Inside the Family Firm

Research Question

- What is the impact of having a family versus external CEO on firm performance?
- Theoretically speaking, the impact of family CEOs can be ambiguous.
    - Family CEOs could perform better.
        - They are exposed to higher nonmonetary reward.
        - They have better relationship with key stakeholders and are able to obtain firm-specific knowledge and higher levels of trust.
    - Family CEOs underperform.
        - There are tensions between family and business objectives.
        - They are selected from a small pool of candidates.
- Are there any industries that hurt more from having family CEO?

Data

- Freshly constructed data set for limited liability firms in Denmark between 1994-2002
- Firm performance is measured by
    - Operating return on asset: Earnings before interest and taxes (EBIT) to the book value of assets
        - Its advanage is that it is unaffected by firms' capital structure decision.
        - The number is also adjusted to industry(four-digit) specific.
    - Other measures for robustness check: Return on asset, Return on capital employed, Total assets, Likelihood of bankruptcy and liquidation

Empirical Strategy

- Since family CEO is endogenous, this paper uses gender of the first child of a departing CEO as IV.
    - Gender of the firstborn child is correlated with decision to having family CEO.
        - Family transition is more frequent when the first-born child is male (39 percent)
    - Gender of the firstborn child is unlikely to affect firm performace.
        - Gender is likely to be random because ...
            - Most of the first childbirths were in 1980s, before techniques to identify the gender of children were widespread.
            - No evidence for "missing women" in Denmark.
        - Check validity by comparing firm and family characteristics between firms with male firstborn VS female firstborn
            - firm characteristics: profitability, age, size
            - family characteristics: number of children, spouses, divorce rate
    - Advantage of this IV over having a male child as IV is that it is more random.
- Dependent variable is the change in 3-year-average ROA before and after the transition.

Results

- Family CEOs reduce firm profitability by at least 4 percentage points.

- Family CEOs are costlier in fast-growing industries. In industries where family succession concentration is high, there is no statistically significant gap in performance.

Robustness Checks

- It is possible the timing of succession is non-random. i.e. Former CEO hand over the company when profit is going down.
  - Use death of CEO as alternative instrument.
  - However, death is not the preferred instrument because it can affect firms and families through other channels.
- The difference in performance may come from measurement error in performance of firms with family CEOs.
  - e.g. family CEOs tend to divert cash flow to the family fund, resulting in smaller reported profit.
- IV method only estimates the average effect of family CEOs on the set of firms that respond to the instrument, i.e. only firms with male successor, but not applicable to firms that select a CEO from other family members.
  - Compare the quality of firstborn male CEOs VS family CEOs VS unrelated CEOs
  - Unrelated CEOs are more skilled than firstborn male CEOs, but family CEOs are not different from family CEOs.

Reference

Bennedsen, M., Meisner, K., Francisco, N., Rez-Gonza´lez, P. É., Gonza´lez, G., & Wolfenzon, D. (2007). Inside the Family Firm: the Role of Families in Succession and Performance.
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