first-generation firms once the 'lone founder' firms are excluded from the group. Therefore the reasons that make founder-led firms outperform and later-generation firms under-perform also remain unclear: are they the benefits that founders bring with them (e.g., vision, dedication, entrepreneurial culture); the costs that later generations bring with them (e.g., regression to the mean in management skills, maturity of the business); or the higher coordination costs of having multiple family members involved in the business? Perhaps further research can help us untangle these different possibilities.

One caveat to the founder-led firm results in all of these studies is that the samples in these studies are always relatively large, publicly listed firms. Thus, there is an inherent survivor bias in that, for young, high-growth firms to have reached their large, public status while still under founder management or control, these firms must really be the very top performers among their peers. Given the natural attrition in family firms as they age and Pérez-González's (2006) and Villalonga and Amit's (2006) finding that family firms performance declines after the founder's generation, however, one could argue that the survivor bias might even be greater in second- and later generation firms, which would imply that the existing estimates of a founder premium are in fact conservative.

## **Drivers of Variation in the Cumulative Evidence About Family Firm Performance**

After Anderson and Reeb (2003) and Villalonga and Amit (2006), the literature about family business has burgeoned, including a large number of studies that have provided further evidence about the performance of family businesses. [Table 9.2](#) reports the main results of these studies.

### **Table 9.2 Summary of studies of family business performance**

Authors	Year	Journal	Measure			Main Results							
			Family ownership	Family control	Family management Succession	Effect of family ownership	Effect of family control	Effect of family management	Effect of succession	Performance measure	Country sample	Time period	
Adam et al.	2009	<i>Journal of Empirical Finance</i>			Founder CEO					Positive	Tobin's q, ROA	USA	1992–1999
Allouche et al.	2008	<i>Family Business Review</i>		Dummies for strong control (family ownership and management) or weak control (family ownership or management)			Positive			Positive	ROA, ROE, ROIC	Japan	1998 and 2003
Ali et al.	2007	<i>Journal of Accounting Economics</i>	Dummy for family firm				Positive				ROA	USA	1998–2002
Anderson et al.	2003	<i>Journal of Financial Economics</i>	Dummy for family firm		CEO-family	CEO-descendent	Positive (negative to the DV in the paper)		Negative (positive to the DV in the paper)	Negative (positive to the DV in the paper)	Corporate yield spread	USA	1993–1998
Anderson and Reeb	2003	<i>Journal of Finance</i>	Dummy for family firm and family ownership stake		Family CEO		Inverted U-shape			Positive	Tobin's q and ROA	USA	1992–1999
Anderson and Reeb	2003	<i>Journal of Law and Economics</i>	Dummy for family firm	Percentage of family ownership stake	Founder CEO	Descendent-CEO	Positive		Positive (marginal)	Negative (marginal)	Excess value, economic value added	USA	1993–1999
Anderson and Reeb	2004	<i>Administrative Science Quarterly</i>	Dummy for family firm	Board representation			Negative	Negative (moderator)			Tobin's q	USA	1992–1999
Barontini and Caprio	2006	<i>European Financial Management</i>	Dummy for family firm	Dummy for family firm	Family CEO	Next generation CEO or non-executive		Positive	Positive	Depends on whether descendent CEO or non-executive director	Tobin's q and ROA	Continental West Europe	1999–2001
Basu et al.	2009	<i>Journal of Banking and Finance</i>	Family ownership stake				U-shape				Acquiring firm's CAR	USA	1993–2000
Ben-Amar and Andre	2006	<i>Journal of Business, Finance and Accounting</i>		Ultimate voting block held by a family	Family CEO			Positive	Positive		Acquiring firm's value: Abnormal return	Canada	1998–2002
Benedson et al.	2007	<i>The Quarterly Journal of Economics</i>			Family CEO				Negative	Negative	ROA	Denmark	1994–2002
Berrone et al.	2010	<i>Administrative Science Quarterly</i>	Dummy for family firm		Family CEO		Positive		Insignificant		Environmental performance	USA	1998–2002
Bloom and Van Reenen	2007	<i>Quarterly Journal of Economics</i>	Dummy for family firm			CEO is chosen by primogeniture (the eldest male child)	Positive however insignificant			Negative	Management practice (z-score)	US, France, Germany and UK	2004–2005
Boubaker	2007	<i>Multinational Finance Journal</i>		Excess voting right				Negative			Tobin's q	France	2000
Bozec and Laurin	2008	<i>Journal of Business, Finance and Accounting</i>	Dummy for family firm	Cash-flow right/voting right			Positive	Negative			Tobin's q, ROI, ROA, ROE	Canada	1999

Chang et al.	2010	<i>British Journal of Management</i>		Board control/ voting right > 20%/voting right – cash flow right		Negative		Innovation announcement-period abnormal return	Taiwan	1999–2005
Chen et al.	2010	<i>Journal of Financial Economics</i>	Dummy for family firm			Positive		ROA	USA	1996–2000
Ding and Pukthuanthong-Le	2009	<i>Journal of Enterprising Culture</i>	Family ownership stake	Percentage of non-family directors		Negative	Positive	IPO pricing	Taiwan	1997–2004
Driffield et al.	2007	<i>Economics of Transition</i>		Excess voting right		Positive		Tobin's q	Indonesia, Korea, Malaysia and Thailand	1994–1998
Dyer and Whetten	2006	<i>Entrepreneurship: Theory and Practice</i>	Dummy for family firm			Mixed		Corporate social performance	USA	1991–2000
Gomez-Mejia et al.	2007	<i>Administrative Science Quarterly</i>	Dummy for family firm			Positive/depends		Socioemotional wealth/risk	Spain	1944–1998
Guedri and Hollandts	2008	<i>Corporate Governance: An International Review</i>		Two family directors + 5% ownership		Insignificant		ROI and Tobin's q	France	2000–2006
Heaney and Holmen	2008	<i>Applied Financial Economics</i>		Excess voting right		Negative		Cost of under-diversification	Sweden	1988–1991
Hillier and McColgan	2009	<i>Journal of Business, Finance and Accounting</i>			Family CEO		Negative (family CEO turnover has positive effect)	Cumulative Abnormal Return	UK	1992–1998
Holmen and Nivorozhkin	2007	<i>Applied Financial Economics</i>	Dummy for family firm	Dual class of share		Positive (partial)	Negative	Tobin's q and ROA	Sweden	1985–2001
Jara-Bertin et al.	2008	<i>Corporate Governance</i>		Contestability of control among shareholders			Negative	Tobin's q	Europe	1996–2000
Jiraporn and DaDalt	2009	<i>Applied Economics Letters</i>	Dummy for family firm			Positive		Abnormal accruals (earning management)	USA	1992–1999
Klein et al.	2005	<i>Corporate Governance: An International Review</i>	Dummy for family firm			Mixed		Tobin's q	Canada	2002
Lee	2004	<i>SAM Advanced Management Journal</i>	Dummy for family firm			Mixed		Profitability, operation, and financial	USA	2002
Lin and Hu	2009	<i>Corporate Governance: An International Review</i>			Family CEO		Depends	Tobin's q, ROA	Taiwan	1991–2000
Luo and Chung	2005	<i>Administrative Science Quarterly</i>			Percentage of family members in inner circle		Positive	ROA	Taiwan	1973–1996
Martikainen et al.	2009	<i>The Quarterly Review of Economics and Finance</i>	Dummy for family firm					Productivity	USA	1992–1999

Miller et al.	2007	<i>AoM Proceedings</i>	Dummy for family firm		Next generation ownership and CEO	Negative		Positive	Negative	Growth and shareholder return	USA	1996–2000	
Miller et al.	2007	<i>Journal of Corporate Finance</i>	Dummy for family firm			Depend (lone founder FF or not)				Tobin's <i>q</i>	USA	1996–2000	
Nelson	2003	<i>Strategic Management Journal</i>		Founder CEO				Positive		IPO premium	USA	1991	
Oswald et al.	2009	<i>Journal of Small Business Management</i>	% of family-owner employees	Percentage of family-owner top management team members		Negative		Negative		Sales growth, revenue, capital structure	USA	1997	
Perez-Gonzalez	2006	<i>The American Economic Review</i>			Next generation CEO				Negative	ROA, Tobin's <i>q</i>	USA	1994	
Perrini et al.	2008	<i>Corporate Governance</i>	Dummy for family ownership			Insignificant				Tobin's <i>q</i>	Italy	2000–2003	
Sciascia and Mazzola	2008	<i>Family Business review</i>	Percentage of family ownership	Percentage of family members among top managers		Insignificant		Negative quadratic		Survey measure of performance relative to competitors, based on 7 accounting items	Italy	2000	
Simon et al.	2008	<i>Entrepreneurship: Theory and Practice</i>	Dummy for family ownership							Value added	France		
Sraer and Thesmar	2007	<i>Journal of the European Economic Association</i>	Dummy for family firm	Family CEO	Heir CEO	Positive		Positive	Positive	ROA, ROE, Tobin's <i>q</i> and dividend to profit	France	1994–2000	
Villalonga and Amit	2006	<i>Journal of Financial Economics</i>	Dummy for family firm and family ownership stake	Control-enhancing mechanism and family excess vote-holding	Family CEO	Next generation chairman or CEO	Positive	Negative	Depends	Negative (for the second generation)	Tobin's <i>q</i>	USA	1994–2000
Villalonga and Amit	2009	<i>The Review of Financial Studies</i>		Family excess vote-holding	Founder CEO		Mixed	Positive		Tobin's <i>q</i>	USA	1994–2000	
Viviani et al.	2008	<i>Journal of Private Equity</i>	Dummy for family firm			Insignificant				Buy-and-hold abnormal return	Italy	1995–2005	
Wang	2006	<i>Journal of Accounting Research</i>	Dummy for family firm and family ownership stake		Family CEO	Descendent CEO	Negative	Negative		Negative	Earning quality (abnormal accruals)	USA	1994–2002
Zhao and Millet-Reyes	2007	<i>Journal of International Financial Management and Accounting</i>	Family ownership stake				Negative			Content of accounting information	France	1994–1998	

The cumulative evidence suggests that family businesses significantly outperform their non-family-owned peers. However, as [Table 9.2](#) suggests, there is significant variation in results across studies. Four factors appear to drive this variation: family business definition, geographic location, industry affiliation, and intertemporal variation in economic conditions.

- 1 *Family business definition.* As Villalonga and Amit (2006) show, the answer to the question of whether family firms are better or worse performers than non-family firms is contingent on how family businesses are defined, and in particular how family ownership, control, and management enter the definition. Decomposing family firm definition in this way allows them to find a positive performance effect of family ownership per se, a negative effect of family control in excess of ownership, and an effect of family management that is entirely contingent on the family's generation (positive for founders, negative for subsequent generations). [Table 9.2](#) shows whether and how different empirical studies of family business performance have incorporated these three elements into their operational definition of a family firm, and what the resulting impact has been on their findings

about family firm performance.

- 2 *Geographic location.* As [Table 9.2](#) shows, there is also geographical variation in these results. For instance, Barontini and Caprio (2006) followed our family ownership-control-management decomposition and found that, in Western Europe, the effects of family ownership and control are exactly as we found for the United States, as is the existence of a significant founder-CEO premium. However, they found no significant descendant-CEO discount. Maury (2006) found similar results for Europe, including a premium for family management, although they did not distinguish among generations. In Amit et al. (2010) we found a negative association between family firm's relative performance and the degree of institutional development of different regions within China.
- 3 *Industry affiliation.* Several studies have shown that there is significant variation across industries in the prevalence of family businesses (Anderson and Reeb, 2003; Villalonga and Amit, 2006; Miller et al., 2007). In Villalonga and Amit (2010), where we examine what drives family control of firms and industries, we further find that the value of family control – the value premium or discount of family firms relative to non-family firms – also varies significantly across industries.
- 4 *Intertemporal variation in economic conditions.* Villalonga (2010) examines whether and how the value of family control changes with economic conditions. Using a sample of US and European companies, she finds that the difference in value between family and non-family businesses changed significantly from before to after the 2007–2008 financial and economic crisis. The differences are attributable to differences in structural characteristics between the two groups of firms, rather than to differences in their response to the crisis. Consistent with the view that families 'manage for the long run' and strive to maintain control of their firms, family firms have more conservative financial and strategic management policies, which benefits both family and non-family shareholders during economic downturns. These findings suggest that the value of family control is countercyclical, making family businesses more stable and longer-lived than non-family businesses even if after the founder's generation their performance levels are lower. They also help understand the puzzle of how family firms can survive as publicly traded entities beyond the founder stage, given the evidence about later-generation firms' underperform, and the finding that families as controlling shareholders often appropriate private benefits of control.

## Challenges of Measuring Performance in Family Businesses

It is important to note that these and all other empirical studies of the performance of family firms rely exclusively on financial performance measures – i.e., accounting profitability or market value. Demsetz and Villalonga (2001) compare the adequacy of accounting profits and market value (or Tobin's  $q$ , which is the ratio of market to book value of assets) in the context of the relationship between corporate ownership and firm performance. As they note, there are two important respects in which these two measures differ. One is in time perspective, backward-looking for accounting profits and forward-looking for market-based performance measures. Whether one wants to look at an estimate of what management has accomplished or at an estimate of what management will accomplish is clearly a choice; thus, one cannot say that one approach is better than the other; they are just different. The second difference is in who is actually measuring performance. For the accounting profit rate, this is the accountant constrained by standards set by his profession. For market measures, this is primarily the community of investors constrained by their acumen, optimism, or pessimism. Again, it is not clear which of the two is preferable or more subject to behavioral biases.

Moreover, business families often think of performance in a broader sense, including both pecuniary and non-pecuniary benefits. For instance, Gómez-Mejía et al. (2007) use a catch-all construct *socio-emotional wealth* (SEW) as a label for all non-economical, non-financial performance objectives of family-controlled firms. Pre-

sumably these objectives may include such factors as the protection of the family brand, its heritage, its legacy, its reputation, and its political influence. Berrone et al. (2010) establish that family-controlled, publicly traded firms protect their SEW by having superior environmental performance relative to non-family firms. Gómez-Mejía et al. (2007) show that families are willing to take on more business risk in order to protect their SEW (see Berrone et al., 2012, for a review of their work on SEW). McKenny et al. (2012) propose the use of content analysis as a way to incorporate families' multidimensional performance objectives into empirical studies of private family firm performance. Likewise, Basco and Pérez-Rodríguez (2009) use a survey measure of family success that captures 13 different items, including time to be with the family, family loyalty and support, and the generation of possibilities for the children among others.

While we fully appreciate and acknowledge the complexity and multidimensionality of family business success, we argue that defining performance in such a broad way is a dangerous proposition, since almost any decision can be justified on those grounds. Moreover, non-pecuniary benefits are difficult, when not impossible, to measure. Nevertheless, it is important to keep these aspects in mind to understand decision-making at family businesses.

To complicate matters further, it is often unclear for whom the family seeks to optimize performance, however defined: for the family itself, for all of the firm's shareholders, for all stakeholders, or for society at large? The longstanding debate about whether firm owners and managers should protect the interests of shareholders or a broader base of stakeholders takes on special relevance in the family business context, since of all shareholder types, founding families are arguably the most likely to take some of those other constituencies into account.

Even if we as researchers agree to focus on financial performance, its measurement raises special challenges in the context of family business. To begin with, most family firms are private. As a result, their financial accounts are rarely available to researchers. Even when they are, they are not subject to the same disclosure and auditing requirements as those of publicly listed firms and as a result are typically less reliable. Moreover, family business owners might want to prioritize asset growth over profitability and to do so in such a manner that minimizes taxes and increases value transferred across generations – for example, by reducing profits in a senior generation business to an entity owned by a subsequent generation – which begs the question of how to measure the value of a family's broad holdings and not of any particular asset. The unavailability of a stock price that is readily available to measure private firms' market value forces researchers to estimate it. Another implication of these firms' private status is that the value estimates from standard valuation methods like DCF and multiples need to be adjusted to account for the illiquidity or lack of marketability of the stock.

In addition, the value of a share depends on who holds it. For instance, a share is worth more in the hands of a controlling shareholder than in the hands of a minority shareholder, because control is valuable in itself. Hence a controlling interest in a firm is worth more on a per share basis than a minority interest. Another way to say this is that the value of a share depends on how many additional shares the holder – and other shareholders – own and control. For example, a share representing 1 per cent of a company is worth a lot more to a shareholder who has 49.5 per cent than to one who has 48 per cent (or 51 per cent, for that matter).

A share can also be worth more for a founding family than for a non-founding family, due to emotional considerations – which are only partly subsumed in the value of control. It is also worth more to a diversified shareholder than to an undiversified shareholder (as business families often are), because the latter are exposed to idiosyncratic risk in addition to systematic risk. In summary, the value of the family firm is unlikely to be allocated among different shareholders in proportion to their ownership stakes, and the net effect on value of each shareholder's characteristics needs to be estimated. Villalonga (2009) describes how standard valuation methods can be adjusted to address the different performance measurement challenges mentioned above, and proposes a general valuation framework that can be used to value family businesses.

Finally, the measurement of performance in family business studies is also challenging because of the econo-



metric issues involved. There is a voluminous literature in financial economics, starting with Demsetz and Lehn (1985), that has looked into the relation between corporate ownership and performance. Challenging the Berle and Means' (1932) thesis that ownership concentration should lead to increased corporate performance and supporting Demsetz's (1983) theoretical arguments to the contrary, Demsetz and Lehn (1985) found that, after correcting for the endogeneity of corporate ownership, ownership structure has no significant effect on performance. Morck et al. (1988) argued that Demsetz and Lehn's failure to find such an effect was due to their use of a linear regression model, and they found a significant effect of managerial ownership on performance when using a non-linear (piece-wise) specification, as did McConnell and Servaes (1990) using a quadratic specification. Many subsequent studies of the ownership-performance relation have found significant effects on performance using similar quadratic specifications. However, Demsetz and Villalonga (2001) analyze the ownership-performance literature in detail and find that those studies failed to control for endogeneity as Demsetz and Lehn (1985) had in their seminal study; they further show, empirically, that after such endogeneity is controlled for, even the nonlinear effects go away.

This finding has important implications for the literature on family firm performance, which can be framed as a specific case of the broader corporate ownership-performance literature where the identity of those owners are the firm's founding families. Some studies of family business performance, like Sciascia and Mazzola (2008), have used quadratic specifications and found significant effects of family ownership, control, or management on firm performance. As Demsetz and Villalonga show, however, the use of non-linear specifications for measuring ownership effects on performance adds little to our understanding of these effects unless researchers can further show that those effects are robust to endogeneity and sample selection biases. Unfortunately, few of the studies shown in [Table 9.2](#) do this. However, Villalonga and Amit (2006) do devote careful attention to controlling for the endogeneity of family ownership, control, and management, and find that, unlike the broader results about ownership and performance, their findings about family business performance are robust to such controls.

## Conclusion

This chapter has reviewed what we know and do not know about the performance of family businesses. The cumulative evidence at this point suggests that there is wide variation in performance within family business, which is why, when comparing them to non-family businesses, different studies have found apparently conflicting results. Our review has highlighted several drivers of variation in the cumulative evidence about family firm performance: family business definition, geographic location, industry affiliation, and intertemporal variation in economic conditions. Several results appear to hold quite universally, namely, the superior performance of founder-led firms over later-generation family firms and non-family firms, and the negative impact of performance of family's control over their economic ownership. The impact of second- and later generation family management on performance, however, has been found to be dependent on the time and geographic context.

This chapter has also discussed the theoretical and empirical challenges associated with measuring family business performance. We have centered our review on quantitative, objective financial measures, which apply to both family and non-family businesses. However, because of the interplay between family dynamics, family brand, family legacy, and business issues in family businesses, especially in multi-generational and multi-branch family businesses, we believe that there is room for researchers to develop new, integrated, and holistic performance measures which capture, in an objective and quantifiable manner, both the behavioral issues as well as the economic/financial issues that affect the performance of family businesses. While it is a challenging task, since the context and issues of every family are very different, we believe that the development of such performance measures would enable families and researchers alike to benchmark family business performance in a manner that captures the family dynamics issues that are so important in the context of family business.

## Note

1 Even recently assembled databases that include corporate ownership information, like Amadeus or Osiris, only provide a crude and often inaccurate approximation of who ultimately controls a given company. A few countries such as the Nordic countries in Europe do collect sufficient taxpayer information to establish whether or not any firm in those countries – public or private – is family-owned. Still, a significant amount of work is required from researchers to arrive at a reasonable classification to distinguish family businesses from non-family businesses (see, e.g., Bennedsen et al., 2007; Sjögren et al., 2011).

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- family business
- firms
- shareholders
- relatives (family)
- ownership
- ownership and control
- families

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