Family firm research – A review [*]

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Abstract

This article reviews family firm studies in the finance and accounting literature, primarily those conducted using data from the United States and China. Family owners have unique features such as concentrated ownership, long investment horizon, and reputation concerns. Given the distinguishing features of family ownership and control, family firms face unique agency conflicts. We discuss the agency problems in family firms and review the findings of recent family firm studies. We call for more research to understand the unique family effects and encourage more research on Chinese family firms.

Part I of the article discusses the fundaments of family firms: the prevalence of and the agency conflicts within family firms. Part II summarizes the findings of recent U.S. family firm studies. It reviews the evidence on the family firm premium (how, which, and when family firms are associated with a valuation premium), the manifestation of the agency conflict between majority and minority shareholders in family firms, earnings quality and corporate disclosure, and the determinants of family ownership and control. Part III discusses the prevalence and characteristics of Chinese family firms and reviews the findings of related studies. The article concludes with some suggestions for future research.

Key words: Family firms, ownership structure, agency problems, controlling owners, minority owners
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Part I. Fundamentals of family firms

1. The prevalence and uniqueness of family firms

A family firm is a firm in which the founders or descendants of the founding family continue to hold positions in the top management, serve on the board, or are blockholders.[1] As an important organizational form, family firms account for 44% of large firms in Western Europe (Faccio and Lang 2002), over two-thirds of firms in East Asian countries (Claessens et al. 2000), and 33% and 46% of the Standard and Poor (S&P) 500 and 1500 index companies, respectively (e.g., Anderson and Reeb 2003; Chen, Chen, and Cheng 2008). Family firms also operate in a broad range of industries. Among the S&P 1500 companies, family firms account for two-thirds of firms in the high-tech industries (e.g., pharmaceutical products, electronic equipment), wholesale and retail, transportation, and printing and publishing. Even among capital-intensive industries (steel works, machinery, automobile, petroleum, and natural gas), regulated industries (banking and insurance companies), and the business supplies industry, which are the least likely to be family controlled, over 30% are family firms (Chen, Chen, and Cheng 2008).

Compared to nonfamily owners and other blockholders, family owners have some

[1] This definition is widely used in family firm studies conducted using U.S. data (e.g., Anderson and Reeb 2003; Villalonga and Amit 2006; Ali et al. 2007). Using this commonly used definition is important for several reasons. First, it facilitates comparison of the results across studies. Second, it is less subject to researchers' discretion in the classification of family. Third, to the extent that the family owners in some of the classified family firms have weak influence in the firms, it would introduce a conservative bias to the results. A more restrictive definition (e.g., requiring multiple generations to be involved in the firm) makes the results less generalizable. One should keep in mind the tradeoff between using a more restrictive versus a more lenient definition and the most appropriate definition is likely to be country specific. See Villalonga and Amit (2010, pp. 866-867) for a further discussion of family firm definition.

unique characteristics. First, founding families hold poorly diversified portfolios due to their concentrated ownership in family firms. Within family firms in the S&P 1500 index, founding families hold 17% of the shares in their firms on average. Moreover, 69.5% of founding families hold more than 5% ownership in their firms, and 24.7% of them hold more than 25%. Due to their high ownership and low diversification, founding families enjoy the benefit of good corporate decisions and at the same time bear the consequences of bad corporate decisions, and thus family owners have strong incentives to increase firm value.

Second, family owners have longer investment horizons than other shareholders. They generally regard their ownership as an asset to pass on to future generations. For example, when William Lauder, grandson of the founder of Estee Lauder, stepped down, he made the following comment: “I am committed to the company. It’s the vast majority of my personal wealth and my family’s personal wealth – and we fully expect to be actively involved with this company going forward” (The *Wall Street Journal* Nov 9, 2007, ‘Lauder Scion Way Out, P&G Executive Way In’). Such long-term commitment implies that family owners care about the long-term value of the firm, rather than the short-term gain.

Third, family members are actively involved in the management of their firms, either as top executives or as directors. On average, founding families hold the CEO position in 62% of family firms within the S&P 1500. Moreover, 98.4% of founding families appoint at least one family member to their boards, 54.6% of them appoint two family members, and 22.9%

of them appoint three or more family members. Founding families' substantial involvement in their firms' management teams ensures that their preferences are reflected.

Not all family firms are the same. The most important classification within family firms is the identity of the CEO. Depending on the identity of the CEO, family firms can be classified as (1) founder CEO firms, (2) descendant CEO firms, and (3) other family firms, usually referred to as professional, or hired, CEO family firms.[2] Founder CEOs are usually charismatic and visionary leaders with great management skills. They also tend to have a strong will and an undisputed and powerful status in their firms. In contrast, descendants are often criticized for being spoiled brats and less skilled. This classification is critical to the understanding of the agency problems in family firms, as discussed in the next section.

The unique characteristics of family owners and family firms motivate many of the interesting topics in family firm research. This is the key reason for the emerging line of research on family firms in the past decade. This review focuses primarily on family firm studies published in leading accounting and finance journals.

2. Agency problems in family firms

The foundation on which most family firm studies are built is the agency conflict framework. The unique characteristics of family firms affect the nature and extent of agency

[2] The name of the third category does not imply that founder CEOs or descendant CEOs are not professional; nor does it imply that founder CEOs and descendant CEOs are not hired.

problems, which also vary with the type of family firm. There are two main agency problems in public companies: the conflict between managers and shareholders and the conflict between majority and minority shareholders. Below we discuss the two types of agency problems that apply to family firms relative to non-family firms.

2.1 The conflict between managers and shareholders

In the classic owner-manager conflict, as described in Jensen and Meckling (1976), the separation of managers from shareholders may lead to managers not acting in the best interest of the shareholders. We refer to this type of agency problem as the Type I agency problem. However, the extent of Type I agency problems is reduced in family firms for several reasons.

First, as discussed above, family owners tend to hold concentrated and under-diversified ownership of their firms. As a result, family owners are likely to have strong incentives to monitor managers, reducing the free rider problem that is prevalent among other firms. [The benefit of monitoring does not outweigh the cost of monitoring for small atomistic shareholders, and as such, they tend to free ride on others' monitoring (Shleifer and Vishny 1986).] Given the under-diversification of their portfolios, family owners bear the idiosyncratic risk associated with the firm and are thus concerned with the cash flows it generates. Founding families' long tenure and substantial involvement in management imply that they are knowledgeable about their firms' activities, which in turn enables them to provide better monitoring of managers.

Second, founding families tend to have much longer investment horizons than other shareholders. Their long-term presence in the firm implies that family owners are willing to invest in long-term projects. Thus, family owners can help to mitigate the managerial myopia problem (Stein 1988, 1989). Because the founding family views the firm as an asset to pass on to future generations rather than as wealth to be consumed during their lifetimes (James 1999), firm survival is an important concern. Hence, family owners have even stronger incentives to monitor than other large and long-term shareholders.

Third, founding families are concerned with the family's reputation. They are more willing to build and protect their reputation, which is likely to have long-term effects on third parties, and hence the family business. Founding families are likely to deal with other stakeholders, such as banks, suppliers, and customs, for longer periods. This also gives family firms stronger incentives to execute effective monitoring than other large shareholders.

Lastly, in founder and descendant CEO firms, the owner and the CEO are one and thus there is no incentive misalignment and no Type I agency problem. Recall that Type I agency problems arise when the owners' and the managers' interest are not aligned.

In summary, compared to non-family firms, family firms face less severe Type I agency problems arising from the separation of ownership and control.

2.2 The conflict between majority and minority shareholders

The second type of agency problem is the conflict between majority and minority shareholders. As they hold substantial ownership and have controlling positions in the firm, majority shareholders may seek private benefits at the expense of minority shareholders (Shleifer and Vishny 1986). We refer to this type of agency problem as the Type II agency problem. Family firms have a large shareholder (the family owner) and a fringe of small shareholders. As such, family firms are subject to severe agency problems between family owners and minority shareholders.

The primary source for this type of agency problem is founding families' concentrated equity holdings and substantial control in their firms, which gives them the opportunity to extract private benefits at the expense of other shareholders. Private benefits may be both the monetary and the non-monetary benefits from running a firm. For example, when discussing the CEO turnover decision in Ford Corporation, *Business Week* (August 21-28, 2006) comments that "[given his poor performance,] CEO Bill Ford would have been fired by now by most boards if his name were Smith." Families are also capable of expropriating wealth from the firm through excessive compensation, related-party transactions, or special dividends (Burkart et al. 2003).

Another important source of potential family entrenchment is the difference between their control rights and cash-flow rights. Villalonga and Amit (2009) show that founding families are the primary type of blockholders to hold control rights in excess of their cash-flow rights in U.S. corporations. Based on 3,006 U.S firm-year observations from 515 firms between 1994 and 2000, they find that founding families on average own 15.3% of the shares (cash flow rights), but control 18.8% of the votes in those firms. The wedge is primarily due to the issuance of dual-class shares. For example, Google's co-founders, Sergey Brin and Larry Page, own super-voting class B shares, which have 10 votes per share. Other high-tech firms, such as Facebook, have similar dual-class structures. Founding owners also obtain disproportionally higher control via disproportionate board representation, voting agreements, and pyramid ownership structures. Such a wedge provides them with the incentive and ability to pursue private benefits. While families may take actions that maximize their personal benefit, many of these actions can lead to suboptimal corporate decisions that reduce the value to minority shareholders.

In summary, compared to non-family firms, family firms face more severe agency conflicts between majority and minority shareholders.

2.3 Tension within the family

Compared to Type I and Type II agency problems, the intricate relationships within families are even more unique and interesting. Family feuds can exist between founders and descendants and, more commonly, between descendants, due to differences in their interest and vision.

One example of a family feud between founders and descendants is the Redstone family. Sumner Redstone, an American media magnate who is the controlling shareholder and chairman of the National Amusement theater chain, shoved a succession of ‘heirs apparent’ out of the door. His daughter, Shari Redstone, was set to assume his role. However, in 2007, when Sumner Redstone was 84 years old, they feuded publicly over issues of corporate governance and the future of the cinema chain.[3]

Another example of a family feud is the discord in the Georgina Rinehart family. Georgina Rinehart’s farther, Lang Hancock, established the Hope Margaret Hancock Trust before his death, nominating Georgina Rinehart as the trustee and his four grandchildren as beneficiaries.[4] However, in 2011, Rinehart’s three older children brought legal action in the Supreme Court of New South Wales, Australia, to have Georgina Rinehart removed as sole trustee due to a commercial dispute.[5,6]

The tensions within the family have not yet been fully investigated. A case study, rather than a large sample study, is better suited for such investigations.

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[3] Jenn Abelson, “Redstone says he relies on his instinct,” *The Boston Globe*, September 19, 2007.
[4] Hall, Louise and Pennells, Steve. “Rinehart’s children win first round,” *The Sydney Morning Herald*, October 8, 2011.
[5] Hall, Louise. “Family feud details to stay secret for at least five more weeks,” *The Sydney Morning Herald*, February 2, 2012.
6 Amy Dale. “Days away from being billionaires, Gina Rinehart locks trust for half a century,” *The Daily Telegraph*, March 13, 2012.

Part II. What have we learned from recent family firm research?

3. Valuation premium

One fundamental finding in the family firm research is that family firms on average perform better than non-family firms. Anderson and Reeb (2003) document in their seminal work that family firms have higher returns on assets and Tobin's Q than non-family firms. This finding is confirmed by later studies (e.g., Villalonga and Amit 2006; Maury 2006; Andres 2008) and suggests that family ownership is an effective organizational structure. The questions then are how, which, and when family firms create value.

First, how do family firms create more value? Anderson and Reeb (2003) attribute the family firm valuation premium to the reduction in agency problems associated with managerial opportunism, or Type I agency problems. They and others find that family firms perform better when family members serve as the CEO (Anderson and Reeb 2003; Maury 2006; Andres 2008), suggesting that active family involvement and control can readily align managers' interest with that of the family. Anderson, Mansi, and Reeb (2003) further investigate the issue from the angle of the cost of debt. They find that founding family ownership is associated with lower cost of debt. This result is consistent with the notion that agency conflicts between equity and debt claimants are also lower in family firms, and/or the notion that family owners' reputations and long horizons are beneficial and can reduce the transaction costs of dealing with other stakeholders.

Another reason family firms perform better is that they are less likely to destroy value through mergers and acquisitions. Caprio et al. (2011) investigate 777 large European companies during the 1998-2008 period and show that family firms are less likely to make acquisitions and that their acquisitions are of higher quality. Focusing a sample of Janpanese firms, Shim and Okamuro’s (2011) analysis of a Japanese also find that family firms are less likely to conduct mergers than non-family firms.

Second, who creates value in family firms? Some studies show that founders create value and descendants destroy value (Villalonga and Amit 2010). Founder CEOs can bring innovative and value-enhancing expertise to the firm (Morck, Shleifer, and Vishny 1988). Villalonga and Amit (2006) find that family ownership creates value only when the founder serves as the CEO of the family firm or as the Chairman with a hired CEO. Fahlenbrach (2009) documents that 11% of the largest U.S. public firms are headed by founder CEOs, and these firms invest more in research and development, have higher capital expenditures, make more focused mergers and acquisitions, and earn a benchmark-adjusted annual return of 8.3% during the 1993-2002 period.

Pérez-González (2006) observes that compared with professional CEO family firms, descendant CEO firms underperform in terms of operating profitability and market-to-book ratio. Bertrand et al. (2008) also document lower firm performance associated with greater involvement by founders’ sons, especially after the founders pass away. Cucculelli and Micucci (2008) find similar results based on a sample of Italian family firms.

The underperformance by descendant CEO firms is largely attributed to their lack of managerial skills. These descendants are chosen as the CEO not because they are the best candidates for the position, but because they are the descendants of the founders. To use Warren Buffett's analogy, picking executives from the small pool of family heirs would be like "choosing the 2020 Olympic team by picking the eldest sons of the gold-medal winners of the 2000 Olympics."[7]

The third question is, when do family firms create value? As founding families can use their power to accrue private benefits at the expense of minority shareholders, the checks and balances on founding families' power can help to reduce Type II agency problems. Anderson and Reeb (2004) find that family firms perform best when the power of the founding family is balanced by the presence of independent directors. Family firms, on average, only out-perform when there is no dual-class structure or over representation on their boards (Villalonga and Amit 2009). Anderson, Duru, and Reeb (2009) further document that publicly traded firms exploit opacity to extract private benefits at the expense of minority shareholders. They find that founder- and descendant-controlled firms outperform other firms only when the information environment is of high quality. Evidence from Western European countries shows that family control is associated with higher firm value mainly in economies with better shareholder protection and country-level legal infrastructure, which reduce Type

[7] David C. Johnston, "Dozens of Rich Americans Join in Fight to Retain the Estate Tax," *New York Times*, February 14, 2001.

II agency problems (Maury 2006).

4. Evidence of Type II agency problems in family firms

Because founding families enjoy substantial control as a result of their concentrated equity holdings, family firms have more severe Type II agency problems than non-family firms, as discussed above. The valuation premium enjoyed by family firms is consistent with the notion that the benefit from the reduction in Type I agency problems outweighs the cost from the more severe Type II agency problems. Several recent studies provide some direct evidence that family firms are subject to more severe Type II agency problems.

Villalonga and Amit (2006) find that the use of control-enhancing mechanisms, e.g. dual-class structures, pyramids, and voting agreements, reduce family founder CEO firms' valuation premium. Similarly, Anderson and Reeb (2004) find that in firms with continued founding-family ownership and relatively few independent directors, firm performance is significantly worse than in non-family firms. These results indicate that the Type II agency problem is particularly severe for family firms with control-enhancing mechanisms and less effective monitoring of family members.

More direct evidence comes from the investigation of specific corporate decisions. Anderson, Duru, and Reeb (2012) examine the information content of short sales in family and non-family firms and find that founding families are involved in more aggressive informed trading than other large shareholders. Moreover, Chen, Cheng, and Dai (2013) observe that both founder and descendant CEO family firms are less likely to let the CEO go after their firms perform poorly. CEO turnover–performance sensitivity, a measure of agency problems in the CEO turnover setting, is lower for family CEO firms than for professional CEO family firms. When the family ownership is higher, family CEO turnover is even less sensitive to firm performance. Their evidence suggests that the Type II agency problem manifests itself in the CEO turnover setting and the problem increases with family ownership and control. They also find that CEO turnover–performance sensitivity is higher in professional CEO family firms than in non-family firms. Overall, they find that family ownership/control is a double-edged sword: it leads to Type II agency problems when family ownership is combined with family control and reduces Type I agency problems when family ownership is separated from control. The effects increase with the level of family ownership.

5. Accounting phenomenon

The unique ownership structure of family firms has important implications for their financial reporting and disclosure practices. In terms of earnings quality, Wang (2006) argues that the incentives for founding families to expropriate wealth from other shareholders leads to lower earnings quality (the entrenchment effect), while greater monitoring by founding families implies higher earnings quality (the alignment effect). He shows that founding family ownership is associated with lower abnormal accruals, greater earnings informativeness, and less persistence of transitory loss components in earnings, suggesting higher earnings quality in family firms. Ali et al. (2007) further suggest that family firms can address agency problems through direct monitoring rather than rewarding managers based on accounting performance, such that managers are less likely to manipulate the earnings. Consistent with this notion, they find that family firms report higher earnings quality, including lower discretionary accruals, higher predictability of cash flows, and higher earnings response coefficients, thus corroborating the results reported by Wang (2006).

In addition to the quality of mandatory reporting, studies also examine the voluntary disclosure policies adopted by family firms. Ali et al. (2007) argue that maintaining the opacity of corporate governance practices may facilitate family members' entrenchment. They find that family firms make fewer disclosures about their corporate governance practices. Chen, Chen, and Cheng (2008) further argue that family owners have a longer investment horizon than other shareholders; hence, they do not enjoy the benefit of timely disclosure but bear the cost of disclosure due to their high ownership. Consistent with their prediction, they find that managers are less likely to provide earnings forecasts and hold fewer conference calls. However, withholding bad news is costly for the firm and shareholders because of the potential litigation costs. Given founding families' concentrated and under-diversified equity holdings, they are more concerned with the litigation and reputation costs. Consistent with their conjecture, Chen, Chen, and Cheng (2008) document that family firms provide more earnings warnings than non-family firms.

Because tax avoidance activities are complex and opaque, they can be used to hide losses or rent extraction by the majority shareholders (Desai and Dharmapala 2006). Building on this line of logic, Chen, Chen, Cheng, and Shevlin (2010) find that family firms are less tax aggressive than their non-family counterparts. They suggest that family owners are willing to forgo tax benefits to avoid the non-tax cost of a potential price discount. As family firms are characterized by a unique agency conflict between dominant and small shareholders, family owners enjoy greater share price discounts if they are more tax aggressive, which can be viewed as masking rent extraction activities. In addition, due to their much larger equity ownership and their much longer investment horizons, family owners are more concerned with the potential penalties imposed by the IRS and the reputation damage from being involved in a tax-related lawsuit.

Overall, the extant literature finds that family firms generally have better financial reporting quality, are more likely to issue earnings warnings, and are less tax aggressive.

6. Determinants of family ownership

Because the decision to control a firm is endogenous, a crucial issue in the study of family firms is what determines the ownership and control structure of family firms. The current evidence suggests that both micro and macro factors shape the family ownership concentration and the wedge between family control and ownership.

The majority of firms start as family firms. Whether the founders or later generations decide to maintain family ownership and control depends on the costs and benefits of doing so, and on the structure of the founding family. Bennedsen et al. (2007) find that the gender of the departing family CEO's eldest child strongly influences the decision to appoint a family member or an outsider as the CEO. The frequency of appointing a family CEO is 29 percent when the eldest child is female, but 39 percent when the eldest child is male, suggesting that founding families are more likely to maintain control when they have sons. Bertrand et al. (2008) document a positive association between family size and family ownership and control. Such evidence is corroborated by anecdotal evidence and reflects the general culture of letting the son take over the family business. In addition, Bertrand and Schoar (2006) suggest that the family values in a culture play an important role in shaping how businesses are organized and their efficiency.

At the macro level, family ownership is found to be related to the institutional and market environment. Burkart et al. (2003) show that family ownership is negatively correlated with the level of investor protection in a country: when investor protection is weak, family ownership is high. In their international study, Franks et al. (2012) observe that family firms gradually evolve into widely held companies in countries with developed financial markets and strong investor protection. In contrast, family control is prevalent in countries with less developed financial markets and weak investor protection.

Studies of how family business groups are structured come to a similar conclusion: pyramids are formed to allow a family to achieve control of the business group using only a small cash flow stake (e.g., Claessens et al. 2000; Almeida and Wolfenzon 2006). In an empirical study of family-controlled business groups in 45 countries, Masulis et al. (2011) document that family groups, especially those structured as pyramids, are more prevalent in markets with low capital availability, suggesting that group structures emerge not only to maintain control, but also to alleviate financing constraints.

Additional evidence from King and Peng (2009) shows that family ownership concentration varies with industry characteristics. Founding-family firms in cyclical, capital intensive, and growth businesses have significantly shorter control spans than other family firms.

In sum, whether the founding family can maintain control and high ownership depends on the level of investor protection at the country level, the characteristics of the business at the industry level, the capital needs at the firm level, and the structure of the founding family at the family level.

Part III. Family firms and family firm research in China

The above discussion focuses primarily on studies using U.S. data and some international studies. In this section, we briefly discuss the characteristics of Chinese family firms and review the literature on these firms in the area of accounting and finance.

7. Family firms in China

Compared to family firms listed on the U.S. exchanges, Chinese family firms are still at an early stage. Since China started to transform from a planned economy to a socialist market economy in 1992, family firms have grown rapidly in both prevalence and size. To obtain a basic understanding of the characteristics of Chinese family firms, we examine those listed on the Shenzhen and Shanghai Stock Exchanges in the 2003-2012 period.[8] Because Chinese listed firms have been required to disclose their control structure and ultimate ownership since 2003, our sample period starts in that year. Disclosure of the control structure makes it possible to identify whether a listed firm is controlled by the government, an institution, or a family. We use the same definition as discussed in Section 1 to classify family firms.[9]

7.1 The distribution of Chinese family firms

Table 1 presents the distribution of Chinese family firms. Several features emerge. First, the majority of Chinese family firms are founded by mainland Chinese citizens. A small

[8] We only include A-share family firms here. There are only about eight B-share family firms and most of them also issue A-shares.

[9] This definition is different from others in that it extends the definition of "family" to include not only founding families but also individual investors or families that are not (related to) the founder. See Villalonga and Amit (2010, p. 867).

proportion of them are controlled by citizens from Hong Kong, Macao, Taiwan, or overseas (Table 1, Panel A).[10]

[Insert Table 1 here]

Second, the number of family firms was small compared to the number of state-owned firms in the early years. This is consistent with the notion that the Chinese stock market was established to help state-owned firms to obtain capital and to reform, and that it was difficult for family firms to obtain IPO approval from the regulators in the early years. From 1992 to 2002, an average of 17% of IPOs are family firms (not tabulated). The number of family firm IPOs gradually increased after May 2004 when the small- and medium-sized enterprise board was established, and increased dramatically after October 2009 when the growth enterprise board was founded. As shown in Panel A of Table 1, the number of Chinese family listed firms increased from 170 in 2003 to 1,373 in 2012. Given the strict IPO criteria for family firms in the early years, most of them went public by taking over a listed firm and then relying on the seasoned equity offerings to obtain capital.

Third, although family firms operate in a wide range of industries, most are in industries that have enjoyed growth in recent years, such as petro-chemical, electronic, iron/steel mills, machinery, pharmaceutical, telecommunication, and real estate (see Panel B of Table 1).

Fourth, most Chinese family firms are clustered in the more developed provinces, as

[10] Note that based on the data available from the database, it is impossible to completely separate firms into single-family firms, multi-family firms (where founders are not related to each other), and multi-generation family firms (held by multiple members of the same family). It is also difficult to identify firms controlled by the founder or the descendent. Such data need to be hand-collected.

shown in Panel C of Table 1. Over 60% of Chinese family firms are located in coastal provinces and regions: Guangdong (250), Zhejiang (188), Jiangsu (169), Beijing (94), Shandong (88), and Shanghai (79). Very few family firms are located in interior provinces such as Qinghai (5), Ningxia (6), Yunnan (6), and Guizhou (6). The heterogeneous marketization across provinces provides a good opportunity to study how the institutional and market environment affects Chinese family firms. Are family firms the main driver of growth in the region, or does the infrastructure in the region help the growth of family firms? Does the social and commercial culture affect the formation and evolvement of family firms?

7.2 Ownership structure, corporate governance and financial characteristics

Table 2 presents some basic descriptive statistics for Chinese family firms. Several points are noteworthy.

First, Panel A of Table 2 shows that Chinese family firms have average assets of US$393.3 million (median of US$206.7 million) and an average market value of US$594.2 million (median of US$324.3 million).[11] Chen, Chen, and Cheng (2008) report that during the 1996-2000 period, S&P 1500 firms had average assets of US$1,152.9 million (median of US$982.4 million) and an average market value of US$6,266 million (median of US$1,150 million). In terms of profitability, the average return on assets of Chinese family firms is 3.36% (median of 4.39%), while the average return on assets in the S&P 1500 family firms is

[11] We use the official 2012 exchange rate of US$1=RMB6.39.

5% (median of 6%). With respect to growth opportunities, the average market to book ratio is 4.32 (median of 3.19) for Chinese family firms and 4.31 (median of 2.64) for S&P 1500 family firms. While not exactly comparable, Chinese family firms are smaller, less profitable, and have higher growth than their U.S. counterparts.

[Insert Table 2 here]

Second, the ownership concentration is very high in Chinese family firms. Panel B of Table 2 shows that the average ownership among family owners is 34.59% (median of 31.36%), which is about twice the proportion among S&P 1500 family owners (Chen, Chen, and Cheng 2008). Considering the pyramid structure, Chinese founding families own an average of 28.32% (median of 24.74%) of the cash flow rights and 36.44% (median of 33.33%) of the voting right in their firms, while Villalonga and Amit (2009) report that the founding families of Fortune 500 companies own an average of 15.3% of the shares and 18.8% of the votes in their firms.[12] Chinese family firms present a much higher level of ownership concentration and higher degrees of separation between cash flow rights and voting rights.[13]

Third, as Panel B of Table 2 shows, only 30% of CEOs in family firms serve as the

[12] If a family owns 60% of firm A, which then owns 40% of firm B, which is listed on one of the exchanges, then the family's direct ownership in firm B is considered to be 40% and the cash flow right in firm B is considered to be 24% (= 60% × 40%). These terms are commonly used in the literature on pyramid structures. The direct ownership and cash flow right are naturally the same in cases without a pyramid structure. Cash flow rights differ from voting rights when some shares have different voting and cash flow rights.

[13] The ownership, cash flow rights, and voting rights reported here are those of the controlling family owners. Because family ownership consists of controlling ownership and other family ownership, the amounts of family ownership, family cash flow rights, and family voting rights would be even greater than those reported here.

Chairman of the board in Chinese family firms.[14] A typical board has nine members, three of whom are independent. This fraction is much lower than it is in U.S. family firms. Chen, Chen, and Cheng (2008) report that 62% of the directors on the boards of S&P 1500 family firms are independent. Furthermore, a mere 21% of Chinese family firms have implemented equity-based incentive plans for their CEOs.

Fourth, compared to non-family firms, family firms are smaller, have lower leverage, better performance, and higher growth potential. Family firms are also more likely to have CEOs serving as the chairman of the board, have smaller boards, and are more likely to use incentive-based compensation for their CEOs.

These statistics suggest that Chinese family firms are smaller and younger than U.S. firms. At this stage, the ownership, control, and management are mainly centralized in the hands of the founders and their immediate family members. The family members of Chinese founding families are likely to have much greater influence on their firms' corporate governance and financial decisions than family members of U.S. family firms. Hence, the "family effect" is likely to be much more prominent in Chinese than in U.S. family firms.

8. Chinese family firm research

To date, there are very few studies of Chinese family firms. A search on Google

[14] Recently, the founder of the Alibaba Group, Ma Yun, resigned from the CEO position while still serving as the chairman of the board.

Scholar for studies published in the international accounting and financial journals[15] revealed only three papers that focus exclusively on Chinese family firms and 27 papers that investigate the differences between state-owned enterprises (SOEs) and non-SOE firms, most of which are family firms. Research on family firms is also limited in the Chinese academic journals. This lack of research is puzzling given how prevalent Chinese family firms are and how different SOEs and family firms are in terms of their ownership structures and managers' incentives. Below we discuss some important findings based on these studies and offer some suggestions for future research.

8.1 Corporate valuation and firm performance

Similar to those in the U.S. market, Chinese family firms outperform non-family firms in the Chinese markets. Allen, Qian, and Qian (2005) find that the private sector in China grows much faster than other sectors and is the primary driver behind most of the country's economic growth. Similarly, Chen, Firth, Xin, and Xu (2008) document that when control of a firm is passed to a private entity, the firm's performance improves.

Given that family firms perform better than non-family firms, one natural question is

[15] The academic accounting journals include *The Accounting Review*, *Journal of Accounting & Economics*, *Journal of Accounting Research*, *Review of Accounting Studies*, *Contemporary Accounting Research*, *Journal of Accounting & Public Policy*, *Journal of Accounting, Auditing and Finance*, and *Journal of Business Finance and Accounting*. The academic financial journals include *Journal of Finance*, *Journal of Financial Economics*, *Review of Financial Studies*, *Journal of Financial and Quantitative Analysis*, *Journal of Banking and Finance*, *Journal of Corporate Finance* and *Financial Management*. Because the A*sia-Pacific Journal of Accounting & Economics* and *China Journal of Accounting Research* mainly focus on the Asia-Pacific and Chinese markets, we also include these two journals in the Google search.

why family firms are more efficient in an economy where the legal and market environments are far from perfect. This question is particularly interesting because SOEs enjoy most of the financing and political advantages. One possible reason is the better incentive mechanism in Chinese family firms, although the evidence is scarce at the moment. Some studies argue that Chinese family firms establish incentive systems for profit maximization. Firth et al. (2006) find that firms owned by private blockholders link the CEO's pay to stock and accounting performance. Chen, Liang, and Zhu (2012) find that family firms use relative performance evaluation for top executives' compensation. Cheng, Li, and Tong (2008) find that turnovers in family firms are negatively associated with core earnings. More research can be done to examine whether there are other drivers of family firms' outperformance.

8.2 Type II agency problems in Chinese family firms

Some recent studies examine Type II agency problem in Chinese family firms. Compared to SOEs, family firms appear to be less likely to use related party transactions for "tunneling" (Peng et al. 2011; Ying and Wang 2013). However, Chinese family owners have a significant wedge between voting rights and cash flow rights, which can motivate the founding family to tunnel corporate resources at the expenses of minority shareholders.

To date, most of the studies examining Type II agency problems in family firms are published in Chinese journals. The general conclusions are as follows: (1) founding families use group companies, internal capital markets, and pyramid structures to tunnel resources from their listed companies (Shao and Liu 2007; Liu et al. 2008; Jiang et al. 2010); (2) the investment efficiency is low in family firms where the founding family has excessive control rights and low cash flow rights (Han et al. 2007; Chen, Li, and Lei 2012); and (3) family firms have a lower cash dividend payout ratio and a lower propensity to pay dividends than non-family firms (Wei et al. 2011). Extant studies also examine the consequences of such agency problems and they find that (1) family firms with a higher degree of separation between control and cash flow rights are associated with lower firm value (Su and Zhu 2003; Zhang et al. 2004; Ye et al. 2007; Yang and Su 2009); (2) family firms with a multiple-layer corporate structure and a higher degree of separation between control and cash flow rights are associated with higher bid-ask spreads (Lei et al. 2013); and (3) auditors charge higher fees for family firms that have a higher degree of separation between control and cash flow rights, a disproportionally high number of family directors on the board, and a family member as the CEO (Hu et al. 2012; Liu and Subramaniam 2013).

8.3 Financial reporting quality

In contrast to their counterparts in the U.S. market, Chinese family firms exhibit lower financial reporting quality than non-family firms. Huang and Zhang (2011) and Wang Yung (2011) document that Chinese family firms have higher abnormal accruals, lower earnings predictability, and lower conservatism. They attribute their findings to the weak investor protection in China and Type II agency problems in family firms. In contrast, Xu and Lv (2011) indicate that when family members are appointed as top executives, financial reporting quality is higher.

Some studies examine how market intermediaries affect the extent of earnings management. Chen, Chen, Lobo, and Wang (2011) find that the effects of audit quality on earnings management and the cost of equity capital are more pronounced for non-SOEs (primarily family firms) than for SOEs. Chen, Shi, and Xu (2013) also find a significantly negative relationship between underwriter reputation and pre-IPO earnings management for non-SOE issuers. This negative relationship is due either to reputable underwriters' selection process or to their active monitoring and intervention in the pre-IPO stage.

8.4 Financing decision and the governance structure of family firms

The Chinese capital markets are characterized by (1) an uneven level of marketization across provinces; (2) weak investor protection and legal infrastructure; (3) strong governmental intervention; (4) uneven resource allocation between SOEs and non-SOEs; and (5) a lack of trust among market participants. These characteristics affect the formation and development of Chinese family firms.

In terms of financing, Chinese family firms achieve tremendous growth despite the limited support from state-owned banks. This finding provides a unique setting to test how firms in a country with poorly developed financial institutions fund their growth opportunities. Ge and Qiu (2007) find that compared to SOEs, non-SOEs use more trade credit for financing. Lu et al. (2012) find that non-SOEs have a greater propensity to hold significant ownership in commercial banks, and such ownership helps them to reduce interest expenses and obtain short-term loans when the government's monetary policy is tight.

The uneven resource allocation system in China also motivates Chinese family firms to establish political connections. Chen, Li, Su, and Sun (2011) find that in regions where the local economy is less market-oriented or where the government has more discretion in allocating economic resources, non-SOEs are more likely to establish political connections. Wu et al. (2012) also show that family firms with politically connected managers enjoy tax benefits and outperform those without such managers.

In terms of governance structure, Li et al. (2008) find that the discrimination of state-owned banks against non-SOEs encourages the founding families to build a pyramid ownership structure to reduce their financial constraints. Chen, Jin, and Liu (2011) find that the layers of pyramids and the wedge between voting and cash flow rights decrease with the quality of government services. The early stage of Chinese family firms and the poor legal infrastructure in China provide great opportunities for future research to examine how the governance structure of family firms evolves.

8.5 The allocation and effects of family authority

Although it is widely accepted that the involvement of family members in the family business is the most unique feature of family firms (Chua et al. 1999), little research has been done in this area. Data availability is the biggest challenge. Nevertheless, as suggested above, Chinese family firms are still young and family members still hold large ownerships and are involved in their firms' boards and management teams. These unique attributes provide great opportunities to explore how the founding family controls the firm, how the allocation of family authority affects operating efficiency and corporate governance, and how the conflicts among family members affect firm operations. Field research and case studies might be more appropriate for such research than a large sample study.

Some recent studies have started to explore these issues. He, Li, and Chen (2010), He, Li, Lian, and Zhang (2010), and He and Lian (2009) examine the composition of family firms in terms of core family members, close relatives, and distant relatives. Lian et al. (2011) find that ownership of the firm is more likely to be held by core family members, but only capable family members or professional CEOs are assigned to the management team. He and Lian (2009) and He, Li, Lian, and Zhang (2010) show that conflicts among family members are induced when a family member's ownership and management position do not match, and such conflicts reduce firm value. He, Li, and Chen (2010) find that the conflict among core family members is the lowest, and the majority of conflicts are between distant relatives or between close and distant relatives. These studies collectively provide some initial evidence on how the characteristics of the founding family affect the ownership, corporate governance, and valuation of a family business.

9. Concluding remarks and opportunities for future research

Family firms are very common around the world. Founding family ownership exhibits unique characteristics. Family owners have concentrated and under-diversified ownership. They also have longer investment horizons than other shareholders, including other blockholders. Family owners are usually actively involved in firms' management, serving as directors and/or managers. These characteristics imply that family firms have less severe agency conflicts between owners and managers, but more severe agency conflicts between family owners and non-family minority shareholders. Family firms are also affected by the tensions or conflicts among family members. These agency conflicts affect the operations, financial reporting, and valuation of family firms.

The low-hanging fruits have been picked in the last decade, although opportunities for further research still bound. First, it would be of particular interest to explore the potentially "disguised" family effects. Some phenomena documented in prior research might be due to family firm effects. For example, many studies have examined the effect of a dual class structure. However, as most dual class shares are owned by founding family members, is it possible to separate the dual class effect from the family firm effect?

Second, the founding family is treated as a black box and is assumed to be homogeneous. As indicated by Bertrand and Schoar (2006), “much can be learned by investigating the ‘family’ part of ‘family firms’.” Understanding the nexus within the family and its influence on firm operations would move the literature forward. Such studies would also be useful for family owners in improving the governance, succession planning, and operations of their firms.

Third, more data are needed to provide additional insights. An interesting example along this line is a study by Bunkanwanicha et al. (2013). They compile a unique and comprehensive dataset of family firms in Thailand and find that family firms’ stock prices increase when one family member marries a member from a prominent business or political family.

Fourth, case studies are quite limited in the family firm literature and might provide the most value-added in future research. While such studies are more difficult to publish due to the lack of generalizability, the collective evidence from such studies can provide much needed insights into the operation of family firms and provide guidance for family owners who are concerned with governance, operation, and succession.

Finally, international studies are helpful in understanding how different cultural norms and legal infrastructures affect the evolvement of family firms. Morck, Yavuz, and Yeung (2011), Masulis et al. (2011), and Franks et al. (2012) are some recent examples. Of course, both authors and readers must be mindful of the heterogeneity across countries, which imposes challenges for research design and might affect the interpretation of results.

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Table 1

The distribution of Chinese family firms

Panel A. Chinese family firms clustered by year

Year	Chinese listed firms	Family listed firms	Type of founding family owner: Chinese citizen	Type of founding family owner: Hong Kong/Macao/ Taiwan/overseas citizen
2003	1,249	170	157	13
2004	1,349	329	312	17
2005	1,346	349	331	18
2006	1,406	430	405	25
2007	1,520	514	483	31
2008	1,597	574	537	37
2009	1,684	661	618	43
2010	2,031	961	902	59
2011	2,303	1,243	1,171	72
2012	2,460	1,373	1,284	89

Panel B. Chinese family firms clustered by industry

Industry	N	Industry	N	Industry	N
Agriculture	24	Iron/steel mills	107	Trade	55
Mining	19	Machinery	309	Banking/insurance	7
Brewage/food	51	Pharmaceutical	95	Real estate	66
Textile/apparel	52	Other manufacturing	23	Tourism	39
Wood/furniture	12	Utilities	8	Media	12
Paper/printing	31	Construction	26	Conglomerate	18
Petro-chemical	155	Transportation	10		
Electronic	108	Telecommunication	146	**Total**	1,373

Panel C. Chinese family firms clustered by province

Province	N	Province	N	Province	N
Anhui	36	Heilongjiang	16	Shanxi	7
Beijing	94	Hubei	41	Shanxi	9
Chongqing	16	Hunan	35	Shanghai	79
Fujian	59	Jilin	18	Sichuan	55
Gansu	11	Jiangsu	169	Tianjin	9
Guangdong	250	Jiangxi	12	Xizang	7
Guangxi	15	Liaoning	36	Xinjiang	12
Guizhou	6	Neimeng	14	Yunnan	6
Hainan	17	Ningxia	6	Zhejiang	188
Hebei	23	Qinghai	5		
Henan	34	Shandong	88	**Total**	1,373

Note: The sample consists of firms issuing A-shares and listed on the Shanghai and Shenzhen Exchanges in the 2003-2012 period. Industry classification is based on the industry classification guideline issued by the China Security Regulation Committee.

Table 2

Descriptive statistics for Chinese family firms

Panel A. Financial characteristics

	Family firms		Non-family firms		p-value for the differences	
	Mean	Median	Mean	Median	Mean	Median
Assets ($million)	393.32	206.67	2,349.77	397.65	0.000	0.000
Sales ($million)	244.11	110.39	992.83	230.44	0.000	0.000
Market value ($million)	594.24	324.28	2,637.48	560.12	0.000	0.000
Debt ratio	0.49	0.43	0.53	0.53	0.000	0.000
ROA (%)	3.36	4.39	2.76	2.92	0.000	0.000
ROE (%)	5.81	7.49	4.93	6.64	0.003	0.000
Market to book ratio	4.32	3.19	3.61	2.57	0.974	0.000
Tobin's q	1.94	1.43	1.54	1.22	0.000	0.000

Panel B. Ownership structure and corporate governance

	Family firms		Non-family firms		p-value for the difference	
	Mean	Median	Mean	Median	Mean	Median
Family direct ownership (%)	34.59	31.36				
Family cash flow rights (%)	28.32	24.74				
Family voting rights (%)	36.44	33.33				
CEO duality	0.30	0.00	0.10	0.00	0.000	0.000
Board size	8.64	9.00	9.68	9.00	0.000	0.000
Board independence	0.37	0.33	0.35	0.33	0.000	0.000
Incentive plan	0.21	0.00	0.07	0.00	0.000	0.000

Note: The sample consists of firms issuing A-shares and listed on the Shanghai and Shenzhen Exchanges in the 2003-2012 period. *Assets* is the total assets at the year-end. *Sales* is the total sales during year t. *Market value* is the market value of common stock plus the market value of debt, where the value of non-tradable stock and non-tradable debt is measured by book value. *Debt ratio* is the ratio of debt to total assets at the year-end. *ROA* is the ratio of net income to total assets in year t. *ROE* is the ratio of net income to equity in year t. *Market to book ratio* is the ratio of the market value of the tradable stock to the book value of the stock. *Tobin's q* is the ratio of the market value to the book value of total assets. *Direct ownership* is the ownership held by the controlling shareholder. *Cash flow rights* is the product of the ownership stakes along the control chain. If an ultimate owner controls a firm via multiple control chains, cash flow rights is the sum of the products of the ownership stakes along each chain. *Voting rights* is the weakest link in the control chain. If an ultimate owner controls a firm via multiple control chains, voting rights is the sum of voting rights along each chain. *CEO duality* is a dummy variable that equals 1 if the CEO also serves as the chairman, and 0 otherwise. *Board size* is the number of directors serving on the board. *Board independence* is the ratio of independent directors to the total number of directors. *Incentive plan* is a dummy variable that equals 1 if the firm has a stock incentive plan in place for the top executives. The variables are winsorized at the 1% and 99% levels.