2012 | Faculteit Bedrijfseconomische Wetenschappen

DOCTORAATSPROEFSCHRIFT

Essays on Executive Compensation and Dividend Policy in Privately-held Family Firms

Proefschrift voorgelegd tot het behalen van de graad van doctor in de toegepaste economische wetenschappen te verdedigen door:

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D/2012/2451/48

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KNOWLEDGE IN ACTION

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Acknowledgements

There are many people to whom I am indebted for helping and supporting me during my doctoral studies. First and foremost, I would like to thank my supervisor, Wim Voordeckers, who provided me with the skills and knowledge necessary to work in academia. Wim, I am very grateful for your guidance and advice throughout these four years. Thank you for your seemingly never-ending stream of critical comments and suggestions, which, in the end, definitely improved my work. I am also indebted to my co-promotor, Nadine Lybaert, whose advice and support during my doctoral studies has been invaluable. Nadine, you taught me how to face the difficulties and hard times that lie in the road ahead, and you have always put your trust in me. Your academic support and personal cheering are greatly appreciated. Thank you. Furthermore, my special thanks goes to Tensie Steijvers, member of my doctoral committee. Tensie, I am grateful that you were willing to share your expertise with me.

At the final stage of my PhD term, I was privileged to have Lorraine Uhlaner, Marc Deloof and Vincent Molly as members of my jury. Thank you for taking the time to read this manuscript. Your suggestions have helped me greatly in improving and finalizing this dissertation.

I had some hesitations before starting my PhD. There was one thing that held me back: the fear of loneliness. When, during my last year in college, someone asked me whether I was interested in doing a PhD, the typical horror picture came in my mind: me, alone in a room, with my computer and not having any social contact at all. Luckily, I had the privilege to become part of the KIZOK-family, a group of young (and not-so-young), enthusiastic researchers. Complemented with some researchers of other disciplines, our lunch-breaks became unforgettable. On top of that, we always found a reason to celebrate: a publication, a birthday, a promotion, a

wedding, ... or no reason at all – then we simply called it 'happy hour'. After these four years, I can honestly say that I have never, not even for a second, experienced the solitude that is so-often associated with PhD studies. Special thanks go to four ladies who welcomed me so warmly on the very first day I arrived at campus. Karolien, Lien, Annelies and Julie: we've laughed, danced, cried and among other things, cursed together. Thank you girls, for being persistent and encouraging, for believing in me, for the many precious memories along the way, and for the ones that are yet to come.

Besides all these wonderful people at Hasselt University, I would also like to thank my other close friends: thank you guys and girls, for taking so much interest in what I have been doing these last few years.

Of course, no acknowledgements would be complete without giving thanks to my dearest family: parents, sister, grandparents, and in-laws. Thank you for constantly showing your genuine interest in my PhD, or as my mom so affectionately refers to it, 'The Book'. Mom and dad, thank you so much for all the opportunities you provide me in life. I couldn't have asked for better parents.

... and last but certainly not least I would like to thank my husband. Hans, you have been a true and great supporter of me and everything I do. As from the day we met, you encouraged me to take on new challenges and you taught me that there is no need to cancel all the fun when you are working hard. Thanks to your "it is not or/or, it is and/and" motto, we were able to make some long, unforgettable and inspiring journeys. You have never been judgmental of me and you have always instilled confidence in me. Thank you for that.

Anneleen Michiels

November 15, 2012

Samenvatting

Familiebedrijven zijn -door de eeuwen heen- de meest dominante vorm van ondernemerschap in de hele wereld. Ook in deze 21ste eeuw blijkt dat het belang van familiebedrijven moeilijk kan worden overschat. In België, bijvoorbeeld, zijn meer dan driekwart van de ondernemingen in familiehanden en samen realiseren ze een derde van de totale toegevoegde waarde in ons land. Ondanks het aanzienlijke economische gewicht van familiebedrijven in onze maatschappij, werden familiebedrijven grotendeels genegeerd door wetenschappelijke onderzoekers tot de jaren '90.

Vandaag de dag wordt de grote impact van familiebedrijven echter ook erkend in de academische wereld, wat blijkt uit het ontstaan van vele academische tijdschriften, boeken en conferenties. De topics van deze onderzoeken komen vaak voort uit praktijkproblemen waar eigenaars en managers van familiebedrijven mee kampen. Een van de meest belangrijke en gevoelige problemen, is het verloningsbeleid. Familiale eigenaars en bedrijfsleiders stellen zich vele vragen, zoals bijvoorbeeld: *Hoeveel zou onze CEO moeten verdienen? Kan ik best alle zonen/dochters hetzelfde loon geven, of moet ik hier onderscheid in maken? Gaan we een dividend uitkeren?* Immers, het totale inkomen van familieleden die zowel werknemer als aandeelhouder van het familiebedrijf zijn, bestaat niet alleen uit een loon (vergoeding voor arbeid), maar bevat vaak ook dividenden (vergoeding voor hun kapitaal). De stijgende interesse in verlonings- en dividendbeleid, zowel vanuit de praktijk als vanuit de media en regulerende organen, vraagt daarom ook naar extra onderzoek in dit domein.

Empirisch wetenschappelijk onderzoek over verlonings- en dividendbeleid in familiebedrijven is nagenoeg onbestaande (zowel in België als internationaal). De voornaamste reden hiervoor is dat de data voor dit soort onderzoeken niet voor handen is, omwille van het ontbreken van een publicatieplicht (voor niet-beursgenoteerde ondernemingen) en de taboesfeer

die nog steeds rond deze thema's hangt. Nochtans beschikken familiebedrijven over enkele specifieke karakteristieken die het verlonings- en dividendbeleid kunnen beïnvloeden. De familiecultuur en –geschiedenis, verschillende verwachtingen en rivaliteit tussen het nageslacht en tussen familiale en niet-familiale managers kunnen extra moeilijkheden opleggen, bovenop de gangbare uitdagingen van een effectief en efficiënt verlonings- en dividendbeleid. Dit maakt bijvoorbeeld de bepaling van de hoogte en samenstelling van het verloningspakket van familiale en niet-familiale managers een complexe en gevoelige beslissing.

Het doel van dit doctoraatsonderzoek is daarom om meer inzicht te krijgen in hoe familiebedrijven omgaan met hun verlonings- en dividendpolitiek. De algemene onderzoeksdoelstelling van dit doctoraat wordt als volgt geformuleerd: *Wat bepaalt het verlonings- en dividendbeleid van private familiebedrijven en hoe kunnen ze deze mechanismen gebruiken om de verschillende agency conflicten waarmee ze te maken krijgen, te managen?*

De eerste twee empirische studies van dit doctoraatsproefschrift (hoofdstuk 2 en 3), zijn gebaseerd op een vragenlijst die we in 2012 verstuurd hebben naar een steekproef van Vlaamse niet-beursgenoteerde ondernemingen met 10-500 werknemers. In hoofdstuk 2 werd onderzocht in welke mate het verloningsbeleid van Vlaamse (familie)bedrijven geformaliseerd is. Familiebedrijven werden vroeger vaak geassocieerd met 'minder formele', 'minder professionele' processen. In tegenstelling tot andere studies tonen de resultaten van dit onderzoek aan dat, tijdens het afgelopen decennium, familiebedrijven de formalisering van hun processen hebben versneld. Immers, de familie- en niet-familiebedrijven in onze steekproef vertonen een zeer gelijkaardige mate van formalisering van hun verloningsbeleid. Wanneer we kijken naar de relatie met bedrijfsprestaties, blijkt het belangrijker te zijn om een *effectief* verloningssysteem te hebben (een systeem dat de doelstellingen van de onderneming ondersteunt), dan een *formeel* systeem te hebben. Vervolgens wordt er verder ingegaan op het verloningspakket van de CEO. Het loonpakket bestaat voornamelijk uit een vast basisloon (78%), 10% uit

een prestatiegerelateerde bonus en 12% uit niet-monetaire vergoedingen (zoals, bijvoorbeeld, een bedrijfswagen of verzekering). De lonen van CEO's van familiebedrijven verschillen niet significant van die van niet-familiebedrijven. Maar binnen de groep van familiebedrijven zijn er wel verschillen tussen familiale en niet-familiale CEOs.

Hoofdstuk 3 bouwt verder op deze bevindingen en geeft de resultaten van een multivariaat onderzoek weer, wat nagaat welke de belangrijkste determinanten zijn van de hoogte van het loon van een CEO in een Vlaams familiebedrijf. Uit de resultaten blijkt dat bedrijfsgrootte en bedrijfsprestaties de belangrijkste factoren zijn die de hoogte van het loon beïnvloeden. De macht van de CEO in het bedrijf blijkt geen significant effect te hebben op zijn/haar loon.

In hoofdstuk 4 wordt de relatie tussen bedrijfsprestaties en de hoogte van het loon van de CEO verder uitgespit. Hiervoor wordt beroep gedaan op een database van meer dan 500 private familiebedrijven uit de USA. De belangrijkste bevinding van deze studie, is dat bedrijfsprestaties weldegelijk positief gerelateerd zijn aan het loon van een CEO (hogere/lagere bedrijfsprestaties leiden tot een hoger/lager loon). Dit resultaat bevestigt onze eerdere bevindingen uit hoofdstuk 3 (die gebaseerd waren op Vlaamse familiebedrijven), maar het is in tegenspraak met traditionele agency theorie die claimt dat familiebedrijven geen nood hebben aan prestatiegebonden verloning. Verder wordt onderzocht of er factoren zijn die deze relatie tussen bedrijfsprestaties en verloning kunnen beïnvloeden. De resultaten geven aan dat deze relatie vooral significant is wanneer er weinig aandeelhouders zijn, en in het controlerend-eigenaarschap stadium. Ten slotte blijkt dat de relatie tussen prestaties en verloning sterker is voor niet-familiale CEOs dan voor familiale CEOs.

Aangezien de voorgaande hoofdstukken vooral focusen op de CEO, en een onderneming in de praktijk meestal geleid wordt door een *team* van managers, bespreekt hoofdstuk 5 verloning van de leden van het top management team. Meer specifiek wordt er in deze conceptuele studie dieper

ingegaan op de gevolgen van ongelijke verloning binnen dat topmanagement team. Er wordt geargumenteerd dat, of ongelijke verloning tussen de topmanagers zal leiden tot betere dan wel slechtere bedrijfsresultaten, afhangt van het feit of deze managers zich voornamelijk als agents dan wel als stewards gaan gedragen in de onderneming. Er worden een aantal hypothesen ontwikkeld, die in verder onderzoek empirisch getest kunnen worden.

De laatste empirische studie, weergegeven in hoofdstuk 6, onderzoekt het dividendbeleid in private familiebedrijven. Ten eerste bespreken we het bestaan van conflicten tussen actieve (familieleden die werkzaam zijn in het bedrijf) en passieve (familieleden die niet werkzaam zijn in het bedrijf) aandeelhouders. Daarna gaan we, op basis van een steekproef van Vlaamse familiebedrijven, empirisch na of bedrijven waar deze conflicten voorkomen, dividenden gaan gebruiken om deze conflicten te verminderen. De resultaten bevestigen dit vermoeden. Verder blijkt dat familiale governance mechanismen (zoals een familieforum of een familiecharter) ervoor kunnen zorgen dat het dividendbeleid correcter is afgestemd op de groei-opportuniteiten van de onderneming.

Met deze doctorale studie wordt meer inzicht verkregen in het verlonings- en dividendbeleid van private familiebedrijven, twee topics die van groot belang zijn in het bedrijfsleven, maar waar tot nu toe nog zeer weinig academisch onderzoek over bestaat. Verder creëert dit onderzoek nieuwe onderzoekspisten voor verder toekomstig onderzoek.

Chapter 1

Introduction

1.1 Objective of the Dissertation

From Marx to Schumpeter[1], economists have predicted a long-term triumph of large publicly-traded firms at the expense of privately-held family businesses (Salvato & Aldrich, 2012). Nonetheless, over time, family businesses have persisted as the predominant form of business organization in the world (La Porta et al., 1999) and they are especially prevalent among privately-held small and medium-sized enterprises (SMEs) (Neubauer & Lank, 1998).

Despite the massive impact family businesses have on the economy as a whole, they have been overlooked by most academics until the 1990s (Litz et al., 2012). Today, scholars worldwide recognize this omnipresence of family businesses and have focused on their complexity which is caused by the institutional overlap of family and business (Sharma et al., 2012). Although there still is no general accepted definition of what constitutes a family business, the main distinguishing characteristic is that organizational processes and policies are substantially influenced by family involvement in ownership and/or management (Chua et al., 1999; Sharma, 2004). As such, the most common way to describe family businesses, is via the three-circle model of

[1] In their Manifesto of the Communist Party (1906), Marx and Engels warned that small local businesses will inevitably be wiped out by large multinational companies in a form of imperialist capitalism. Similarly, Schumpeter's (1942) idea of 'big-is-better' also claimed that large, monopoly firms (as opposed to small local firms) are the most able and the most likely to produce new, leapfrogging innovations and thus to survive in the long-run.

Gersick et al.(1997), who characterize family businesses by the overlap of three independent components: the business, the family and the owners (Gersick et al., 1997; Tagiuri & Davis, 1996). These three spheres are constantly interacting, making family firms very different from their nonfamily counterparts (Gersick et al., 1997), which justifies the special research attention that family firms are increasingly enjoying (Sharma, 2004).

Family business research topics are often originated from the paradoxes faced by the owners and managers of family firms (Zahra & Sharma, 2004). One concern that is at the heart of more family-business questions than any other topic except succession, is *compensation* (Aronoff et al., 2011), as is shown by the huge amount of 'how-to' books with best practices on family business compensation. Yet, although succession has become the leading topic of family business literature (Chrisman et al., 2005; Sharma et al., 1997; Sharma et al., 2012), academic interest in compensation in private family firms has been rather limited, and the available literature is mainly anecdotal and lacks sound analytical research. Additionally, academic interest in *dividend* policies in private family firms seems to be nonexistent. Yet, dividends can be considered as an important source of income for family shareholders as well. The income of family employees who are also shareholder of the family firm thus not only consists of a *salary* (compensation for labour), but often also includes *dividends* (compensation for their capital).

The mismatch between practitioner concerns and academic research on compensation and dividend policies in private family firms appears to have three main reasons. Firstly, reliable data on family firms is extremely difficult to obtain (Schulze et al., 2003a), since they have no legal obligation to disclose information. Therefore, family business research relies heavily on surveys to gather data (Litz et al., 2012). However, as compensation data is such sensitive information, small business owners may be reluctant to participate in academic studies requiring this information (Heneman et al., 2000). Additionally, even when compensation data can be obtained, this is

likely to result in small samples that may preclude the use of quantitative data analysis.

Secondly, most scholars are trained in compensation issues that confront large, complex, listed organizations, and this background may be of limited use in the case of most privately-held (family) firms (Cruz et al., 2011). Additionally, corporate finance research is predominantly based on agency theory (Jensen, 1986), which presumes that topical issues such as dividends and CEO pay-for-performance are irrelevant in the context of private family firms, due to the absence of agency conflicts.

Finally, developing theoretical rigor and at the same time addressing practitioner concerns is a balancing act (Astrachan, 2008), and thus the publication process itself may be an important reason of why so little attention has been paid to these issues in privately-held (family) businesses. After all, most mainstream management journals are likely to view dividend and compensation practices in family-owned firms as "too phenomenological to be of theoretical value to a broader academic audience" (Cruz et al., 2011, p. 169). As a result, in order to gain tenure, researchers may be more inclined to focus on conventional large publicly traded firms.

Although researchers have started to introduce compensation and dividend topics into family business research (e.g. Carlson et al., 2006; Cruz et al., 2011; Gomez-Mejia et al., 2003; McConaughy, 2000; Pindado et al., in press), much remains to be done. To this end, the objective of this dissertation is to enhance the understanding of compensation and dividend policies in private family firms. By doing so, this dissertation takes a small step along the path to fill some of the research gaps at the intersection of research in finance, human resource management and family businesses.

1.2 Research Questions and Outline of the Dissertation

Dividends and (incentive) compensation are often mentioned mechanisms that can mitigate conflicts of interest between owners and managers. The discussion above revealed that these topics have been mainly

ignored by family business researchers because of the so-called absence of conflicts of interests in family firms, thus making dividends and compensation irrelevant topics in this context. However, in the last decennium several authors (e.g. Chrisman et al., 2007; Lubatkin et al., 2007; Schulze et al., 2003b; Schulze et al., 2001b) argued that private family firms do face several sorts of agency costs, but of a different kind than in large, public firms. It has, however, not yet been examined whether dividends and compensation can be a solution to these specific kinds of agency problems in private family firms.

Based on these thoughts, and relating to the main research objective of this dissertation, the overall research question can be described as follows*:* ***What determines the compensation and dividend policies in privately-held family firms and how can they use these mechanisms to manage the different conflicts of interests they face?*** This broad research question will be dealt with by addressing several more specific research questions, which are tested using data from samples of US-based (Chapter 4) and Belgian (Chapters 2, 3 and 6) privately-held family firms.

Chapters 2 and 3 rely on survey evidence so as to provide a complete view on executive compensation policies in Flemish (family) firms. **Chapter 2** aims at answering the following research questions: *(1) To what extent do Flemish (family) SMEs adopt formal compensation practices? (2) How do CEOs assess the effectiveness of their firm's compensation system?* and *(3) Does increased formality and/or effectiveness of the compensation function lead to higher firm performance?* Relying on the same survey data, **Chapter 3** examines whether the 'traditional' determinants of CEO compensation also hold true in private family firms inasmuch as in large, public firms. As such, it addresses the following research question: *(4) What determines the compensation of CEOs in private family firms?* Based on the abundance of research on CEO pay in large public firms, we examine the ability of determinants derived from managerialist, agency, managerial power, and human capital theories to explain variations in CEO pay in the context of privately-held businesses.

Next, **Chapter 4** draws on recent literature which, contradicting classical agency theory predictions, suggests that making the CEO's pay dependent upon firm performance might mitigate different kinds of agency problems in private family firms (Schulze et al., 2001a). More specifically, chapter 4 discusses the following research question: *(5) Do objective performance-based measures play a significant role in private family firm CEO compensation?* As the scant amount of evidence on the pay-for-performance relation in privately-held (family) firms produced inconsistent results, this chapter introduces some moderating variables that might affect this relationship. As such, it addresses the fourth research question: *(6) How, and to what extent, is the pay-for-performance relation moderated by a firm's ownership and management structure?*

As research on executive compensation has focused almost exclusively on compensation levels of individual executives, mainly CEOs, and executive work is typically shared among a team of managers (Minichilli et al., 2010), **Chapter 5** explores pay patterns among top managers. Current literature displays contrasting understandings and conclusions concerning the specific impact of pay dispersion on firm performance. Much of that literature falls under two perspectives: the tournament and the equity perspective, which seem to conflict quite directly. From an economic point of view, tournament theory predicts a positive effect of pay dispersion on firm performance. By contrast, equity theory has a more behavioral view on pay dispersion and predicts a negative effect on firm performance. Relying on these theories, this chapter develops a set of propositions which could be a starting point for addressing the seventh research question: *(7) Under which conditions do the productive or counter-productive effects of pay dispersion within the top management team predominate in various kinds of family businesses?*

A type of conflict that may occur in the specific context of private family firms, is the intra-familial principal-principal conflict of interest (Gersick et al., 1997; Stewart & Hitt, 2012). This conflict of interest commonly occurs between shareholders that are employed by the firm and

actively participate in management (active shareholders), and shareholders that do not work in the family business (passive shareholders) and require remedies different from those that deal with principal-agent conflicts. As anecdotal literature indicates that dividends may be an instrument to mitigate these intra-shareholder conflicts of interests, **Chapter 6** considers the following research question: *(8) Do private family firms use dividends as instruments to cope with conflicts of interest between active and passive family shareholders?* Given that privately-held family firms lack the disciplining role of the stock market, which forces controlling managers in public firms to pay out dividends in order to avoid a decline in stock price, the final research question is: *(9) Do family governance practices take over the disciplining role of the stock market in private family firms?*

To conclude, **Chapter 7** summarizes the main empirical findings of this dissertation, and discusses its most important theoretical and practical implications. To conclude, it provides suggestions and avenues for future research to focus on.

Chapter 2

Compensation Practices in Family and Nonfamily SMEs: Survey Evidence from Flanders

2.1 Introduction

When they are asked about the main challenges they are facing, SMEs often point to human resource concerns (Heneman et al., 2000; McCann et al., 2001). More specifically, *compensation issues* are frequently indicated as a significant concern (Cardon & Stevens, 2004; Rutherford et al., 2003). For family firms, which represent the majority of the SMEs (Astrachan & Shanker, 2003), compensation issues are particularly important, as "compensation is at the heart of more family-business questions than any other topic except succession" (Aronoff et al., 2011, p. 3).

Despite the clear importance of this matter for small (family) businesses practitioners, academic interest has been rather limited (Astrachan, 2010; Cruz et al., 2011) and the available literature appears to be rich in recommendations, but limited in sound descriptive surveys or analytical research (Heneman et al., 2000). Therefore, over the past decade, a number of calls for research on human resources management (HRM) in small (family) businesses (Astrachan, 2010; Heneman et al., 2000; Sharma, 2004) emerged. This paper responds to these calls and aims at filling a part of this vast gap in the literature, focusing on one specific HRM aspect: the formalization, effectiveness and performance effects of compensation practices in SMEs.

In an attempt to provide an overview of the compensation practices used in Flemish SMEs, the following three research questions are addressed in

this study: **(1) To what extent do Flemish SMEs adopt formal compensation practices?** And do family and nonfamily firms use different kinds of compensation practices? **(2) How do the CEOs assess the effectiveness of their compensation system?** And is this effectiveness related to the adoption of some specific compensation practices? and **(3) Does increased *formality* and/or *effectiveness* in the compensation function lead to higher firm performance?** And, again, is this relationship different for family SMEs than for their nonfamily counterparts?

To address these research questions we executed a survey in cooperation with one of the leading Belgian employers' associations. As privately-held firms are extremely secretive when it comes to compensation data (Jensen & Murphy, 1990), this approach helps us to collect this sensitive information. The layout of this chapter is as follows. Sections 2.2 and 2.3 explain the methodology of the data collection and the general characteristics of the sample firms. In section 2.4 we attempt to answer the three research questions. Section 2.5 concludes.

2.2 Methodology

2.2.1 Sample & data collection

Data was collected by means of an internet survey sent to Flemish (situated in the Dutch-speaking part of Belgium) privately-held firms. Given the normal restrained enthusiasm of businesses in general, and private family firms in particular, to give confidential information to outsiders, we opted to conduct a survey in cooperation with one of the leading Belgian employers' associations (VKW). This association provided us with a mailing list of 1028 Flemish privately-held firms.

Before distributing the internet survey, a copy was sent to the directors of the employers' association, who reviewed the survey and suggested a few modifications. After that, a pre-test was carried out with two firms and with our colleagues. This pre-test resulted in some rephrasing, adding a few

extra options for answering selected questions, and expanding the questionnaire with other relevant questions. The questionnaire was finally distributed via email to the target group of 1028 companies, all of which are members of the employers' association. The focus of our research is on the compensation practices of private *family* firms. However, it is difficult to ex-ante determine whether a firm can be classified as a family firm or not. Therefore, this initial group of 1028 companies contains both family and nonfamily firms, which also enables us to compare the compensation practices of family and nonfamily SMEs.

Because of the sensitivity of the information that was asked for in the questionnaire, and in order to boost the response rate, the email was sent from the employers' association email address. For each of the five Flemish regions that the survey was sent to[2], the email was addressed to the firm's CEO and accompanied by a cover letter from the regional chairman of VKW. This letter explained the aim of the survey, encouraged the CEOs to participate and included a hyperlink to the website containing the questionnaire. Persons that participated in the research and completely filled in the questionnaire, would receive a complimentary research report with the main results. While this approach will plausibly lead to a higher response rate, the cooperation with the employers' association could possibly cause a bias in the sampling. That is, as these firms are a member of the employers' association, they might be more eager to learn from colleagues and therefore more open to academic research. However, this approach has been adopted in other studies as well (e.g. Berent-Braun & Uhlaner, 2012; Eddleston et al., 2008; Ling & Kellermanns, 2010) and it has the advantage of reaching firms more willing to participate in research.

The initial email was sent in February 21, 2012. Subsequently two reminder-emails were sent to the firms that had not started or completed the questionnaire. A total of 246 questionnaires were received by the closing date

[2] The percentage of surveys distributed, per region: Limburg (83%), Kempen (10%), West-Vlaanderen (2%), Oost-Vlaanderen (1%); Brabant (4%)

of April 2, 2012, representing a response rate of nearly 25%. Seen the profoundness of the survey and the sensitivity of the questions, together with the secretive nature of family firms (Neubauer & Lank, 1998), this can be considered a very good response rate. As the questionnaire was explicitly addressed to the CEO, this group represents almost 80% of all respondents. The remaining questionnaires were mainly filled in by another member of the management team.

As the focus of our study is on small and medium-sized firms, we apply the Small Business Administration definition of SMEs (Carlson et al., 2006; de Kok et al., 2006; Flanagan & Deshpande, 1996) and include all privately-held firms with 1 to 500 employees in our analysis. This means we drop 6 cases with more than 500 employees. Next, we also exclude all 'micro businesses' (i.e. firms with less than 10 employees) in our analyses, because they generally lack a defined compensation system (Carrasco-Hernandez & Sanchez-Marin, 2007; Gomez-Mejia & Balkin, 1992). This restriction further reduces our sample size with 23 cases, and thus the final sample size is 217[3]. Not all respondents have filled in the questionnaire completely, but due to the fairly small sample size, we also include the partial completed cases. In the following sections, we will clearly indicate the number of respondents per question.

In order to assess potential non-response bias, we tested for differences between early and late respondents, as late respondents are more similar to non-respondents (Kanuk & Berenson, 1975; Oppenheim, 2000). As suggested by Wallace and Mellor (1988) and Graham and Harvey (2001), we classify firms that returned the survey before we sent out a first reminder as 'early respondents', and the other group as 'late respondents'. After all, the firms that did not reply to the initial email can be thought of as a sample from the nonresponse group, in the sense that they did not completed the survey until we bothered them further with a reminder. We compared several key firm

[3] The final sample includes limited liability companies (84% public limited companies (NV) and 16% private limited liability companies (BVBA)

characteristics (such as firm size, age, sector and profitability) between the two groups, using Kruskal-Wallis tests. No statistical significant differences are found, which suggests that non-response bias does not appear to pose a major problem in our study. Still, there can be concerns about the use of survey data, namely that the respondents might not answer truthfully (Graham & Harvey, 2001). As we ensured complete anonymity to the respondents, we consider this problem to be minimal. Moreover, we expect that the CEOs would not take the time to fill in our questionnaire if their intent was to be untruthful.

We complement the data from our survey with financial data from the Bel-First database by Bureau Van Dijk, which contains financial statements of all Belgian firms. The following paragraph provides an extensive overview of the general characteristics of the sample firms and their CEOs.

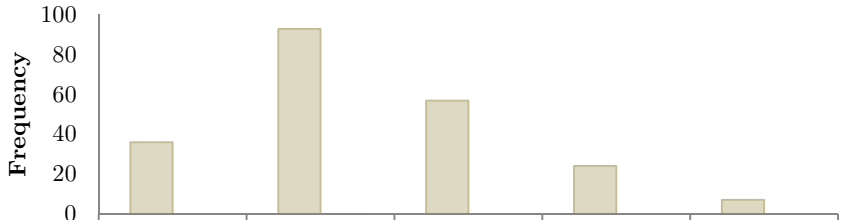
2.3 General Characteristics of the Sample Firms

2.3.1 Family versus nonfamily firms

The focus group of our survey are family firms. As we cannot identify family firms ex ante, the survey included two questions which enable us to assess whether the firm can be considered a family firm or not. A firm was identified as a *family firm* when (a) more than 50% of the shares were owned by one family, and/or (b) the CEO considered the firm to be a 'family firm' (Dyer, 2003; Westhead & Cowling, 1998). According to this definition, our final sample consists of 186 (86%) family firms and 31 (14%) nonfamily firms. In the next sections, we will discuss the general (firm and CEO) characteristics of both family and nonfamily firms together. We will clearly mention when a specific table of figure focuses on the subgroup of family or nonfamily firms. Otherwise, the characteristics cover the total sample of family *and* nonfamily SMEs.

2.3.2 General firm characteristics

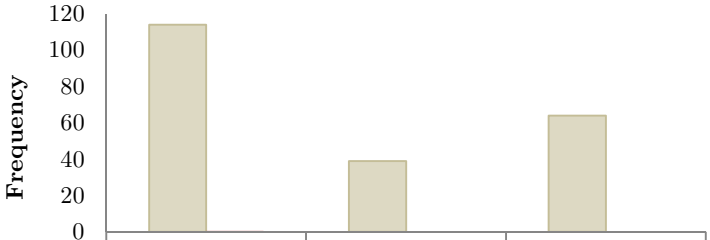
Figure 1 below represents all respondent firms per industry classification (based on Bel-First data). The majority of the sample firms are manufacturing and service firms.



	Wholesale and Retail Trade	Manufacturing	Services	Building & Construction	Other
Absolute Frequency	36	93	57	24	7
Relative Frequency	16,59%	42,86%	26,27%	11,06%	3,23%

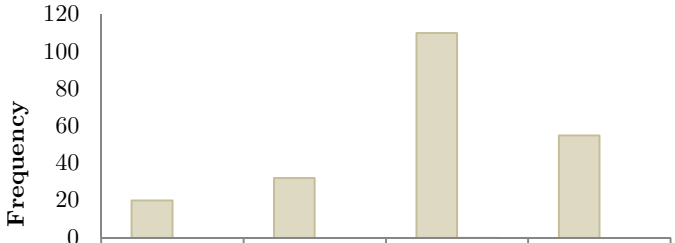
Figure 1 Industry (N=217)

The average firm in our sample is 38 years old (the oldest being 181 years old, the youngest was founded in 2011) and has on average 91 employees (with a minimum of 10 and a maximum of 435). The graphs below represent a subdivision of our sample in size- respectively age-categories. Concerning firm size, we created three size-categories: small (10-49), medium (50-99) and large (100 and more). As shown by Figure 2, the majority of the sample firms are small businesses. For the subsequent analyses, we will combine the group of medium and large firms so as to create two groups with approximately the same number of observations (small versus medium-large firms). As for firm age, the majority of the sample firms are between 20 and 49 years in business (Figure 3).



	Small	Medium	Large
Absolute Frequency	114	39	64
Relative Frequency	52,53%	17,97%	29,49%

Figure 2 Firm size (N=217)



	0-9	10-19	20-49	>=50
Absolute Frequency	20	32	110	55
Relative Frequency	9,22%	14,75%	50,69%	25,35%

Figure 3 Firm age (N=217)

As indicated below (Figure 4), more than half of the respondent firms is situated in a later developmental stage (maturity), while about 44% of the firms is still in an early developmental stage (start or growth).

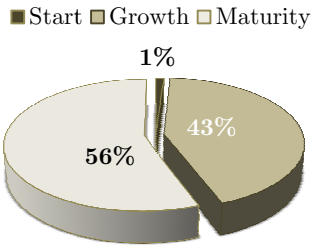
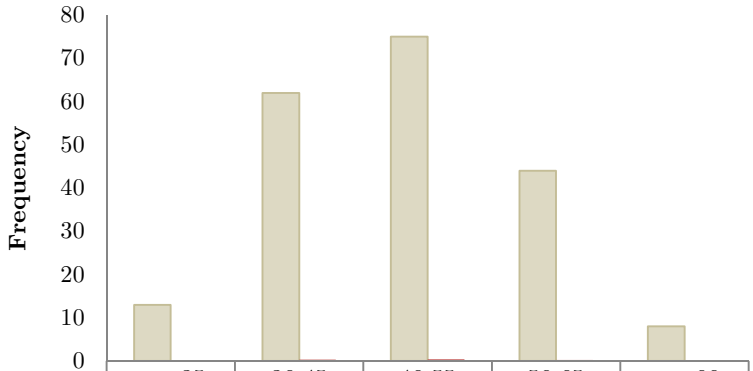


Figure 4 Developmental stage of the firm (N=217)

2.3.3 General CEO characteristics

Next, the survey contained a number of questions about the characteristics of the CEO. They are on average 49 years old (with a median value of 48): the youngest being 31, the oldest 72. Figure 5 represents graphically the number of CEOs per age-category. The majority of the CEOs have an age between 36 and 65.

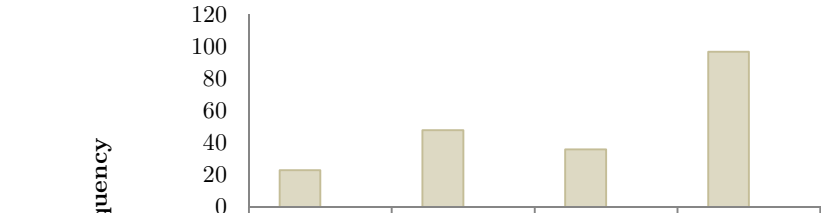


	<= 35	36-45	46-55	56-65	>= 66
Absolute Frequency	13	62	75	44	8
Relative Frequency	6,44%	30,69%	37,13%	21,78%	3,96%

Figure 5 CEO age (N=202)

Over 93% of the CEOs in our sample are male, which is in line with previous studies in privately-held SMEs (e.g. Cruz & Nordqvist, 2012). The female CEOs of our sample are especially active in smaller businesses (10-49 employees) and in the trade (retail and wholesale) industry. None of the female CEOs works in the construction industry.

Figure 6 shows the highest education level of the respondent CEOs. Almost half of the CEOs have an academic master's degree. The CEOs enjoyed mainly an economic (46%) or technical (37%) education.



	Primary or Secondary School	Professional Bachelor	Professional Master	Academic Master
Absolute Frequency	23	48	36	97
Relative Frequency	11,27%	23,53%	17,65%	47,55%

Figure 6 CEO education (N=204)

Table 1 outlines the years of professional experience of the CEOs in our sample. We inquired the number of years of which the CEO is active in (1) his current position (2) the business he is now working in and (3) the industry he is currently active in. On average, the CEOs are working for over 21 years in this industry, 18 years in this business and 13 years as a CEO in this firm. CEOs of small companies have significantly ($p<0.10$) more experience in the function of CEO than in medium or large companies (14 versus 12 years). With regard to seniority in the business or in the industry, no significant differences were found in relation to firm size. Almost 25% of

the CEOs did not have any prior experience in the industry before joining the company.

Table 1 CEO tenure (N=202)

	Min	Max	Mean	Median
Number of years active in the function of CEO	0	55	12.94	10
Number of years active in this business	0	55	17.79	16
Number of years active in this industry	0	55	21.39	21

As displayed in the graph below, about 38% of the CEOs in our sample hold the majority of the shares. 42 CEOs (22%) do not own any shares of the company, whereas 41 CEOs (21%) own all the shares.

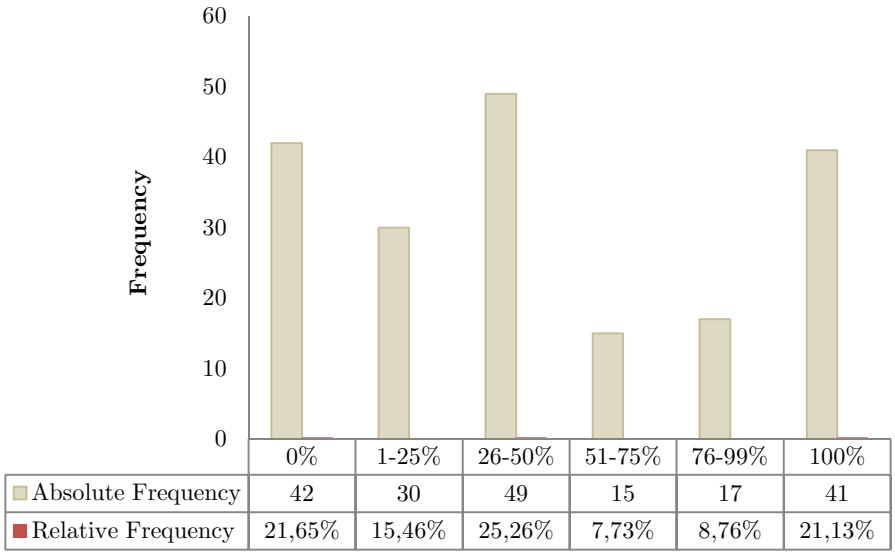


Figure 7 CEO share ownership (N=194)

The *contestability of the CEO position* is considered to be an important element in the design of top management team compensation (Ang et al., 1998). In 75% of the *family firms*, respondents indicate that managers

who are not a member of the family can be taken in consideration for the position of CEO. Thus, in 25% of the family firms, the position of the CEO is not contestable for nonfamily managers. Among the firms where the CEO position is *not* contestable, 66% employs at least one nonfamily manager.

Family firm CEOs can be divided into 3 categories, based on their relation to the owning family (Villalonga & Amit, 2006): founder CEOs, descendant CEOs and nonfamily CEOs (Figure 8). Our sample consists of 61 (35%) founders, 86 (49%) descendant CEOs and 27 (16%) nonfamily CEOs.

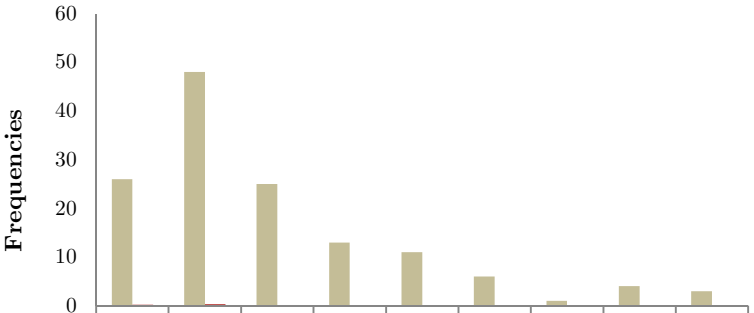
		MEMBER OF THE CONTROLLING FAMILY?	
		YES	***NO***
FOUNDER ?	***YES***	FOUNDER CEO (35%)	
	NO	DESCENDANT CEO (49%)	NONFAMILY CEO (16%)

Figure 8 Types of family firm CEOs (N=174)

While a family CEO on average owns 61% of the shares, a nonfamily CEO owns only 8% of the shares. Among the family CEOs, founder CEOs hold significantly more shares (72%) than descendant CEOs (53%) ($p<0.01$).

2.3.4 Ownership structure

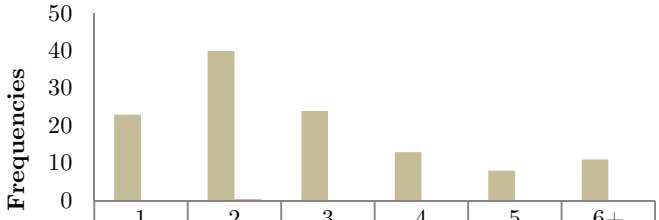
The sample firms have, on average, 3 shareholders (see Figure 9). About 19% of all sample firms have one shareholder.



	1	2	3	4	5	6	7	8	>=10
Absolute frequencies	26	48	25	13	11	6	1	4	3
Relative frequencies	18,98%	35,04%	18,25%	9,49%	8,03%	4,38%	0,73%	2,92%	2,19%

Figure 9 Number of shareholders (N=137)

The subgroup of *family firms* in our sample have, on average, 3 shareholders (with a minimum of 1 and a maximum of 16 shareholders). In nearly 58% of the cases, there is one person who holds the majority (more than 50 percent) of all shares. Next, 52% of the firms have shareholders that are not employed by the firm, also called *passive shareholders.*



	1	2	3	4	5	6+
Absolute frequency	23	40	24	13	8	11
Relative frequency	19,33%	33,61%	20,17%	10,92%	6,72%	9,24%

Figure 10 Number of Family Firm Owners (N=119)

2.3.5 Corporate Governance

In 64% of the cases, the firm has established an active board of directors. Of these firms, the CEO is also the chairman of the board of

directors in 41% of the cases (called *CEO duality*). CEO duality appears more frequently in small companies compared to medium-sized and large companies. Older CEOs and founder CEOs are more often the chairman of the board as well, as compared to their younger and non-founder colleagues. Next, 25% of the firms who do not have an active board of directors, indicate that they do have established an active board of *advice.* 8% of all sample firms have both an active board of directors and a board of advice.

Besides a board of directors, the subgroup of *family firms* can establish some specific *family governance mechanisms* that consider the multiple roles that family members play within the family and the firm, which is necessary to prevent or reduce harmful conflicts among family shareholders (Bartholomeusz & Tanewski, 2006; Mustakallio et al., 2002; Neubauer & Lank, 1998). Code Buysse II, the Belgian corporate governance code for non-listed firms, contains some specific recommendations for family businesses: it encourages family businesses to implement family governance mechanisms such as a family forum and/or a family charter.

The main goal of a family *forum* is to promote communication among the family shareholders (Brenes et al., 2011). Additionally, the forum provides a platform on which present and emerging family conflicts can be discussed and resolved before they affect the firm (Gersick et al., 1997; Habbershon & Astrachan, 1997; Poza, 2009). Family members can express their different values, expectations and opinions (on compensation issues, among other things) which are afterwards presented to the top management team (Gersick et al., 1997; Poza, 2009). A family *charter* (also referred to as a family constitution or family code of conduct) can facilitate the development of a formal compensation policy, by documenting basic compensation principles and guidelines (Aronoff et al., 2011). The development of a family charter is usually a highly participatory process involving the entire family and therefore represents an important asset to family unity and transparency (Berent-Braun & Uhlaner, 2012; Brenes et al., 2011; Suáre & Santana-Martin, 2004).

26% of the family firms has established a family forum, and 26% has formulated a family charter (16% has both a forum and a charter, see Table 2). Section 4 of this chapter goes further into detail concerning the use of these family governance mechanisms for compensation issues.

Table 2 Family Governance Mechanisms

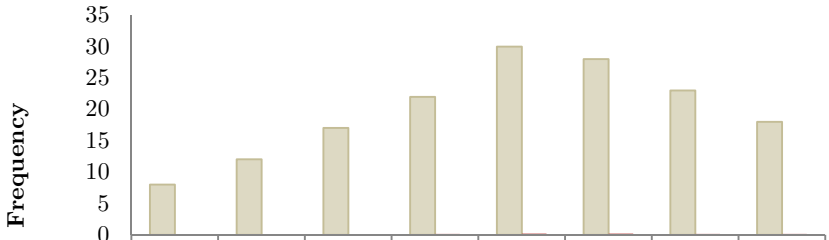
		Family Charter?		
		No	Yes	*TOTAL*
Family Forum?	No	104 (64%)	17 (10%)	*121 (74%)*
	Yes	16 (10%)	26 (16%)	*42 (26%)*
	TOTAL	*120 (74%)*	*43 (26%)*	*163 (100%)*

Notes. Numbers denote the absolute frequency; relative frequencies are displayed between brackets

2.3.6 CEO Compensation: pay level and mix

The mean (median) total compensation of the CEOs in our sample is 144,334€ (125,000€). This figure comprises the total compensation received by the CEO in 2011, including all compensation that was received through the CEO's private management company[4], and excluding all income received in the form of dividends. The figure below represents the distribution of CEO pay among our sample firms.

[4] Belgian CEOs can incorporate their own professional management company, which can either sign a consultancy agreement with the Belgian group company or accept an appointment in the company (e.g. directorship). The use of these management companies is common in Belgium, and, if properly structured, can entail considerable tax benefits. (PWC; Doing Businss Guide in Belgium).



	< 25	25 - 49	50 - 74	75 -99	100 - 149	150 - 199	200 - 249	> 250
Absolute Frequency	8	12	17	22	30	28	23	18
Relative Frequency	5,06%	7,60%	10,76%	13,92%	18,99%	17,72%	14,56%	11,39%

Figure 11 CEO pay ranges in '000€ (N=158)

To gain more insight in the pay *mix* of a CEO, we asked the respondents to indicate how their pay is composed. The response format required them to fill in the percentage of base pay, variable cash incentives (bonus based on individual and/or firm performance), and nonmonetary incentives (such as, for example, health insurance or a company car). As indicated by Figure 12, CEO pay consists mainly of base pay, and about equal amounts of variable cash and nonmonetary incentives.

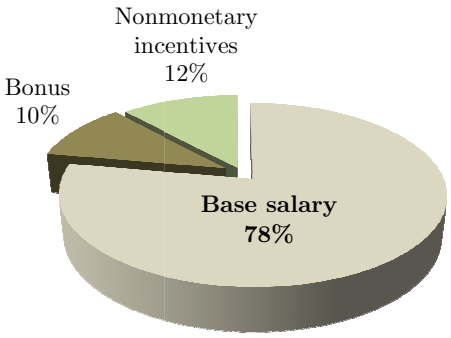


Figure 12 Pay mix (N=179)

Next, we relate this CEO pay level and mix to some firm characteristics in order to discover possible (univariate) relations. We compare the differences in average total pay and pay mix by means of t-test and ANOVA tests with bonferroni correction. The first characteristic we discuss, is firm *size*. We divide the firms into three groups, based on the number of full time employees: small (10-49 employees), medium (50-99 employees) and large (100 and more employees) firms (Table 3). Tests indicate that CEOs of small firms receive significantly less pay than medium- or large firms. CEOs of large firms receive a significantly higher proportion of variable pay than small or medium-sized firms.

Table 3 CEO pay level and mix by firm size

	Small		Medium		Large	
	N		*N*		*N*	
Total pay	*82*	119,291€	*27*	157,444€	*49*	179,020€
% Base pay	*91*	77.59%	*33*	83.09%	*55*	74.93%
% Variable cash pay	*91*	8.81%	*33*	6.73%	*55*	15.43%
% Nonmonetary incentives	*91*	13.58%	*33*	10.19%	*55*	9.62%

Notes. The values and percentages displayed are *mean* values; Small: 10-49 employees; Medium: 50-99 employees; Large: 100 and more employees

Next, we relate CEO pay to *industry.* Tests of mean differences (not reported) indicate that CEOs in the manufacturing industry receive more total pay than in other industries, while CEOs in the wholesale and retail (trade) sector earn significantly less. Next, CEOs of firms in the services industry receive significantly more nonmonetary incentives than other firms, while CEOs in the building and construction industry receive considerably less nonmonetary incentives.

Concerning firm age, we divide the sample firms into four groups, based on the quartile values (Table 4). Tests indicate that CEO of the 25%

youngest (first quartile) firms receive a lower percentage of base pay than in older firms.

Table 4 CEO pay level and mix by firm age

	age =<20		age 21-30		age 30-51		age >= 52	
	N		*N*		*N*		*N*	
Total	*45*	145,411€	*35*	135,211€	*35*	147,800€	*43*	147,814€
% Base	*52*	75.75%	*38*	83.29%	*42*	77.88%	*47*	79.94%
% Variable	*52*	13.94%	*38*	6.50%	*42*	13.07%	*47*	5.51%
% Non-monetary	*52*	14.31%	*38*	10.18%	*42*	9.05%	*47*	12.55%

Notes. The values and percentages displayed are *mean* values

As far as developmental stage of the firm is concerned, we break up the sample into two groups: one with firms in early developmental stages (start or growth) and firms in a later developmental stage (maturity). There appears to be no significant differences in pay level, but the total pay package CEOs of firms in early developmental stages consists of considerably more nonmonetary incentives than of firms in later developmental stages.

Table 5 CEO pay level and mix by developmental stage

	Start/Growth phase		Maturity phase		t-value
	N		*N*		
Total pay	*72*	139,569€	*86*	148,324€	0.52
% Base pay	*81*	75.80%	*98*	79.43%	1.16
% Variable cash pay	*81*	11.05%	*98*	9.99%	-0.40
% Nonmonetary incentives	*81*	13.14%	*98*	10.58%	**-1.24***

Notes. The values and percentages displayed are *mean* values;
*,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively

When a CEO holds the position of chairman of the board as well (*CEO duality*), this appears not to be directly linked to his compensation, as shown in Table 6. However, CEO duality is associated with a smaller percentage of base pay and a considerably higher percentage of nonmonetary incentives. Thus, while total *cash* pay does not differ, holding the function of chairman of the board appears to increase the amount of nonmonetary incentives awarded to the CEO.

Table 6 CEO pay level and mix by CEO duality

	No CEO duality		CEO duality		t-value
	N		*N*		
Total pay	*44*	160,555€	*25*	170,196€	-0.31
% Base pay	*47*	82.38%	*33*	72.15%	**2.64*** **
% Variable cash pay	*47*	10.02%	*33*	12.58%	-0.69
% Nonmonetary incentives	*47*	7.60%	*33*	17.27%	**-2.69*** **

Notes. The values and percentages displayed are *mean* values;
*,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively

As shown by Table 7 below, CEO age appears to be not directly linked to CEO pay level and mix. Although CEOs with a higher age generally have more experience than their younger counterparts, they do not receive higher wages.

Table 7 CEO pay level and mix by CEO age

	age <=42		age 43-48		age 49-56		age >= 57	
	N		*N*		*N*		*N*	
Total pay	*39*	116,154€	*45*	159,389€	*38*	156,211€	*34*	146,129€
% Base pay	*43*	77.53%	*52*	79.27%	*43*	76.26%	*39*	77.79%
% Var pay	*43*	8.53%	*52*	11.50%	*43*	11.16%	*39*	9.97%
% Non-mon incentives	*43*	11.91%	*52*	9.23%	*43*	12.58%	*39*	12.23%

Notes. The values and percentages displayed are *mean* values

When we compare CEOs who have obtained a university degree to those who have not, we find that higher education is directly linked to the level of CEO pay (Table 8). That is: CEOs with a university degree earn considerably higher wages than CEOs who do not. Their total pay package also consists of considerably more variable cash pay and less nonmonetary incentives.

Table 8 CEO pay level and mix by CEO education

	CEO no university degree		CEO university degree		t-value
	N		*N*		
Total pay	*81*	128,877€	*77*	160,569€	**-1.89****
% Base pay	*93*	77.52%	*86*	78.08%	-0.18
% Variable cash pay	*93*	8.46%	*86*	12.64%	**-1.16***
% Nonmonetary incentives	*96*	14.01%	*86*	9.28%	**2.32*****

Notes. The values and percentages displayed are *mean* values;
*,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively

Finally, as far as CEO gender is concerned, Table 9 shows that female CEOs receive significantly less pay than their male counterparts. However, this table should be interpreted with caution for two reasons: first, there are

very few female CEOs in our sample which could distort the results. Second, this difference is only valid on a *univariate* level (this second warning also holds true for the other tables represented above). Previous analyses already indicated that female CEOs are generally active in smaller businesses and in the trade industry, which we also found to be negatively related to CEO pay level[5].

Table 9 CEO pay level and mix by CEO gender

	Female CEO		Male CEO		t-value
	N		*N*		
Total pay	*8*	72,813€	*150*	148,149€	**-1.97****
% Base pay	*11*	73.91%	*168*	78.04%	-0.64
% Variable cash pay	*11*	10.45%	*168*	10.47%	-0.00
% Nonmonetary incentives	*11*	15.64%	*168*	11.48%	0.97

Notes. The values and percentages displayed are *mean* values;
*,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively

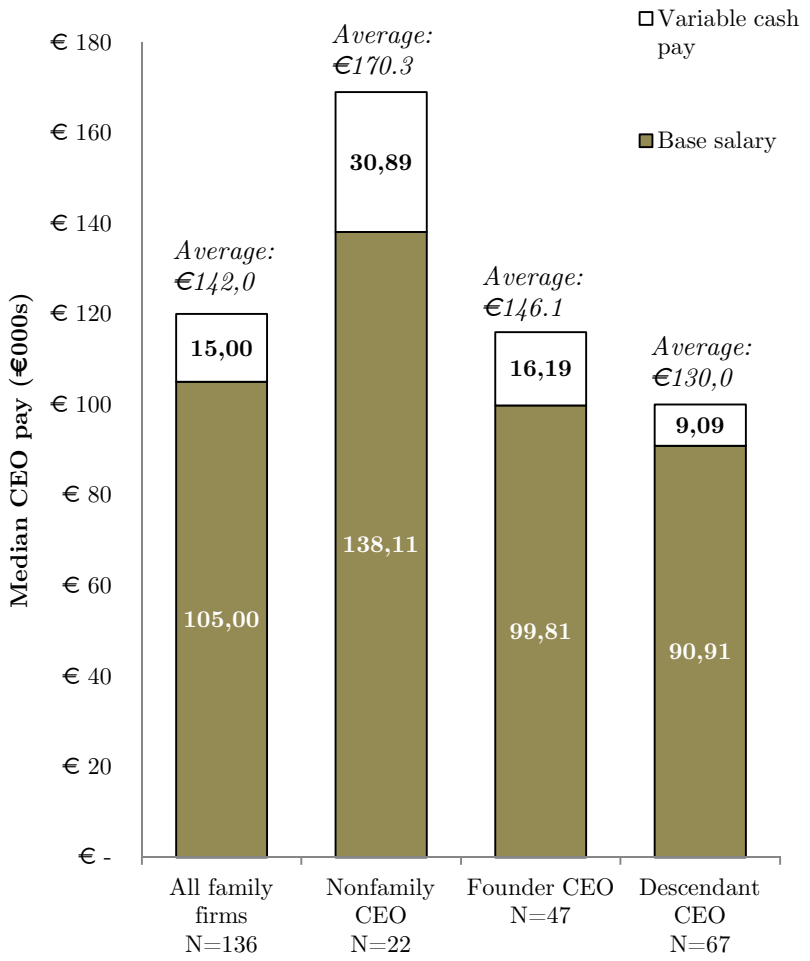
Academic research has highlighted some important differences in the compensation of nonfamily, founder and descendant CEOs in the context of *public* family firms (e.g. Gomez-Mejia et al., 2003; McConaughy, 2000). Figure 13 summarizes the mean and median *cash* pay levels, together with the (cash) pay mix of the subsample of family firm CEOs[6]. At first sight, nonfamily CEOs appear to earn much more, as compared to family CEOs A t-test

[5] Only multivariate regression analyses can overcome this interpretation problem. Chapter 3 of this dissertation therefore investigates the determinants of the level of CEO compensation by taking into account a number of possible contingencies.
[6] Although the graphs and tests of mean differences mentioned above are suitable for descriptive purposes, one must bear in mind that these test do not take into account any other factors that may affect the level of CEO compensation. Chapter 3 therefore employs regression analyses to correctly measure the impact of each factor on CEO compensation in privately-held family firms.

confirms that this difference is significant ($p<0.01$). Also the pay package design differs substantially between family and nonfamily CEOs: while family CEOs receive significantly more nonmonetary compensation ($p<0.01$), nonfamily CEOs receive a considerably higher percentage of variable cash compensation ($p<0.01$). This confirms findings of Michiels et al. (in press)[7] who found that nonfamily CEO pay is more strongly related to firm performance than family CEO pay.

Within the group of family CEOs, the graph goes to show that descendant CEOs earn higher wages. Yet, this difference is not statistically significant. Next, a t-test indicates that the pay mix of founder CEOs consists of a lower percentage of base salary ($p<0.10$) and a higher percentage of variable cash compensation, again confirming prior findings of Michiels et al. (in press).

[7] This paper is included in this dissertation as Chapter 4.



Notes: Median cash pay components in **'000 €;** the bar height depicts ***median*** cash compensation in '000 €, ***average*** cash compensation is reported above each bar.

Figure 13 Level and Composition of Total CEO Compensation, by family firm CEO type

2.3.7 Differences between family and nonfamily firms

Table 10 presents independent samples t-tests for equality of means for the firm characteristics between the family and nonfamily firms in our sample.

Table 10 t-tests for equality of means for firm characteristics by family vs. nonfamily

	Family Firms			**Nonfamily firms**			**t score**
	N	***Mean***	***S.D.***	***N***	***Mean***	***S.D.***	
Firm age	*186*	39.57	29.50	*31*	26.97	19.45	**-2.29****
N° of employees	*186*	84.69	91.61	*31*	126.65	119.22	**2.25****
Development stage	*186*	2.54	0.51	*31*	2.58	0.56	0.37
Profitability[a]	*184*	8.74	13.31	*29*	10.14	10.86	0.54
Liquidity[a]	*184*	1.51	2.10	*29*	1.76	1.94	0.61
Dividend	*186*	0.36	0.48	*31*	0.35	0.49	-0.06
CEO age	*172*	48.94	9.38	*30*	50.17	8.12	0.68
CEO ten1	*172*	13.74	10.71	*30*	8.30	7.62	**-2.67*****
CEO ten2	*172*	18.55	11.04	*30*	13.47	10.53	**-2.34*****
CEO ten3	*172*	21.30	11.90	*30*	21.87	8.95	0.25
CEO education	*174*	0.87	0.33	*30*	0.97	0.18	**1.49***
CEO ownership	*167*	52.38	37.55	*27*	15.78	25.23	**-4.88*****
CEO compensation	*136*	142.05	11.08	*22*	158.43	71.25	0.67
TMT: members	*176*	3.89	1.83	*29*	4.41	1.96	1.41*
Active BoD	*120*	0.62	0.50	*23*	0.74	0.49	1.12
BoD: members	*63*	5.11	2.16	*14*	5.07	3.08	-0.06
CEO duality	*65*	0.42	0.50	*15*	0.40	0.51	-0.11
N° of shareholders	*119*	2.99	2.15	*18*	3.33	2.57	0.61
Trade	*186*	0.17	0.38	*31*	0.13	0.34	-0.59
Manufacturing	*186*	0.42	0.49	*31*	0.48	0.51	0.67
Services	*186*	0.27	0.44	*31*	0.23	0.43	-0.50
Build&Constr	*186*	0.11	0.31	*31*	0.13	0.34	0.35
Industry: Other	*186*	0.03	0.18	*31*	0.03	0.18	0.00

Note: *,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively; [a] data obtained from the Bel-First database; **Definitions of the variables:** Firm Age: number of years since the firm was founded; Number of employees: number of FTE; Development stage: categorical variable equals one for firms in start phase, two for firms in growth stage and three for firms in the maturity phase; Profitability: measured vai ROA (Return on Assets); Liquidity: measured via the current ratio; Dividend: dummy equals one when the firm paid out a dividend in 2011; CEO age: current age of the CEO; CEO ten1: number of years active in the position of CEO; CEO ten2: number of years active in the business; CEO ten3: number of years active in the industry; CEO education: dummy equals one when the CEO had

a higher education after secondary school; CEO ownership: percentage of shares the CEO owns; CEO compensation: total compensation for the CEO in '000€; TMT members: number of managers in the top management team; Active BoD: dummy equals one when the firm has established an active board; BoD members: number of directors in the board; CEO duality: dummy equals one when the CEO is also the chairman of the board; Number of shareholders; Trade, Manufacturing, Services, Building & Construction; Other: industry dummies.

The results show that the family firms in our sample are on average older and smaller (they have less employees) as compared to their nonfamily counterparts. Family firm CEOs have significantly more experience within the business and within their function of CEO, but nonfamily firm CEOs generally have a higher education. Family firm CEOs generally have much more share ownership: whereas CEOs of nonfamily firms own on average 16% of the shares, CEOs of family firms own 52%. Concerning CEO compensation, the use of dividends, the development stage, liquidity, number of managers, directors and shareholders, and industry there are no significant differences between both groups. Whether or not family firms outperform nonfamily firms, is an ongoing debate in the family business literature. A lot of academics have investigated the difference in performance between family and nonfamily firms, but the results remain inconclusive (Miller et al., 2011). In our sample, there appears to be no significant (univariate) difference between the performance (as measured by ROA) of family and nonfamily firms.

2.4 The Adoption of Formal Compensation Practices in SMEs: a Comparison Between Family and Nonfamily Firms

2.4.1 Compensation as an element of formal HRM practices

Both family and nonfamily SMEs point to human resource concerns when asked about the main challenges facing them as they grow their firms (Heneman et al., 2000; McCann et al., 2001). Formal practices that are put in place to deal with these concerns in several key areas such as recruiting and

selection, training and development, compensation, performance appraisal and job specification, are called 'HRM practices' (Huselid, 1995; Rutherford et al., 2003).

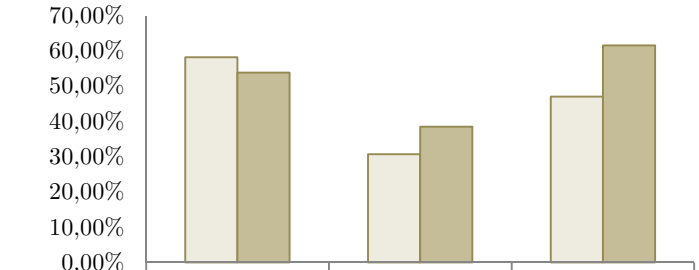
As a result of repeated calls for research on HRM in SMEs (e.g. Astrachan & Kolenko, 1994; Baron, 2003; Heneman & Berkley, 1999; Heneman et al., 2000; Hornsby & Kuratko, 1990), several researchers have examined the use and effects of HRM practices in the context of SMEs. The results show that implementing HRM best practices generally leads to higher firm performance (Carlson et al., 2006; Hayton, 2003; Hornsby & Kuratko, 2003; Kotey & Slade, 2005; Sels et al., 2006). Other studies indicate that SMEs seem to be less able to adopt HRM practices as compared to larger firms, due to the informal atmosphere and the lack of resources, such as for example management expertise, time and money (Bartram, 2005; Hill & Stewart, 2000). Some of these studies specifically focus on family firms. For example, family firms are found to be less likely to adopt formal (or professional) HRM practices than their nonfamily counterparts (de Kok et al., 2006; Reid & Adams, 2001). Yet, HRM practices can be an important factor in explaining family business success (Astrachan & Kolenko, 1994). These results are confirmed by Thack and Kidwell (2009), who find a positive relationship between the use of formalized HR practices and family firm profitability.

A meta-analysis by Cardon and Stevens (2004) revealed that *compensation* is a particularly important HRM topic in SMEs, because it significantly affects their recruiting and retention efforts. Another study revealed that compensation issues are indicated as a significant challenge for all SMEs (Rutherford et al., 2003). Additionally, the compensation system can be an important communication device to foster entrepreneurial activities and to signal legitimacy to external stakeholders (Cardon & Stevens, 2004; Graham et al., 2002). This paragraph therefore examines the implementation of formal compensation practices in Flemish family and nonfamily SMEs.

Drawing on previous literature (Aronoff et al., 2011; De Kok & Uhlaner, 2001; Kotey & Slade, 2005), the word *formal* in this study refers to the documentation and regular application of procedures and best practices.. In that sense, our questionnaire contains five items of formalization of the compensation system that are derived from the literature, which we discuss consecutively.

(a) Presence of an HR Officer. When firms have appointed an HR Officer, this can be considered as an indicator of professionalization of the HRM (and thus also of the compensation) function (Wright et al., 2011). In total, more than half (58%) of the family firms have appointed an HR Officer, and about 54% of the nonfamily firms (Figure 14).

(b) Written compensation policy. When family firms want to formalize their compensation function, Aronoff et al. (2011) advise them to establish a written compensation policy. Additionally, Berger and Berger (2001) mention that a valid and credible compensation system is based on a documented compensation strategy. In 31% of the family firms, a written compensation policy for managers is available, and in 47% of the family firms a written compensation policy for employees (that do not belong to the management team) is established (see Figure 14). Nonfamily firms appear to have written compensation policies more often: 38% has formulated a written compensation plan for managers and 62% has one for employees. Thus, although family firms more often appoint an HR Officer than do nonfamily firms, this does not result in more written compensation policies. Additionally, both family and nonfamily firms more often have a written compensation policy for employees than for managers. This result is in line with that of Kotey and Slade (2005), who find that HRM practices are less formal for managers than for lower-level employees in small firms.

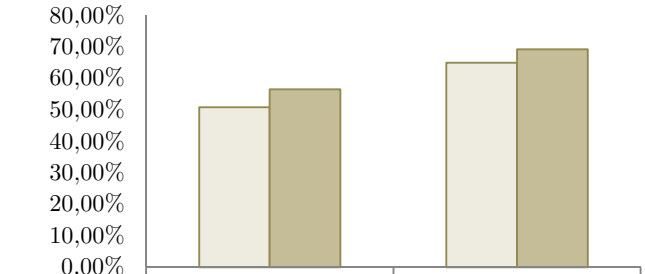


	HR Officer	Comp. policy Managers	Comp. policy Employees
Family	58,17%	30,72%	47,06%
Nonfamily	53,85%	38,46%	61,54%

Figure 14 HR Officer and written compensation policies (N=179)

(c) Benchmarking. Using an objective basis to setting pay is essential for developing a consistent compensation policy (Aronoff et al., 2011; Berger & Berger, 2001). In addition, the Code Buysse II (2009) indicates that compensation in privately-held businesses must be conform to the market and form the basis for attracting the best professionals. In our questionnaire, we asked the respondents whether they use some sort of benchmarking to assess their compensation policy in relation to their competitors. When the respondent answered 'yes', a consecutive question asked whether this information is actively followed, that is whether the use of benchmarking tools effectively leads to an adaptation of the compensation policy. The results indicate that benchmarking is used more actively within nonfamily firms, as compared to family firms: whereas 51% of the family firms use some sort of benchmarking, 57% of the nonfamily firms do. When benchmarking is used, it leads to an adjustment in the compensation policy in 65% (family) or 69% (nonfamily) of the cases. Within the group of family firms, first-generation family firms make significantly less use of benchmarking than later-generation family firms. This result is in line with the recommendations of Aronoff et al.

(2011). They advise family businesses to base pay on the market value of the jobs as soon as the next generation assumes leadership and ownership.



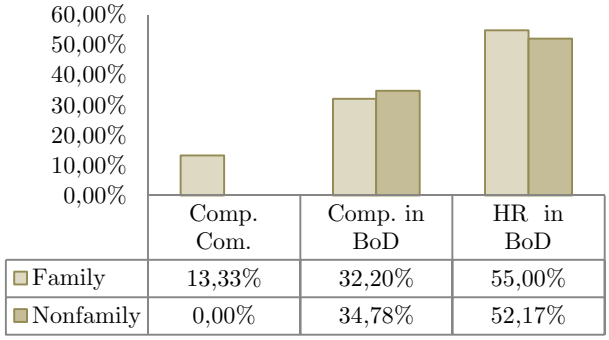
	Benchmark	Benchmark followed
Family	50,83%	65,00%
Nonfamily	56,52%	69,23%

Figure 15 The use of benchmarking (N=143)

(d) Compensation issues in the Board of Directors. As a best practice, compensation matters are discussed in the board, and major changes to executive compensation are made only with the board's approval (Aronoff et al., 2011). In the Belgian context, the Corporate Governance code for non-listed firms (Code Buysse II, 2009), indicates that the board should determine the compensation for managers. However, this code only consists of recommendations and is subject to voluntary application of the rules (i.e. principle of self-regulation). Our results indicate that 32% of the family firms and 35% of the nonfamily firms discuss general compensation issues in their board of directors (Figure 16). General HR policy is discussed more often in the board; in about half of the family and nonfamily SMEs. When we only look at the firms that actually have established an *active* board of directors, these numbers change quite a bit: in this case, about 48% of the firms uses this board to discuss compensation issues and over 78% discusses general HR issues. The Belgian CG code also adds that compensation policy should be discussed by preference at the suggestion of a compensation committee.

(e) Compensation Committee. A compensation committee is a proven tool for making compensation decisions and to act as a management-development aid (Barrett, 2001). As from 2009, the Belgian Corporate Governance code for non-listed firms (Code Buysse II), advises firms to establish such a committee. The tasks of such a committee should be to advise the board concerning compensation issues for senior management. The Code Buysse (2009) explicitly mentions that a compensation committee can be especially valuable in family firms, as it facilitates the discussion over compensation for family members. In our sample, only 13% had a compensation committee installed, all of which are family firms (Figure 16). This result is similar to the 12% in the sample of Baeten and Dekocker (2007), whose sample also consists of Flemish family firms. Thus, although the corporate governance code of 2009 clearly indicates the necessity and the usefulness of a compensation committee, the minority of firms have actually installed one. Additionally, only 12% of the firms that do not have a compensation committee, indicate that they are planning to establish one (11% of the family firms and 17% of the nonfamily firms). Compensation committees occur more frequently in medium- and large-size firms than in the smaller family firms. There is no significant difference between first- and later generation family firms.

For most family firms, a three-member committee is supposed to be sufficient (Barrett, 2001). In our sample, the committee consists on average of 3 members, 1 of which is a family member and 2 members of outside the family. In 56% of the cases, the CEO is a member of this committee. In half of the cases, the chairman on the committee is not a member of the controlling family.



	Comp. Com.	Comp. in BoD	HR in BoD
Family	13,33%	32,20%	55,00%
Nonfamily	0,00%	34,78%	52,17%

Figure 16 Compensation committee and Board of Directors (N=143)

2.4.2 Formal compensation practices (RQ1)

2.4.2.1 FCP: Formal Compensation Practices Scale

In order to answer the first research question of this study ('*to what extent do Flemish SMEs adopt formal compensation practices?*') we compute a Formal Compensation Practices (FCP) scale, using the aforementioned best practices. So as to a FCP-score to each firm, we use the sum of the scores of the relevant dichotomous items (best practices). This approach is similar to the one used in many other studies (e.g. Astrachan & Kolenko, 1994; Kim & Gao, 2010; La Porta et al., 1998). The FCP-score thus represents the degree of formalization of the compensation function of each SME with the minimum score of zero and a highest possible score of six. Table 11 gives an overview of each item used in the calculation of the FCP score for the 141 Flemish SMEs in our sample (this group of firms filled in all the questions needed to compute the FCP-score), and Figure 17 graphically shows the distribution of the FCP-scores.

Table 11 Formal compensation practices scale

	Total Sample (N=141)	Family Firms (N=118)	Nonfamily Firms (N=23)	t-value
1.The firm has appointed a full-time HR Manager	55%	57%	48%	-0.79
2.The firm has a written compensation policy for managers	33%	31%	39%	0.72
3.The firm has a written compensation policy for employees other than managers	51%	48%	65%	**1.49***
4.The firm makes use of benchmarking tools for compensation decisions	52%	51%	57%	0.50
5.The firm has established Compensation committee	10%	12%	0%	**-1.75****
6.Compensation issues are discussed in the board	33%	32%	35%	0.24
Mean FCP-Score	**2.33**	**2.31**	**2.43**	**0.32**

Note: *,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively; percentages denote proportion of firms that has implemented this compensation practice.

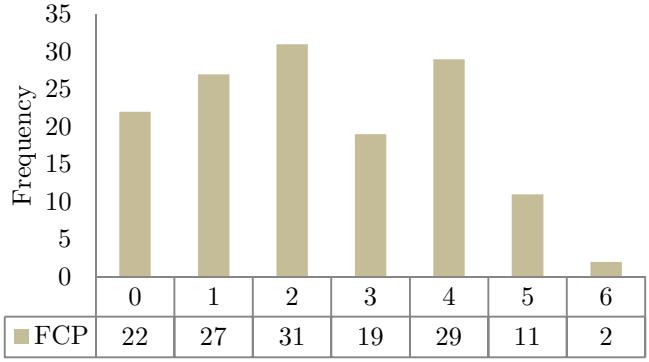


Figure 17 Absolute frequencies of the FCP-scores for the total sample (N=141)

The Flemish SMEs in our sample adopted on average 2.33 formal compensation practices, but almost 16% of the sample firms have not implemented any of the examined formal compensation practices. About half

of the firms have appointed an HR Manager, have designed a written compensation policy for their employees, or make use of benchmarking tools for compensation decisions. Despite recommendations in the Belgian Corporate Governance Code for non-listed firms, compensation committees are still rarely used.

The FCP-score is strongly related to firm size: within our focus group of SMEs, small firms have a significant lower FCP score compared to larger firms ($p<0.01$). This is in line with many other studies who find that size is an important factor for the adoption of HR practices (for an overview, see Kim & Gao, 2010): large firms tend to employ a more formal and standardized HR (and thus also compensation) system, as compared to smaller firms. This can be explained by economies of scale of larger firms (Gooderham et al., 1999), or by the informal nature of smaller firms (Hill & Stewart, 2000). We find no significant direct relationship between firm age and the FCP-score of a firm. Thus, older firms not necessarily have a more formal compensation function. This is in line with the findings of Rutherford et al. (2003), who suggest that the occurrence of HR problems (and, consequently, HR practices) is not related to firm age. In that same study, the authors find that HR problems and practices do vary with the life cycle stage of the firm. We, on the other hand, find no significant difference in FCP-scores of firms in early developmental stages (start, growth) as compared to firms in a later developmental stage (maturity).

2.4.2.2 FCPs in family versus nonfamily SMEs

For the subsample of family firms, the mean score is 2.31 while the nonfamily firms have a mean score of 2.43. Earlier studies on the formalization of the HRM function in family versus nonfamily firms find that nonfamily firms generally have a higher degree of formalization as far as HRM is concerned (Astrachan & Kolenko, 1994; de Kok et al., 2006; Reid et al., 2002). A test of mean differences indicates that the difference in FCP score

between the family and nonfamily firms in our sample is not statistically significant (Table 11). Additionally, as mentioned earlier (paragraph 2.3.5), apart from the board of directors or a compensation committee, family firms can use some peculiar governance mechanism to formalize its compensation policy: family governance practices. In this section, we describe the use of these governance mechanisms, and we compute an additional FCP score for the subsample of family firms, which takes into account the use of these family governance practices for compensation issues.

The questionnaire contains two items to measure the use of 'family governance practices': the installation of a family forum, and the presence of a family charter. According to family business literature (Aronoff et al., 2011; Poza, 2009), these two family governance practices are very useful in developing a compensation policy for family firms. Figure 18 provides more information regarding the presence of family governance mechanisms in our sample firms. 26% (43 firms) of the private family firms have designed a family charter. In 30% of these cases, this family charter contains some specific rules or agreements on compensation policy. Similarly, over 25% of the family firms have established a family forum. Of these firms, 75% use this forum to actively discuss compensation issues. In total, about 26% of the family firms discuss their compensation policy in a family forum and/or a charter.

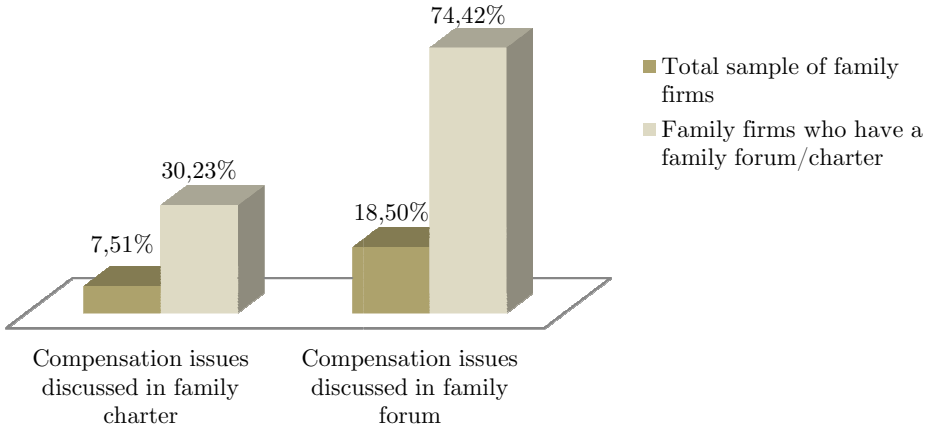


Figure 18 Compensation Policy and Family Governance Practices (N=173)

In order to take into account the use of these family governance mechanisms in discussing and formalizing a compensation policy, we compute a separate FCP-score for the subsample of family firms: FCPF-score (Formal Compensation Practices in *Family* firms). This score consists of the FCP-score plus 1 when the family firm has established a family forum/charter *and* explicitly uses it to discuss compensation issues. The minimum score is zero, the maximum seven. The distribution of the FCPF-scores in our sample of family firms is displayed below in Figure 19.

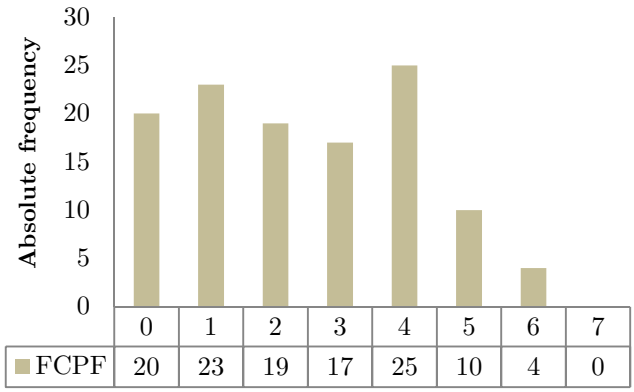


Figure 19 FCPF scores (N=132)

When we relate this FCPF-score to some firm characteristics, we find that the scores are significantly higher in (a) large and medium-sized firms, as compared to smaller firms, (b) in firms with a nonfamily CEO, as compared to firms with a family CEO, and (c) in later-generation family firms, as compared to first-generation family firms.

As indicated above, no statistical significant difference is found between the use of professional compensation practices between family and nonfamily firms, based on the FCP-score. Furthermore, family firms possess some additional mechanisms (family governance) which they can use for developing a more formal compensation function. Thus, when we compare the average FCP-score for nonfamily firms (2.43) with the FCP*F*-score of family firms (2.42), we find that they are almost identical. This finding is in contrast to earlier studies, who claim that family firms have lagged behind their nonfamily counterparts in implementing formal HR policies and practices (Astrachan & Kolenko, 1994; Reid & Adams, 2001). Our results thus suggest that in the last decennium, family firms have accelerated the formalization of their processes, so that the compensation practices in family firms are now more in line with those of their nonfamily opposites. This evolution towards a higher use of formal compensation practices in family firms may have several reasons. First, several Belgian employers organizations took initiative to raise the awareness of family business owners on the importance of professionalized (or formalized) management of their company. Second, the updated version of the Belgian corporate governance code for non-listed firms (Code Buysse II, 2009) has called the attention to the potential benefits of for example using a benchmarking to set pay levels, or installing a compensation committee, especially for family firms. Although not legally binding, these initiatives appear to have triggered family business owners to implement more formal compensation practices. Third, family business may have increased the professionalization of their compensation policy as it may have become more difficult for them to attract and retain external managers.

In conclusion, as an answer to the first research question: Over 80% of the firms in our sample have adopted at least one of the formal compensation practices we examined. The most frequently occurring practices are: the assignment of an HR Officer, benchmarking, and a written compensation policy for employees. Although recommended by the Corporate Governance Code, the use of a compensation committee is very limited. Next, no significant differences are found between the use of formal compensation practices in family firms and their nonfamily counterparts. Furthermore, about 10% of the family firms also discuss compensation issues in a family forum and/or a charter.

2.4.3 Compensation system effectiveness (RQ2)

Apart from following the 'best practices', it is important that the design of a compensation system contributes to the achievement of organizational goals (Balkin & Gomez-Mejia, 1990). After all, when formal compensation practices are effective, they can be an important source of competitive advantage (Collins & Clark, 2003; Hayton, 2003). Therefore, this paragraph aims at answering the second research question of this chapter: **How do the CEOs assess the effectiveness of their compensation system?** And is this assessment of effectiveness related to the adoption of some specific compensation practices?

In order to measure the perceived compensation system effectiveness, we asked the respondents five related questions. These items are based on a scale of Balkin and Gomez-Mejia (1990) and the response format of each item consisted of a seven-point Likert scale, ranging from 'strongly disagree' (1) to 'strongly agree' (7) (see Table 12 for an overview of the items).

Table 12 Compensation system effectiveness

Item	Question
1	Our pay policies and practices are highly effective
2	Management is very happy with the way the compensation system contributes to the achievement of overall organizational goals
3	All things considered, the compensation strategies used in our organization truly give shareholders 'their money's worth'
4	Our pay policies and practices appear to enjoy widespread acceptability among employees
5	Our pay policies and practices greatly contribute to retention, attraction, and motivation of employees

To assess whether the abovementioned items indeed are proxy variables of the latent (unobserved) variable '*compensation system effectiveness'*, we execute a confirmatory factor analysis (CFA) with one factor. Hair et al. (2006) suggest to use at least three or four items per latent variable, so the five items in our analysis should be sufficient. The analysis is executed using the cfa1 command of Kolenikov (2006) in STATA.

CFA is a simple version of a structural equation model and is represented as a path diagram in Figure 20. The $y_1 - y_5$ represent the *measured variables* (here: items) and ξ_1 is the *latent construct* (here: compensation system effectiveness). The relationships between the latent construct and the measured variables are represented by the numbers on the arrows from the construct to the measured variable (*standardized factor loadings* [8]) . Finally, each measured indicator variable has an error term (shown as a δ_i in Figure 20), which is the extent to which the latent factor does not explain the measured variable.

[8] The cfa1 command displays the unstandardized factor loadings, which represent covariances. Hair et al. (2006) recommend researchers to only interpret the *standardized* loadings because they are constrained to range between -1 and +1, whereas unstandardized loadings have no lower- or upperbound. The standardized loadings are calculated manually as the square root of each individual item R-square. *** indicates significance at a 1% level.

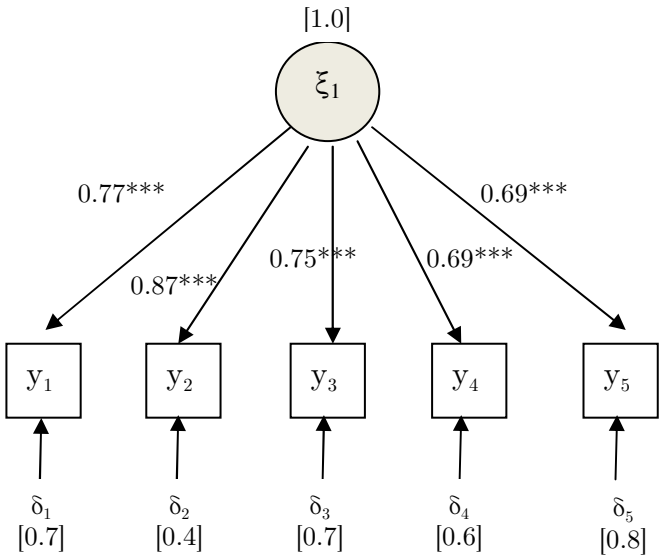


Figure 20 Confirmatory Factor Analysis for *Compensation system effectiveness* (N=143)

Hair et al. (2006) list some rules of thumb for assessing the construct validity. First, the standard loading estimates should be at least 0.5, or ideally above 0.7. The high loadings thus indicate that they converge on a common point, the latent construct *compensation system effectiveness.* Second, the average variance extracted (AVE) should be at least 0.5 or higher. The AVE value can be calculated as follows:

$$\text{AVE} = \sum_{i=1}^{n} L_i^2$$

where i represents the number of items (5) and L_i represents the standardized factor loading. In our case, the AVE is 0.57, suggesting adequate convergence (i.e. the variance explained by the latent factor structure imposed on the measure is larger than the remaining error in the items). Third, the coefficient

alpha should be 0.7 or higher. The alpha of our scale is 0.87, suggesting good reliability. This high construct reliability indicates that the items all consistently represent the same latent construct (compensation system effectiveness).

As the abovementioned tests assure unidimensionality and content validity of our *compensation system effectiveness* scale, it is allowed to calculate a summated scale by averaging the scores of the five items (Hair et al., 2006). The mean (median) value for the compensation system effectiveness scale is 4.91 (5), with a minimum score of one a maximum score of seven (Figure 21).

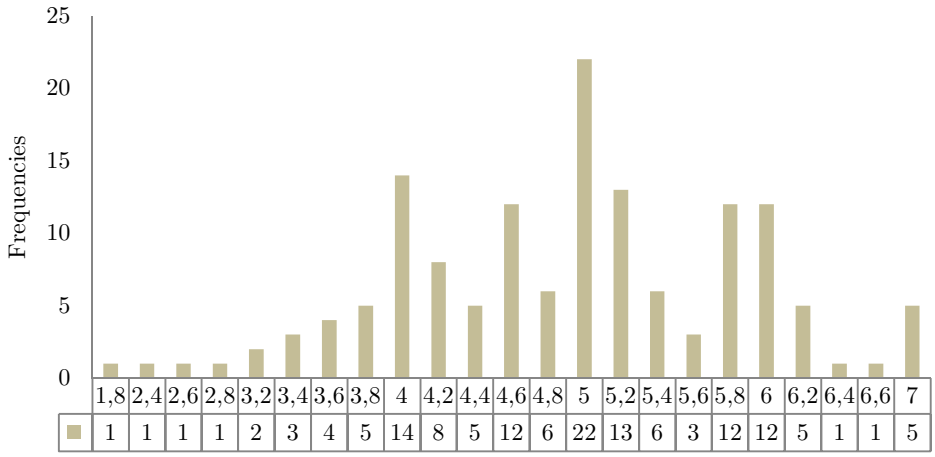


Figure 21 Compensation system effectiveness scores (N=143)

No significant differences are found between the compensation system effectiveness of family and nonfamily firms: the mean (median) value for family firms is 4.89 (5), and 4.91 (5) for nonfamily firms. Thus, as an answer to the first part of RQ2: both family and nonfamily SME business owners consider their compensation system to be quite effective.

Concerning the second part of RQ2, whether this assessment of effectiveness related to the adoption of some specific compensation practices,

we check the correlations between the effectiveness score and each of the individual formal compensation practices (presented in Table 13 on page 65). The results indicate that none of the compensation practices is correlated to the compensation system effectiveness at a 10% level of significance. The table also indicates that the use of formal compensation practices (*FCP-score*) is not significantly correlated to the compensation system effectiveness. So implementing a lot of formal compensation practices not necessarily leads to a higher effectiveness of the compensation system.

There are two theories which might explain why SMEs adopt formal compensation practices (Thach & Kidwell, 2009). From a contingency perspective, firms take on formal compensation practices because they expect them to improve firm performance. From an institutional perspective, firms may adopt formal compensation practices because others do and therefore they expect them to be effective. The abovementioned analyses reveal that the use of formal compensation practices is not directly linked to compensation system effectiveness. Therefore, the next paragraph examines whether firms that adopt more formal compensation practices also perform better. Or, alternatively, whether it is rather firms with an *effective* compensation system that outperform firms with a less effective system.

2.4.4 Effect of compensation system formality and effectiveness on firm performance (RQ3)

Will increased *formality* or rather increased *effectiveness* of the compensation function improve organizational performance of SMEs (RQ3)? We aim at answering this third research question by first looking into previous academic studies. Thereafter, we will empirically test the effect of compensation system formality and effectiveness on firm performance by means of regression analyses.

First, academic literature reveals two different views on the relation between the use of formal compensation practices and firm performance. On the one hand, some authors claim that formalizing HRM may suppress

creativity and innovation (Kaman et al., 2001) and reduce flexibility (Welbourne & Cyr, 1999). Additionally, small firms may benefit from informal settings, instead of formalized rules and procedures (Kaman et al., 2001). On the other hand, a number of researchers have argued *for* the adoption of formal HR practices in small firms, as they might increase firm performance (e.g. Heneman et al., 2000; Marlow, 2002). Since the seminal work of Huselid (1995), a lot of researchers have empirically examined the impact of formal HR practices on firm performance (for overviews, see: Subramony, 2009; Wright & Boswell, 2002). Although there is less evidence of the HRM-performance link in SMEs (Kaman et al., 2001), most studies have found a positive relationship between (formalized) HRM and firm performance in smaller firms (e.g. Heneman & Berkley, 1999; Kotey & Meredith, 1997; Sels et al., 2006; Welbourne & Andrews, 1996). Some of these studies focus specifically on family firms and find the same positive relationship (Astrachan & Kolenko, 1994; Carlson et al., 2006; Thach & Kidwell, 2009). De Kok et al. (2006) indicate that further research is needed that examines the relation between the use of formal HR practices and performance for family firms.

Second, we investigate whether compensation systems that are assessed as 'effective' by the CEO, also are 'effective' in the sense that they lead to higher firm performance. We found no previous studies that examined this relationship.

We empirically investigate whether or not compensation system *formalization* and/or *perceived effectiveness* influence a firm's performance by means of regression analyses. The **dependent variable** used in these regressions, our performance measure, is based on a validated scale of Kellermanns and Eddleston (2006, 2007). To achieve a reliable subjective performance measure, eight different performance indicators are used. For each item, respondents were asked to assess their performance relative to their competitors. Specifically, the question was: "how would you compare your *[item]* to major competitors in your industry?" with possible answers on a Likert-scale varying from 1 (much worse) to 5 (much better). The items were:

growth in sales, growth in market share, growth in employees, growth in profitability, return on equity, return on assets, profit margin on sales, and the ability to fund growth from profit. The coefficient alpha for this scale is 0.89, which is identical to the alpha found in Eddleston et al. (2008) and well above the threshold of 0.70 of acceptable reliability (Hair et al., 2006). The individual scores of each item were added to form an overall performance score per company (*Performance*), where higher values connote better performance (the lowest score possible being 8, the highest 40) (Dess & Robinson Jr, 1984; Kellermanns & Eddleston, 2006; Kellermanns & Eddleston, 2007).

The **independent variables** used in the regression are the FCP-score, which represents the extent to which firms use formal compensation practices, as calculated in paragraph 2.4.2.1 on page 50). Compensation system effectiveness is operationalized as the extent to which the CEO perceived the system to be effective (see paragraph 2.4.3). We **control** for other factors that could influence firm performance, such as firm *size* (measured by the number of employees), firm *age*, *industry* (measured via a dummy variable which equals one when a firm is in the manufacturing industry, and zero otherwise), and *CEO education* (dummy variable which equals one when the CEO has enjoyed some sort of higher education, and zero otherwise).

Table 13 contains some descriptive statistics. On a univariate level, firm performance is significantly correlated to compensation system effectiveness, but not to the formalization of it (see Table 13). In order to draw valid conclusions, we perform regression analyses where we also take into account the control variables as discussed above.

Model 1 in Table 14 examines the effect of a firm's FCP-score and compensation system effectiveness on firm performance. In contrast to the aforementioned studies, we find no significant effect of the use of formal compensation practices and firm performance. Our findings thus suggest that a formalized compensation function as such does not lead to higher firm

performance. In model 2, we examine the influence of each individual compensation practice. The results show that firms who discuss compensation issues in the board of directors, generally perform worse than firms who do not. In model 3, we only consider the subsample of family firms and we add a seventh formal compensation practice: the use of family governance (charter, forum) to explicitly discuss compensation issues. This practice seems to have no significant influence on firm performance, and, again, discussing compensation issues in the board is negatively associated with firm performance. Thus, although small business owners indicate that compensation issues represent a major challenge to their business, and formal HR practices can deal with this (Rutherford et al., 2003), the use of formal compensation practices in itself appears to be insufficient for increasing firm performance. Concerning the impact of compensation system *effectiveness*, all three models show a significant positive effect. That is, firms where the CEO assesses the compensation system to be effective, generally perform better. Finally, firms whose CEO has enjoyed higher education seem to outperform other firms. Firm size, age and industry appear to have no significant influence on firm performance.

In conclusion, as an answer to RQ3, our results suggest that it is the perceived compensation system *effectiveness* that influences firm performance, and not the *amount* of compensation practices used. This finding questions the value of corporate governance codes and 'best practices', who encourage firms to formalize their HR processes. After all, it seems to be more important to have an effective compensation system that contributes to the achievement of the firm's organizational goals than to adopt formal compensation practices. For example, firms who are not in need of formalized compensation practices, still may have their own *in*formal compensation system which contributes to their goals and have a positive effect on firm performance. Adopting a lot of formal compensation practices in these kinds of firms (for instance because corporate governance codes advice them to do so), may perhaps work counterproductive and thus have a negative influence on firm performance.

This last argument may be a possible explanation for the result that discussing compensation issues in the board is negatively related to firm performance. However, this reasoning could of course also be turned around: firms that perform worse, may be more inclined to discusses pay issues in the board of directors. Further analyzing the sample cases that discuss compensation issues in the board (for example via face-to-face interviews) may provide clarity on the direction of this relationship.

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Table 13 Means and Correlations

	Mean	Correlations											
		1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
1. Performance	27.77												
2. Effectiveness	4.89	0.16*											
3. FCP	2.33	-0.10	0.04										
4. HR Officer	0.55	-0.06	-0.06	0.53***									
5. Pay policy Mgrs	0.33	0.00	-0.01	0.69***	0.26***								
6. Pay policy Emp	0.51	0.08	0.12	0.66***	0.26***	0.47***							
7. Benchmarking	0.52	-0.05	0.04	0.61***	0.05	0.34***	0.36***						
8. Comp. Comm.	0.10	-0.14*	-0.02	0.42***	0.11	0.12	-0.01	0.08					
9. Pay in Board	0.33	-0.21**	0.04	0.55***	0.11	0.16*	0.08	0.22***	0.48***				
10. Firm Size	94.23	-0.01	-0.03	0.38***	0.40***	0.26***	0.18**	0.18**	0.04	0.21**			
11. Firm Age	38.71	-0.06	-0.12	0.02	0.07	0.01	-0.01	0.04	0.00	-0.05	0.22***		
12. Industry	0.43	-0.01	-0.08	0.09	0.14	-0.11	0.15	0.08	0.05	-0.02	0.18**	0.13	
13. CEO Education	0.89	0.11	-0.15*	0.09	0.15*	-0.05	-0.02	0.08	0.04	0.09	0.09	0.04	0.02

Notes: N= 141; Effectiveness:: compensation system effectiveness, scores from 1 to 7. Performance: objective performance scale, scores from 8 to 40. FCP: Formal Compensation Practices scale, scores from 0 to 5. HR Officer: dummy with 1= firm has HRO. Written pay policy Mgrs: dummy with 1 = firm has a written pay policy for managers. Written pay policy Emp: dummy with 1 = firm has a written pay policy for employees. Benchmarking: dummy with 1 = firm uses benchmarking for compensation purposes. Comp. Comm: dummy with 1 = firm has established a compensation committee. Pay discussed in Board: dummy with 1 = pay policy is discussed in the board of directors. *,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively

Table 14 Regression results

Model	**1**	**2**	**3**
Constant		22.2993***	21.9574***
		(2.5284)	(2.7114)
Formal Compensation Practices			
FCP	-0.3775		
	(0.2394)		
HR Officer		-0.9532	-1.4051
		(0.9859)	(1.0998)
Pay policy for managers		0.45721	0.8285
		(0.9683)	(1.1293)
Pay policy for employees		0.8667	0.7822
		(0.8895)	(1.0164)
Benchmarking		-0.7022	-0.8108
		(0.7779)	(0.8706)
Compensation Committee		-0.4789	0.0455
		(1.1527)	(1.2135)
Compensation in BoD		**-2.1956****	**-2.9266*****
		(0.9228)	(1.0875)
Compensation in Family Governance			1.8230
			(1.4398)
Compensation System Effectiveness			
Effectiveness Score	**0.8769****	**0.8450****	**0.9794****
	(0.4204)	(0.4218)	(0.4592)
Controls			
Firm size	0.0020	0.0032	0.0022
	(0.4204)	(0.0044)	(0.0049)
Firm age	-0.0084	-0.0099	-0.0123
	(0.0135)	(0.0141)	(0.0158)
Industry	0.1517	0.0848	-0.1099
	(0.8042)	(0.8231)	(0.9361)
CEO education	**2.2270***	**2.7339***	**2.9296***
	(1.3538)	(1.4047)	(1.5837)
Adjusted R^2	*0.0183*	*0.0443*	*0.0663*
Model F-statistic	*1.58*	*2.15***	*1.69**

Notes. Dependent variable = Firm Performance; N=141 for models 1 and 2; N=118 for model 3 which contains the subsample of family firms; Heteroskedasticity-robust standard errors in parentheses; *, **, *** denotes significance at a probability level below 0.10, 0.05 or 0.01 level (two-tailed). Definition of the variables: see Table 13 on page 65.

2.5 Conclusion

Our survey provides evidence into the actual application of common formal compensation practices in Flemish SMEs, based on the 'best practices' as described in the literature. The results reveal that the majority of the SMEs (80%) have adopted at least one of the formal compensation practices we examined. The assignment of an HR Officer, the use of benchmarking for compensation issues, and the establishment of a written compensation policy for employees appear to be the most frequently implemented compensation practices. Despite recommendations in the corporate governance code for non-listed firms (Code Buysse II, 2009), very few firms have actually installed a compensation committee.

Next, our findings support the suggestion that in the last decennium, family firms have accelerated the formalization of their processes because, in contrast to results in earlier studies, their compensation practices are now more in line with those of their nonfamily counterparts. This evolution may be due to an increased awareness of family business owners on professional governance and management of their organizations.

Our results challenge prior studies which suggest that the formalization of the HR function improves firm performance, as we do not find a significant effect of the use of formal compensation practices on firm performance. Thus, although small business owners indicate that compensation issues are a major concern for their businesses, and formal HR practices can deal with this (Rutherford et al., 2003), the use of formal compensation issues as such appears to be insufficient for increasing firm performance. This may be explained by the fact that, from a certain point, the formalization of the HR function may erode many of the potential advantages of small businesses (such as, for example, an informal or family atmosphere) (Bartram, 2005).

Concerning the effectiveness of their compensation system, both family and nonfamily business owners assess their system to be quite effective.

We found no relation between the amount of compensation practices adopted and the effectiveness of the compensation system. However, highly effective compensation systems appear to be associated with high firm performance. Thus, it is rather the quality (effectiveness) than of the quantity (number of practices employed) of compensation practices that is related to firm performance.

The practical implications of this research point to the fact that, instead of adopting a lot of formal compensation practices, firms may benefit from the adoption of *effective* compensation practices. Thus, instead of simply increasing the number of compensation practices, firms could potentially derive positive returns by increasing the effectiveness of their compensation system. Therefore, our results question the recommendations as described in all sorts of 'best practices' and corporate governance codes concerning the formalization of HR processes. After all, our findings indicate that only when a firm's compensation system satisfies the needs of the organization (i.e. the CEO considers it to be effective in contributing to the firm's organizational goals), this can positively influence firm performance.
And this *need* is found to be unrelated to the *amount* of compensation practices used: some firms may need a lot of formal practices, while in other firms they would work counterproductive.

This study is subject to some limitations, which provide opportunities for future research. First, generalizing the findings of this study must be taken with care, as the findings from this study are based on a cross-sectional sample of SMEs in one small geographical area, Flanders. Obviously, expanding the sample size and the geographical area would be interesting and beneficial in developing our knowledge of formal compensation practices in SMEs. Future research will therefore benefit from a larger sample, preferably covering multiple years. Next, future research might include more formal compensation practices in their analysis, apart from the best practices used in this study. Along this same line, more detailed information on costs and benefits of implementing formal compensation practices would be helpful to

SMEs so they could determine which would be more effective for which type of SME. Additionally, as the needs for a professionalized compensation system may depend on the generational stage of the firm, future research could take this into account. Finally, the legal form of a company could influence some of the findings of this study. We therefore encourage future research to explore this possible influence.

Chapter 3

The Determinants of CEO Compensation in Private Family Firms

3.1 Introduction

The majority of studies that examine the determinants of CEO compensation, have relied on data drawn from the population of publicly-held U.S. corporations, such as for example the S&P 500 (for reviews, see: Devers et al., 2007; Tosi et al., 2000; van Essen et al., in press). However, these firms actually compose a very small percentage of all firms, and little is known about CEO compensation in the largest group of firms around the world: privately-held family firms (Astrachan & Shanker, 2003; IFERA, 2003). Yet, family ownership and control may have very important implications for CEO compensation (Finkelstein et al., 2009).

While some studies have focused on the determinants of CEO pay in family firms, these firms were mainly publicly-held. For example, Gomez-Mejia et al. (2003) found that family business CEOs receive less compensation than CEOs of nonfamily firms and McConaughy (2000) reports that family CEOs receive lower total and lower incentive-based pay as compared to nonfamily CEOs in their sample of family-controlled firms. Other studies find that family shareholdings is a strong predictor of CEO pay (Veliyath & Ramaswamy, 2000) and that CEO social capital is an important determinant of nonfamily CEO pay (Young & Tsai, 2008). However, these results may not generalize to *privately-held* family firms. This type of firms provides a particularly interesting case to study CEO pay, as they are insulated from regulatory pressures and media attention, both of which can affect CEO pay

in publicly-held firms (Murphy, 1999). This "presents both an opportunity and a challenge to future research, as access to data from a large sample of these [private family] firms is severely limited" (Gomez-Mejia et al., 2003, p. 236).

We address this gap in the literature by examining the determinants of CEO compensation in Belgian privately-held family firms. As such, the following research question will be the focal point of this chapter: **What determines the compensation of CEOs in private family firms?** Based on the large amount of research on CEO pay in large public firms, we examine the ability of determinants derived from managerialist, agency, managerial power, and human capital theories to explain variations in CEO pay in the context of privately-held family businesses. Belgium, where almost 80% of the firms are family businesses (Crijns & De Clerck, 1997; Faccio & Lang, 2002; Lambrecht & Molly, 2011) offers an interesting context for this study. Not only because examining a non-Anglo-Saxon business context may provide an alternative view on CEO compensation, but also because the Belgian Code Buysse was in 2005 the first corporate governance code for non-listed firms. Although the code is subject to voluntary application of the rules, and thus only consists of recommendations, many firms use this Code as a guideline to improve their governance. In 2009, an updated version of the Code became available (Code Buysse II), which called attention to the topical issue of executive compensation in privately-held firms.

As compensation data is not publicly available in Belgium, and privately-held firms are extremely secretive when it comes to compensation data (Jensen & Murphy, 1990), we executed a survey in cooperation with one of the leading Belgian employers' associations. This approach helped us to collect a unique set of data with this sensitive information, containing compensation data of 140 family firm CEOs.

By doing so, this paper contributes to the compensation and family business literature. Although the research community has gradually responded to the challenges that arise in the vast global population of private family firms, academic research on compensation in family firms has been rather

limited (Astrachan, 2010), despite the fact that family businesses often indicate compensation issues to be a significant concern (Cardon & Stevens, 2004; Rutherford et al., 2003) and compensation policy can be important for family firm growth (Carlson et al., 2006). Therefore, the results of our study offer a useful point of reference outside the well-studied Anglo-Saxon context, at which results from other countries could be compared to.

The remainder of this chapter is organized as follows. In the next section, we provide the motivation for our research questions in greater detail and develop formal hypotheses. The third section describes the sample and reports descriptive statistics. The empirical results are provided in the fourth section, and section five concludes.

3.2 Literature Review and Research Hypotheses

Although research on the determinants of CEO compensation already started in the mid-1920s, the number of published studies on CEO pay has exploded since the 1990s (Murphy, 1999; Tosi et al., 2000). The majority of this research was guided by neo-classical economics and concentrated on the influence of respectively firm size (*managerialism*) and firm performance (*agency theory*) on CEO pay. In their 1997 review, Gomez-Mejia and Wiseman therefore urged researchers to explore alternative theoretical perspectives to expand the scope of executive compensation research and practices. After all, these two determinants (firm size and performance) explain only about half of the variation of CEO pay (Tosi et al., 2000). In the decade that followed, scholars from many different disciplines have uncovered new insights on CEO compensation through a wide variety of theoretical lenses (Devers et al., 2007). A lot of these new studies relied on managerial power theory (developed by Bebchuk et al., 2002; Finkelstein, 1992) or human capital theory (developed by Castanias & Helfat, 1991) in order to explain variation beyond that which can be predicted given objective firm characteristics.

In this study, we examine whether these determinants also hold true in private family firms inasmuch as in public firms. We investigate the ability of firm-specific attributes (relying on neoclassical theories) and of executive-specific attributes (relying on managerial power and human capital theories) to explain variation in CEO pay in the context of privately-held family firms. In the remainder of this paragraph, we review theoretical arguments and empirical evidence and complement them with family-specific arguments to predict the influence of these 'traditional' determinants of CEO pay in public firms on private family firm CEO compensation.

3.2.1 Firm characteristics as determinants of CEO compensation

Research on CEO compensation has been historically driven by economic theory: since the quintessential work of Berle and Means (1932) on the increasing separation of ownership and control in modern organizations, economists have focused on the consequences of this separation for CEO compensation. The main concern of these researchers was about the relative importance of firm size and profitability in explaining CEO compensation. The underlying theories for these determinants can be described from both the managerialist (firm size) and the agency perspective (firm performance) (Finkelstein et al., 2009; Tosi et al., 2000).

Firm size. The positive pay-size relationship is one of the most consistent results in the compensation literature (Jensen and Murphy, 1990; Devers et al., 2007). For example, results of a meta-analysis of Tosi et al. (2000) show that firm size accounts for over 40% of the variance in total CEO compensation. This is not surprising, as large firms are typically more complex and will thus require higher quality (and more costly) executives (Core et al., 1999).

Additionally, the "best documented regularity regarding levels of executive compensation" (Baker et al., 1988, p. 609) is a positive pay-size elasticity of 0.30 which appears to be very stable across both time and industry. A more recent study by Gabaix and Landier (2008) also found that

a good fraction of cross-country differences in the level of CEO compensation can be explained by differences in firm size. These results suggest that the pay-size relation reflects more than just a matching of CEOs to firms based on their abilities, and that CEOs can raise their pay by inflating firm size, even when this increase in size reduces the firm's value (Baker et al., 1988; Gabaix & Landier, 2008). Following this reasoning, the managerialist perspective claims that CEOs seek to maximize firm size because larger firms are able to pay more than smaller firms (Agarwal, 1981), and they can offer more nonpecuniary benefits to their executives (Baumol, 1967).

Although the abovementioned theories are all based on large, public firms, we believe the same arguments hold for private *family* firms: the larger the firm, the more complex the task of the CEO and therefore, the higher CEO pay. Additionally, we believe that also the second (managerial) reasoning holds true for smaller firms, that is: CEOs might increase firm size in order to justify higher pay. Empirical evidence from the context of privately-held (nonfamily) firms agrees on the significantly positive size-pay relationship (Banghøj et al., 2010; Barkema & Pennings, 1998; Wasserman, 2006). This leads us to hypothesize that:

H1: *CEO compensation is positively related to firm size in private family firms*

Firm performance. According to neoclassical economists, executive compensation will be positively related to firm profitability, which is often referred to as the "profit maximization hypothesis" (Ciscel & Carroll, 1980). This hypothesis is based on agency theory, which claims that CEO pay should at least partly depend on firm performance to motivate the CEO to act in the best interest of the shareholders (Murphy, 1986). Whereas traditional agency theorists would argue that agents in private family firms do not need performance-based pay because they do not face any (or very little) agency costs (Jensen & Meckling, 1976), recent theory and evidence states that

private family firms *do* face agency costs but of a different kind (Lubatkin et al., 2005; Schulze et al., 2003b; Schulze et al., 2001; Sharma, 2004) and that performance-based pay can be an important instrument to mitigate these agency problems (Schulze et al., 2001a)[9]. After all, performance-based pay for CEOs in private family firms can reduce the risk of moral hazard behavior and diminish the probability that the CEO will take altruistic, noneconomic efforts that threaten his own welfare as well as those around him (Schulze et al., 2001a). Additionally, as private family firms face few formal or practical obstacles to share large profits with their CEOs and their compensation policy can easily be adapted due to the informal atmosphere and the absence of disclosure obligations, private family firm CEOs are expected to be compensated for improved financial performance.

Empirical results of the influence of firm performance on private (family) firm compensation are, analogous to studies on public firms, not consistent. On the one hand, some authors find performance to have a substantial positive effect on executive compensation (Allen & Panian, 1982; Barkema & Pennings, 1998; Michiels et al., in press). On the other hand, others find a positive, but weak (Banghøj et al., 2010) or no relation whatsoever (Ke et al., 1999) between pay and performance. However, based on the arguments discussed above, we predict a positive relationship between firm performance and CEO pay:

H2: *CEO compensation is positively related to firm performance in private family firms*

3.2.2 CEO characteristics as determinants of CEO compensation

Besides the firm-specific determinants, as discussed in the previous paragraph, also CEO-specific characteristics might determine CEO compensation in private family firms. We consecutively discuss CEO

[9] An elaborate discussion on the CEO pay-performance relation in private family firms can be found in Chapter 4 of this dissertation.

shareholdings, CEO human capital, CEO family status, and CEO founder status.

CEO shareholdings. CEO power is often mentioned as a major determinant of CEO compensation (Finkelstein, 1992; Finkelstein et al., 2009; Grabke-Rundell & Gomez-Mejia, 2002) and it can be especially crucial in family businesses (Veliyath & Ramaswamy, 2000). One of the most important sources of CEO power within a firm, is share ownership (Allen, 1981; Grabke-Rundell & Gomez-Mejia, 2002).

According to managerial power theory, higher share ownership will yield higher power for CEOs (Finkelstein, 1992), which will enable them to increase their own compensation (Allen & Panian, 1982). However, in the context of privately-held family firms, this view should be nuanced. For example, a family firm CEO with no or minimal ownership is expected to have substantially different goals and time horizons than a CEO who fully owns a company (Boyd, 1994; Schulze et al., 2003b). After all, the more share ownership a CEO has, the more he will benefit from increases in shareholder value and thus the higher the utility he will derive from each dollar invested in the firm (Veliyath & Ramaswamy, 2000). A CEO who has high share ownership, will therefore probably settle for receiving a lower salary than a CEO with low share ownership (Wasserman, 2006). Earlier work investigating the relation between managerial ownership and the level of compensation in the context of privately-held firms, mainly found a negative association (Cole & Mehran, 2010; Wasserman, 2006). Thus, the following can be hypothesized:

H3: *CEO compensation is negatively related to CEO share ownership in private family firms*

CEO human capital. While share ownership is referred to as a source of 'overt power', human capital is often associated with 'covert power', because it is based more on influence and less on formal authority (Barkema & Pennings, 1998; Veliyath & Ramaswamy, 2000). According to human

capital theory, unique skills lead to high pay (Castanias & Helfat, 1991). Examples of relevant human capital characteristics for explaining variances in CEO compensation are *experience* and *education* (Finkelstein et al., 2009).. For example, the more years of experience a CEO has in managing this or other firms, the more pay raises he has received, and thus, the higher his level of compensation (Barkema & Pennings, 1998; Gomez-Mejia et al., 2003; He, 2008; McConaughy, 2000). Analogous to the years of business experience, educational accomplishments also enhance the CEO's human capital. The higher a CEO's educational degree, the higher his expertise will be, justifying higher pay (Finkelstein, 1992; Veliyath & Ramaswamy, 2000). In the context of privately-held firms, prior studies have found CEO experience or educational attainment to be positively related to CEO pay (Barkema & Pennings, 1998; Cole & Mehran, 2010; Wasserman, 2006). We expect to find the same positive relationship between CEO human capital and CEO compensation in private family firms, and therefore hypothesize:

H4: *CEO compensation is positively related to CEO experience in private family firms*

H5: *CEO compensation is positively related to CEO education in private family firms*

CEO family status. Family CEOs differ from nonfamily CEOs in some important respects, which might affect their compensation level. Firstly, unlike nonfamily CEOs, family CEOs do not have to be attracted (and retained) out of the labor market (McConaughy, 2000) and thus require less competitive pay. Secondly, family CEOs are more emotionally committed to the firm. This makes it harder for them to leave the family firm (Block, 2011; Gomez-Mejia et al., 2003). Thirdly, as a member of the controlling family, family CEOs are also likely to own (or inherit) a part of the firm, so they may prefer to leave money in the firm to enhance its value instead of receiving high compensation (Carrasco-Hernandez & Sanchez-Marin, 2007). Fourthly,

nonfamily CEOs have lower job security than family CEOs (Gomez-Mejia et al., 2003), which makes their pay more risky and thus may require a form of risk premium (McConaughy, 2000). Lastly, family CEOs are more likely to receive nonpecuniary benefits than nonfamily CEOs. Several studies find empirical evidence that family-member CEOs in public family firms receive less compensation than nonfamily CEOs (Bartholomeusz & Tanewski, 2006; Gomez-Mejia et al., 2003; McConaughy, 2000) and, based on the arguments above, we expect to find this same relation in privately-held family firms. Thus, because family firms have to pay nonfamily CEOs more to get what a family CEO would do, we hypothesize that:

H6: *Compensation for family CEOs is lower than for nonfamily CEOs in private family firms*

CEO founder status. The majority of studies investigating the determinants of CEO pay ignore the influence of founders. However, founder CEOs may have different incentives for managing firm value than other CEOs (McConaughy, 2000) and thus the compensation of founders may differ from that of nonfounders (Wasserman, 2006). We expect this impact to be especially pronounced in the context of *family* firms. After all, a founder CEO typically holds a dominant position in the company. He enjoys augmented authority in the family firm because, apart from being the founder, he also tends to be the biological head of the family (Schulze et al., 2003b). As a result, a founder CEO is expected to be very powerful in the organization and thus the pay of a founder CEO can be pretty much determined by the CEO himself, which gives him the opportunity to inflate his salary. Accordingly, managerial power theory predicts a founder CEO to receive a higher salary compared to a non-founder (Finkelstein, 1992).

This managerial power argument implies that a founder CEO will use his additional power to inflate his salary. However, we presume that three factors will temper the tendency of a founder CEO to use this power to

receive higher compensation in private family firms. First, founder CEOs define the value of their firm in terms of their own utility. Hence, they have powerful incentives to pursue options they perceive as best for the firm (Jensen & Meckling, 1976). In particular, parental altruism will lead the CEO to prefer to keep money in the firm in order to enhance its value and thus benefiting himself as well as his family (Lubatkin et al., 2005). In other words, founders are likely to have a long-term perspective: they tend to be very motivated to help the company they founded to succeed and hand over to the next generation (James, 1999). Second, founder CEOs tend to receive quite some nonpecuniary benefits or even nonmaterial rewards as a result of their position, reducing the need for monetary compensation (Wasserman, 2006). Third, excessive CEO pay would diminish the firm's cash reserves which may threaten the firm's financial stability (Cohen & Lauterbach, 2008). Although descendant CEOs are also likely to be influenced by feelings of altruism, this behavior will occur to a lower extent than for the actual founder (Lubatkin et al., 2005). Prior studies in the context of privately-held firms documented a negative relation of being a founder on CEO compensation (Barkema & Pennings, 1998; He, 2008; Wasserman, 2006). Based on the aforementioned insights, we hypothesize that:

H7: *Compensation for founder CEOs is lower than for descendant CEOs in private family firms*

3.3 Methodology

3.3.1 Sample & data collection

The primary source of data is derived from a wider survey which was conducted in 2012[10]. This survey explores general firm characteristics and compensation policies, with a focus on executive compensation in Flemish

[10] For more detailed information regarding the survey method, and an extensive overview of general sample firm and CEO characteristics, we refer to Chapter 2. The complete questionnaire is attached as an Appendix.

family and nonfamily SMEs. The survey was mailed to CEOs of 1028 firms, all of which were members of one of the leading Belgian employers' associations. After sending two reminders, a total of 246 questionnaires were received by the closing date, resulting in a response rate of nearly 25%. Seen the profoundness of the survey and the sensitivity of the questions, together with the secretive nature of family firms (Neubauer & Lank, 1998), this can be considered a very good response rate. As the focus of our study is on small and medium-sized firms, we apply the Small Business Administration definition of SMEs (Carlson et al., 2006; de Kok et al., 2006; Flanagan & Deshpande, 1996) and include all privately-held firms with 1 to 500 employees in our analysis[11]. We drop 2 cases with more than 500 employees, making the final sample size 244 firms, 212 of which can be classified as family firms[12]. Unfortunately, not all respondents filled in the questions needed for this study, further reducing the sample size. Thus, our tests are based on a final sample of 140 observations.

To assess potential non-response bias, we tested for differences between early and late respondents, as late respondents are more similar to non-respondents (Kanuk & Berenson, 1975; Oppenheim, 2000). We compared several key firm characteristics (such as firm size, age, sector and profitability) between the two groups, using Kruskal-Wallis tests. No statistical significant differences are found, which suggests that non-response bias does not appear to pose a major problem in our study. Still, there can be concerns about the use of survey data, namely that the respondents might not answer truthfully (Graham & Harvey, 2001). As we ensured complete anonymity to the respondents, we consider this problem to be minimal. Moreover, we expect

[11] In contrast to Chapter 2, we keep the firms with 1-9 employees as we do not want to further reduce the sample size. Additionally, whereas the main goal of Chapter 2 was to investigate the entire compensation *system* of a firm, this Chapter only investigates the determinants of *CEO* compensation and therefore we also take into account the micro-businesses.

[12] A firm was identified as a family firm when (a) more than 50% of the shares were owned by one family, and/or (b) the CEO considered the firm to be a 'family firm' (Dyer, 2003; Westhead & Cowling, 1998).

that the CEOs would not take the time to fill in our questionnaire if their intent was to be untruthful. Another source of concern might be the fact that the cooperation with the employers' association could cause a bias in the sampling. That is, as these firms are a member of the employers' association, they might be more eager to learn from colleagues and therefore more open to academic research. However, this approach has been adopted in other studies as well (e.g. Berent-Braun & Uhlaner, 2012; Eddleston et al., 2008; Ling & Kellermanns, 2010) and it has the advantage of reaching firms more willing to participate in research.

The secondary source of data, used for the multivariate analysis of the determinants of CEO compensation, is the Bel-First database by Bureau Van Dijk, which contains information from financial reports and ratios based on accounting information of all Belgian firms. By using two different sources of data, the risk of common method bias is mitigated, since the dependent variable (CEO pay) is based on survey data whereas several independent (firm size, performance and industry) result from a database external to the survey. Additionally, the way the questionnaire was designed and administered also reduced the risk of common method bias (e.g.: respondents were assured of the anonymity and confidentiality of the study and that there were not 'right' or 'wrong' answers). Moreover, the questions were fact-based and therefore less likely to be associated with common method bias (Chang et al., 2010).

3.3.2 Research design

In order to answer the research question: '*What determines the compensation of CEOs in Flemish private family firms?'*, we employ ordinary least squares regressions which include the hypothesized determinants:

$$\text{CEO compensation} = \alpha + \beta_1 \text{ Firm size} + \beta_2 \text{ Firm Performance} + \beta_3 \text{ CEO Shareholdings} + \beta_4 \text{ CEO Experience} + \beta_5 \text{ CEO Education} + \beta_6 \text{ Family CEO} + \beta_7 \text{ Founder CEO} + \delta \text{ Controls} + \varepsilon$$

With the purpose of testing H2, we include firm performance as a determinant of CEO compensation in our analyses. However, this relation might suffer from simultaneous causality, as not only good performance can lead to higher compensation, but high compensation might also lead to improved performance (Anderson et al., 2000). So as to reduce this possible endogeneity problem, which might result in biased and inconsistent OLS coefficients (Bascle, 2008), we use a lagged performance measure in our analyses. In this case, it is unlikely that *present* compensation can influence *past* firm performance. However, in order to fully rule out the possibility of an endogeneity problem in our analyses, we must perform a Hausman test. Following Banghøj et al. (2010) and Michiels et al. (in press), we use leverage and growth as instruments for firm performance (ROA). After assuring that our instruments are indeed exogenous (the Hansen J statistic of 1.89 with a p-value of 0.17) and relevant (the Kleibergen-Paap LM statistic of 4.31 with a p-value of 0.10), a Hausman test confirmed our theoretical predictions that there is no endogeneity problem when using the lagged value of ROA to measure the pay-performance relation (p-value of 0.31). Therefore, coefficients produced via ordinary least squares (OLS) regressions will be reliable.

Dependent Variable. *CEO Compensation* is measured as total annual cash compensation (base salary plus variable cash compensation) received by the CEO in 2011. In order to obtain a clean compensation measure, we asked the respondents to *include* all compensation that was received through the CEOs own professional management company[13] and to *exclude* all income received in the form of dividends. Following many prior studies (e.g. Cheng & Firth, 2006; Conyon, 2006; Ke et al., 1999), we take the logarithm of CEO compensation to reduce heteroscedasticity concerns.

[13] Belgian CEOs can incorporate their own professional management company, which can either sign a consultancy agreement with the Belgian group company or accept an appointment in the company (e.g. a directorship). The use of these management companies is common in Belgium and, if properly structured, can entail considerable tax benefits (PWC, Doing Business Guide in Belgium).

Independent Variables. Firm *Size* is measured via the log transformation of total number of employees, as this proxy is less likely to suffer from collinearity problems than 'total sales' which is often used in the literature (Brunello et al., 2001). Firm *Performance* is operationalized as the return on assets (ROA), extracted from the 2010 BelFirst database. ROA is measured as the net income, that is: income before interest, tax, depreciation and amortization, divided by total assets. As mentioned above, this measure is lagged one year to reduce simultaneous causality problems. The dummy variable *Family CEO* equals one when the CEO is a member of the controlling family, and zero otherwise. Similarly, the variable *Founder CEO* equals one for founder CEOs and zero for descendant CEOs. *CEO shareholdings* are measured as the percentage of shares owned by the CEO. CEO experience is operationalized via two proxies: *CEO Tenure* contains the number of years that the CEO has been active in the firm, and *CEO Age* indicates the current age of the CEO. The dummy variable *CEO Education* equals one for CEOs who did obtain a higher education degree after high-school, and zero for the ones who did not.

Controls. As CEO pay levels may vary by industry (Murphy, 1999), we add five dummy variables based on the firm's industry classifications (wholesale and retail trade, manufacturing, services, construction and other). To control for the impact of dividends on CEO pay, we add a dummy variable *Dividend* which equals one if the respondent of our survey indicated that the firm paid out a dividend in 2011, and zero otherwise. As several studies found a significant pay differential between male and female executives (Bertrand & Hallock, 2001; Blau & Kahn, 2007), we control for gender with the variable *CEO Gender* which equals one for male CEOs and zero for female CEOs.

3.4 Results & Discussion

3.4.1 Descriptive statistics and univariate analyses

Table 15 presents the means and standard deviations, together with the correlation matrix pertaining to the variables used in the testing of the hypotheses. The median (mean) total compensation for family firm CEOs is € 132,887 (€ 120,000). The average sample firm employs more than 52 people and has a ROA of 8.47. Almost 84% of the CEOs in our sample are a member of the controlling family, of which approximately 46% (38% of the total sample) are founders. CEOs on average are 49 years old and have been working for 14 years in the company. They own on average 55% of the firm's shares. About 87% of the CEOs has obtained a higher education degree. The vast majority (91%) of the CEOs in our sample are male. Finally, about 34% of the firms has paid out a dividend in 2011.

The table also shows that firm size, performance, CEO education, CEO gender and dividend payouts correlate significantly positive with CEO compensation. On the other hand, CEO family status or CEO founder status and CEO shareholdings are negatively correlated with CEO compensation. Only CEO tenure and CEO age are not correlated with CEO pay. Although the correlation matrix shows no high correlations among the variables, we checked for the possibility of multicollinearity to ensure that our results are not affected by it. The maximum value is 1.89, which is well below the threshold of 10 above which multicollinearity might be an issue (Hair et al., 2006).

Table 15 Summary data and Pearson correlations between CEO compensation and determinants

Variable	**Mean**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
1. CEO Comp[a]	132.89	1.00									
2. Size	3.26	**0.35*** **	1.00								
3. Performance	8.47	**0.18** **	-0.04	1.00							
4. FamilyCEO	83.84%	**-0.25*** **	-0.27***	0.15**	1.00						
5. Founder	38.38%	**-0.15***	-0.37***	0.20***	0.35***	1.00					
6. CEOShare	55.38	**-0.28*** **	-0.42***	0.11	0.52***	0.43***	1.00				
7. CEOTenure	13.92	-0.07	-0.14**	0.05	0.29***	0.26***	0.30***	1.00			
8. CEOAge	49.41	-0.09	-0.08	-0.01	0.07	0.35***	0.18**	0.61***	1.00		
9. CEOEduc	86.87%	**0.21*** **	-0.04	0.07	-0.13*	-0.00	-.01	-0.25***	-0.20***	1.00	
10. CEOGend	91.41%	**0.20** **	0.03	0.02	0.06	0.17**	0.15**	0.10	0.14**	0.09	1.00
11. Dividend	34.43%	**0.19** **	0.18***	0.28***	-0.14**	-0.10	-0.07	-0.09	-0.02	0.06	-0.12

Notes. N = 140 ; [a] expressed in 000's Euros; *, **, *** correlation is significant at a probability level below 0.10, 0.05 or 0.01 level (two-tailed)

3.4.2 Multivariate analyses: results and discussion

Model 1 in Table 16 presents the full model used to test hypotheses 1 till 6. As expected, firm size has a significant positive effect on total CEO pay, supporting Hypothesis 1. The pay-size elasticity, obtained from a regression of the natural logarithm of CEO pay against the natural logarithm of firm size, is 0.22 when firm size is measured via total assets and 0.24 when firm size is measured via the number of employees. Thus, an increase in firm size of 10% results in an increase of CEO pay of about 2.3%. This elasticity is quite similar to the pay-size elasticities of 0.30, respectively 0.25, as reported by Baker et al. (1988) and Kostiuk (1990) based on a longitudinal study of large US firms. Baker and colleagues have two explanations for this finding: (1) the pay-size elasticity displays a match between firm complexity and CEO ability, (2) as the elasticity is very stable over time and industry, it indicates that CEOs can increase firm size in order to inflate their own pay. Our results suggest that the first argument appears to hold true in the context of private family firms. As we do not have panel data, we cannot examine whether family firm CEOs can also increase their pay by increasing firm size.

Firm performance is also positively related to CEO compensation, as hypothesized in Hypothesis 2. In a subsequent analysis, we regress ROA on the natural log of CEO pay and find an (unadjusted) R^2 of 0.036, which is in line with the 0.045 explained variance of Jensen and Murphy (1990) and the 0.040 of Tosi et al. (2000). This result is in line with other studies in the context of private (family) firms (Allen & Panian, 1982; Barkema & Pennings, 1998; Michiels et al., in press) and supports the suggestion that objective performance-based measures play a significant role in CEO compensation.

Furthermore, supporting Hypothesis 3, the negative and significant coefficient on CEO share ownership suggests that CEO compensation decreases as the percentage of CEO shareholdings increases. This finding is consistent with that of Wasserman (2006), but is in conflict with what might be expected from managerial power theory ('high ownership leads to high pay').

Next, both CEO tenure and CEO age have no significant effect, so our results do not support Hypothesis 4. As a robustness test, we repeated the analysis with two other proxies for CEO tenure (number of years active in the position of CEO; and the number of years active in the industry). All results remained the same (results not reported). Additionally, we used squared tenure in order to capture a possible curvilinear relationship of tenure on performance, but the coefficients were not significant. This source of covert CEO power thus not leads to higher pay, again conflicting the predications of power theory. Consistently with Hypothesis 5, a significant positive relationship is observed between CEO education and CEO pay. So, the often observed relationship in public firms also applies in private family firms: higher educated CEOs earn more.

Hypothesis 6 predicted that family CEOs would receive lower pay than nonfamily CEOs. Although the coefficient of *Family CEO* has the expected sign, it is not statistically significant. Therefore, in contrast to assumptions that hiring external CEOs would be more costly to the firm (McConaughy, 2000), we find that nonfamily CEOs do not receive a higher compensation than family-member CEOs. Whereas McConaughy (2000) only finds a significant negative effect for CEO family status, and not for CEO share ownership, for his sample of US *public* family firms, we find slightly different results (significant negative effect of CEO share ownership but no significant effect of CEO family status). Thus, it appears be that in privately-held family firms, the effect of CEO family status on CEO pay is already implicitly included in the measure of CEO share ownership.

In order to test Hypothesis 7, which compares the pay level of founder and descendant CEOs, model 2 (Table 16) uses a subsample of firms with a family CEO. Although the coefficient for founder CEO has the expected (negative) sign, it is not significant. Despite the fact that Hypothesis 7 is not supported, our results partially support the arguments behind it, that is: although managerial power theory uses founder status as an indicator of

greater power, our finding suggests that founders appear not to use this power to inflate their salary.

Concerning the control variables, the results show that female CEOs earn significantly less than male CEOs. Next, CEOs in the trade (wholesale and retail) industry earn significantly less than CEOs in other sectors. Finally, dividend payouts seem to have no significant influence on the level of CEO pay.

As a matter of robustness test, we repeated the analyses by using the *Base Salary* of the CEO (thus excluding the variable cash compensation), instead of *CEO Total Pay.* The main determinant of CEO base pay, again, is firm size. Other determinants of base pay are CEO education and CEO gender. Although we found a positive significant effect of firm performance on *Total CEO pay,* firm performance has no significant effect on *CEO Base pay.*

Table 16 Regression results for total compensation

Model	*Hypothesis (Predicted Sign)*	**1**	**2**
Constant		10.541***	10.3803***
		(0.4468)	(0.5904)
Firm Characteristics			
Firm Size	*H1(+)*	**0.1590*** **	**0.1771*** **
		(0.0462)	(0.0564)
Firm Performance	*H2(+)*	**0.0128** **	**0.0131***
		(0.0064)	(0.0070)
CEO Characteristics			
CEO Share	*H3(-)*	**-0.0033***	-0.0028
		(0.0019)	(0.0021)
CEO Tenure	*H4(+)*	0.0072	0.0076
		(0.0071)	(0.0079)
CEO Age	*H4(+)*	-0.0077	-0.0092
		(0.0085)	(0.0106)
CEO Education	*H5(+)*	**0.4550***	**0.4649***
		(0.2426)	(0.2380)
Family CEO	*H6(-)*	-0.1339	-
		(0.1721)	
Founder CEO	*H7(-)*	-	-0.0264
			(0.1856)
Controls			
CEO gender		0.4722**	0.5133**
		(0.2230)	(0.2341)
Dividend		0.1451	0.2230
		(0.1309)	(0.1553)
Industry controls		Yes	Yes
Adjusted R^2		*0.2891*	*0.2473*
Model F Statistic		*8.32****	*5.82****

Notes. N= 140 for model 1, and N= 116 for model 2 (subsample of firms with a family CEO in order to distinguish between founder and descendant CEOs); Dependent variable = ln(CEO Compensation); Heteroskedasticity-robust standard errors in parentheses; [a] natural logarithm; ; *, **, *** denotes significance at a probability level below 0.10, 0.05 or 0.01 level (two-tailed).

3.5 Conclusions

This chapter examines the determinants of CEO compensation in privately-held family firms. Although these firms represent the majority of the firms worldwide, not much is known about what determines the pay of their CEOs. We address this gap in the literature by testing whether the 'traditional' determinants of CEO pay also hold true for private family firms inasmuch as in public firms. The central finding of this study is that, as in large publicly-traded companies, firm size and performance are the main determinants of CEO pay in privately-held family firms. This suggests that, although based on different assumptions, predictions made about executive compensation in neoclassical theories (agency, managerialism) are also applicable in the context of private family firms. In contrast, our results are not supporting (even contradicting) managerial power predictions. Our measures of CEO power have no (experience, family or founder status) or the opposite (CEO share ownership) effect on CEO pay. Further, after controlling for firm size, industry, education and tenure, we find that female CEOs earn significantly less than their male colleagues. Yet, this finding must be interpreted with caution, as our sample contains very few (7%) female CEOs.

Inevitably, there are several caveats in this study that should be acknowledged and which offer some interesting avenues for future research. Firstly, our results are based on a particular sample of private family firms from a small geographical area (Flanders) and future research is needed to confirm the generalizability of our results in different countries. Another limitation is the cross-sectional nature of our data set, which limits any inferences regarding causality. A panel data set could reveal variations in time. Secondly, this study is based on data from 2011, an unprecedented period of economic distress. In the future, scholars may try to ascertain whether some of our findings reflect these unique economic conditions. Thirdly, we did not have the data on possible co-CEO ship, so it might be

interesting for future research to account for the effect of co-CEO ship in their analyses. Finally, this study solely focuses on the antecedents of CEO pay, while especially the consequences of it might be of crucial importance for private family firms. Future research could therefore examine the impact of CEO pay on family firm growth and longevity.

Chapter 4

CEO Compensation in Private Family Firms: Pay-for-Performance Sensitivity and the Moderating Role of Ownership and Management[14]

4.1 Introduction

In the last 30 years, CEO compensation is one of the corporate governance topics that has excited a lot of public controversy (Denis, 2001). One of the prominent research questions in this area is whether firm performance has an effect on CEO compensation (Barkema & Gomez-Mejia, 1998). Theoretical arguments for the pay-for-performance debate are principally grounded in agency theory. Agency theory assumes all individuals to be rational, risk adverse and inclined to take actions that maximize their personal welfare with minimal effort (Gomez-Mejia & Wiseman, 1997; Jensen & Meckling, 1976). As such, in order to motivate CEOs to act in the best interest of the shareholders, one of the possible actions is to make CEO pay dependent on firm performance (Murphy, 1986).

[14] This chapter is based on the paper "CEO Compensation in Private Family Firms: Pay-for-Performance Sensitivity and the Moderating Role of Ownership and Management", co-authored with Wim Voordeckers, Nadine Lybaert and Tensie Steijvers, and will be published in Family Business Review. We thank three anonymous reviewers and Allison Pearson (editor) for their valuable comments and suggestions, as well as seminar participants at the RENT 2009 conference in Budapest, at the RENT 2010 conference in Maastricht, at the BERD 2010 in Antwerp, at the EIASM workshop 2010 on Corporate Governance in Brussels and the BERD 2011 in Louvain-La-Neuve for feedback and discussions.

Most empirical research on pay-for-performance has focused on large, public firms (and Berger & Berger, 2001; for reviews see: Devers et al., 2007; Gomez-Mejia, 1994; Tosi et al., 2000). Other forms of organizations, such as small privately-held family firms, have often been overlooked because it is assumed that pay-for-performance is not relevant due to the absence of separation between ownership and control and thus the absence of agency costs. However, recent literature argues that concentrated (family) ownership and owner-management can also be associated with substantial agency costs, which are mainly engendered by altruism and self-control problems (Lubatkin et al., 2005; Schulze et al., 2003b; Schulze et al., 2001a). Therefore, we argue in this paper that the pay-for-performance relationship *is* relevant in private family firms because the complex agency relations make them benefit from performance-related pay. Moreover, several surveys (Chrisman et al., 2007; Schulze et al., 2001a; Welles, 1995) reveal that, in practice, the majority of privately-held family firms does indeed offer performance-based pay to their managers.

The scant amount of evidence on pay in private (family) firms finds inconsistent results (Banghøj et al., 2010; Barkema & Pennings, 1998; Cole & Mehran, 2010; Cooley, 1979; Ke et al., 1999; Schulze et al., 2001a). One potential explanation for these mixed results could be provided by the fact that these studies do not examine the effects of potential moderating variables on the pay-for-performance relation. As private family firms cannot be treated as a homogeneous group (Habbershon et al., 2003; Westhead & Howorth, 2007), the nature and level of agency costs may vary across different types of private family firms. Therefore, the objective of this study is to examine **how (and to what extent) the pay-for-performance relation is moderated by the ownership and management structures.**

Private family firms are an interesting case to study, because they have some characteristics that deviate from large, publicly traded firms which may be reflected in the design of pay contracts. First, owners in privately-held family firms are likely to have different incentives and possibilities to monitor

the CEO (Fama & Jensen, 1983) due to the high level of ownership concentration. Second, compensation policy poses one of the most complex[15] and sensitive problems family firms face (Aronoff & Ward, 1993) due to family considerations such as family history, expectations and sibling rivalries (Coleman & Carsky, 1999; Nuno Pereira & Paulo Esperança, 2008). Third, because private firms are insulated from regulatory pressures to disclose CEO pay, they tend to use less sophisticated[16] CEO compensation plans (Bebchuk & Fried, 2003; Bitler et al., 2005).

Our hypotheses are tested using a cross-sectional sample of 529 private family firms (C-Corporations), gathered by the 2003 Survey of Small Business Finance (hereafter, SSBF). The results suggest that in these firms, objective performance-based measures play a significant role in CEO compensation. Additionally, we find that a CEO's compensation is more responsive to firm performance in firms with low ownership dispersion and in the controlling-owner stage. Furthermore, the positive pay-for-performance relation is slightly stronger for nonfamily CEOs than for family CEOs. Therefore, our findings suggest that private family firms cannot be considered as a homogeneous group when studying CEO compensation.

As such, our paper contributes to the literature in several ways. First, while traditional agency theorists claim the pay-for-performance relation to be irrelevant in the context of private family firms, we provide empirical evidence that suggests the opposite. Second, we respond to recent calls to investigate the conditions or characteristics under which performance determines

[15] In the context of private family firms, establishing a compensation policy is a difficult and sensitive matter, due to the institutional overlap of family and business, which makes the development of a compensation policy even more complex than it already is in nonfamily firms. For example, deciding on the level and type of compensation contract of family members versus nonfamily members, and within the group of family members, can be a very sensitive matter. We refer to Lansberg (Chrisman et al., 2006; Sharma et al., 2012) and Aronoff and Ward (2006) for a more elaborate discussion on this topic.

[16] The composition of a CEO's pay package tends to be less sophisticated in privately-held firms compared to publicly-held firms for example because they generally make no use of stock options or other sophisticated financial instruments (Bitler et al., 2005).

executive compensation (Chrisman et al., 2007; Finkelstein et al., 2009) by taking into account ownership and management characteristics of the private family firm. Third, while previous studies used samples of both family and nonfamily firms (Banghøj et al., 2010; McConaughy, 2000), or both private and public firms (Ke et al., 1999), we focus on privately-held family-owned firms. This focus on private family firms should reveal more clearly the differences within this group of family firms. Fourth, existing literature on executive pay in privately-held family firms is scarce, because data has generally not been accessible (Ke et al., 1999; Wasserman, 2006). In 2003, the Federal Reserve Board released its Survey of Small Business Finances (SSBF), which collected data from a sample of US-based private firms. The survey provides compensation information on a group of firms which are all 100 percent family-owned, which is exactly the case where classical agency theorists expect no agency costs. The database also enables us to test the pay-for-performance relationship in firms with a wide range of ownership and management structures. Finally, from a methodological point of view, our findings are an excellent illustration of the importance of the calculation of marginal effects for the interpretation of interaction models as our results show that it is indeed possible that these effects are significant for relevant values of the moderating variable, even if the coefficient of the interaction term is non-significant (Brambor et al., 2006; Kam and Franzese, 2007).

This chapter proceeds as follows. In the next section, we discuss the pay-for-performance relationship theoretically and derive testable hypotheses. We then test these hypotheses using our sample of 529 privately-held US family firms. The results and conclusions follow.

4.2 Theory Development and Hypotheses

4.2.1 Agency theory on CEO compensation: the optimal contracting perspective

Agency theory is the theoretical framework that is most frequently used to characterize CEO compensation (Devers et al., 2007). This theory

focuses on the conflict of interest that arises from the separation of ownership and control (Berle & Means, 1991), often referred to as *Agency Problem I*. This conflict arises because agency theory assumes all individuals (both agents and principals) to be rational, risk adverse and inclined to take actions that maximize their personal welfare (Jensen & Meckling, 1976). As a result of this conflict of interest between managers (agents) and shareholders (principals), agency costs can arise (Jensen & Meckling, 1976). CEOs, as being agents, are thus also assumed to be entirely driven by self-interest and motivated primarily by financial incentives (Lubatkin et al., 2007). This raises the possibility for opportunistic actions by the CEO because he[17] might pursue a self-serving agenda, which does not necessarily include the same objectives as those of the shareholders. For example, a CEO might undertake aggressive mergers and acquisitions, with modest or even negative returns to the shareholders, just for increasing the size of the firm and, as a result, increasing the level of CEO pay (Kroll et al., 1990). When this incongruence of objectives occurs, shareholders will have to find a way to reduce the possibility of opportunistic actions undertaken by the CEO. As such, in order to motivate CEOs to act in the best interest of the shareholders, agency theory claims that CEO pay should (partly) depend on firm performance (Murphy, 1986). An 'optimal contract' will therefore tie the CEO's expected utility to shareholder's wealth by depending on verifiable performance benchmarks (Jensen & Murphy, 1990; Ross, 1973). As a result, this optimal contract can reduce Agency Problem I because it encourages CEOs to act on behalf of the shareholders (Conyon, 2006; Setia-Atmaja et al., 2009) and thus aligns the incentives of both parties. In other words, agency theory considers performance dependent CEO pay as a tool to alleviate agency problems stemming from the separation between ownership and control.

As discussed above, agency theory claims that pay-for-performance contracts are needed to reduce the agency costs resulting from the owner-

[17] When we refer to the CEO as 'he' or 'his' throughout this dissertation, this relates to both male *and* female CEOs

manager agency conflict. These owner-manager agency conflicts are considered to be prevalent in private family firms when ownership and control are separated, i.e. when a nonfamily CEO (without ownership) leads the firm. But the question remains whether there also exist agency problems when ownership and control are coupled (when a family owner-manager leads the firm) in the context of *private family firms*. There are two opposing views regarding this question.

According to classical agency theorists, Agency Problem I is not a major problem in private family firms because family involvement in both ownership and management should align the interests of owners and managers (Fama & Jensen, 1983). The effects of concentrated ownership and owner-management will lead to a minimized, or even zero, level of agency costs (Ang et al., 2000; Jensen & Meckling, 1976). Several authors (Anderson et al., 2003; Ang et al., 2000; Fama & Jensen, 1983; Jensen & Meckling, 1976) argue that family firms are the most efficient form of organizational governance, because the concentrated ownership that characterizes private family firms, implies several agency benefits.

Possible acts of self-interest will be tempered by kinship and by altruism (Schulze et al., 2003a). Kinship tempers the acts of self-interest with feelings of loyalty and commitment to the firm and the family (Schulze et al., 2003a). Altruism reduces information asymmetry (the basis of many agency problems) by increasing the cooperation and communication within the family firm ('the bright side of altruism') (Daily & Dollinger, 1992). Additionally, several studies (e.g. Karra et al., 2006; Lubatkin et al., 2005) suggest that altruism especially reduces agency costs in the early stages of family business. Thus, although family members might be self-interested, this does not mean that they are selfish because feelings of altruism will motivate the family agent to work in the best interest of the owners (Fiegener, 2010) and other family members. The interdependence among family agents is an important agency benefit as well because their welfare is directly linked to firm performance through their employment (Schulze et al., 2003b). These benefits, together

with family ties, loyalty and stability can be effective in lengthening the horizons of decision making and in providing incentives for efficient investments in family firms (James, 1999). Especially privately-held family firms are expected to have a long-term perspective since they are not 'haunted by quarterly results' and do not have to worry about hostile takeovers (Devries, 1993). In sum, family control is a potential agency cost-reducing mechanism in itself.

This minimum (or absence) of agency costs will imply that performance-based pay is not needed in privately-held family firms, as the main goal of pay-for-performance is to reduce the firm's agency costs. Moreover, shareholders in private family firms have both the incentive (high ownership concentration) and the opportunity (better access to the CEO) to monitor the CEO more closely than public firm shareholders (Fama & Jensen, 1983). This may further reduce the need to make CEO pay dependent on firm performance.

In the last decennium, however, literature argues that private family firms are anything but immune to *agency problems* (Burkart et al., 2003; Lubatkin et al., 2005; Schulze et al., 2003b; Schulze et al., 2001a; Sharma, 2004). These studies focus on the negative effects of concentrated (family) ownership and owner-management. The agency costs in private family firms are primarily engendered by altruism and self-control problems. Although *altruism* may be an advantage of family ownership, it does not make a perfect agent of a manager (Jensen, 1994). Lubatkin et al. (2005) state that parental altruism, combined with private ownership and owner-management, negatively influences the ability of the owner-manager to exercise self-control. Indeed, family logic often overrides business reason (Devries, 1993) because families have non-economic goals as well (Karra et al., 2006). Altruism can thus engender agency costs generated by for example *moral hazard* which includes free riding, shirking or consuming perquisites (Karra et al., 2006), by *adverse selection* in the labor market, for example by hiring family members with insufficient qualifications (Chrisman et al., 2004) or by *hold-up*, when

owner-managers use their power to force agents to accept changes that are not in their best interest (Lubatkin et al., 2005). For example, a CEO's altruistic efforts to improve the welfare of his relatives via involvement in the family firm can also be considered as an expression of self-interest that may counter the economic interests of the (other) family owners (Fiegener, 2010). Moreover, the emotions associated with family ties may reduce the monitoring effectiveness in family firms as the family status of executives will distort the judgments on the appropriateness of their actions and decisions (Gomez-Mejia et al., 2001). As such, not only nonfamily managers but also family executives may behave as agents in private family firms (Chrisman et al., 2007).

Whereas traditional agency theorists would argue that family agents in private family firms do not need performance-based pay because they do not face any (or very little) agency costs (Jensen & Meckling, 1976), recent theory and evidence thus states that private family firms *do* face agency costs but of a different kind (Lubatkin et al., 2005; Schulze et al., 2003b; Schulze et al., 2001a; Sharma, 2004). For example, parental altruism makes it very difficult for family agents to take the necessary disciplining actions in reaction to potential free riding behavior of other family members. A possible solution to this kind of agency problems is "to tie a portion of the family agent's wage to outcomes that can be effectively monitored, such as firm performance" (Schulze et al., 2001: 103). Performance-based pay to family agents then serves a double purpose: (1) it eases the risk of moral hazard behavior of these family agents and (2) it reduces the probability that the agent will take altruistic, noneconomic efforts that threaten his own welfare as well as those around him (Schulze et al., 2001). Consequently, following Schulze et al. (2001), we posit that pay-for-performance is an important instrument to mitigate different kinds of agency problems in private family firms, not only when ownership and control are separated but also when ownership and control are coupled. Therefore, we postulate:

H1: *Firm performance is positively related to CEO compensation in privately-held family firms*

4.2.2 The moderating role of ownership and management on the pay-for-performance relation

Previous empirical studies on the influence of firm performance on managerial pay in private (family) firms provide inconsistent results. On the one hand, some authors find evidence supporting optimal contracting theory, in that firm performance has a substantial effect on managerial salary (Cooley, 1979) or bonus (Barkema & Pennings, 1998). For instance, Schulze et al. (2001a) find that a large percentage of the private family firms in their sample offer pay incentives (in the form of cash bonuses) to their agents. Other findings are in contrast to predictions of this theory and find no relation whatsoever between firm performance and CEO pay (Banghøj et al., 2010; Ke et al., 1999).

However, these studies typically do not take into account the heterogeneity of family firms (with the exception of Schulze et al. (2001a), who differentiate between family and nonfamily agents). Yet, research has highlighted that (private) family firms may have various goals, resources and needs (Habbershon et al., 2003) as well as diverse ownership and management structures (Chrisman et al., 2005; Westhead & Howorth, 2007). As a result, there seems to be a growing consensus that private family firms should be treated as a heterogeneous entity. According to Finkelstein et al. (2009), it is therefore much more productive to investigate *the conditions or characteristics under which performance affects compensation.* Filatotchev and Allcock (2010) confirm this view by mentioning that there is too little attention to the distinct contexts in which firms are embedded. Evidence from meta-analyses by Tosi et al. (2000) and van Essen et al. (2001)in press) indicate that moderator variables may affect the relationship between performance and total pay.

Since private family firms cannot be seen as an homogeneous group, they will not all face the same type and amount of agency costs. As a result, we must acknowledge this heterogeneity when investigating CEO pay-for-performance in private family firms. After all, the need and impact of performance-related pay will be contingent on the amount and type of agency costs. We distinguish several types of family firms, based on different ownership and management structures, so as to take into account this heterogeneity (Figure 22). Hence, we examine whether the pay-for-performance relation depends (1) on the ownership structure (Balkin & Gomez-Mejia, 1990; Lawler, 1981; Lubatkin et al., 2005), (2) on the generational stage of the firm (Gersick et al., 1997; Lubatkin et al., 2005) and (3) on whether the CEO is a family member or not (Gomez-Mejia et al., 2003; McConaughy, 2000). With this subdivision, we also respond to a call of Chrisman et al. (2007) for further research that investigates whether the pay-for-performance relation in private family firms depends on the level and types of family involvement.

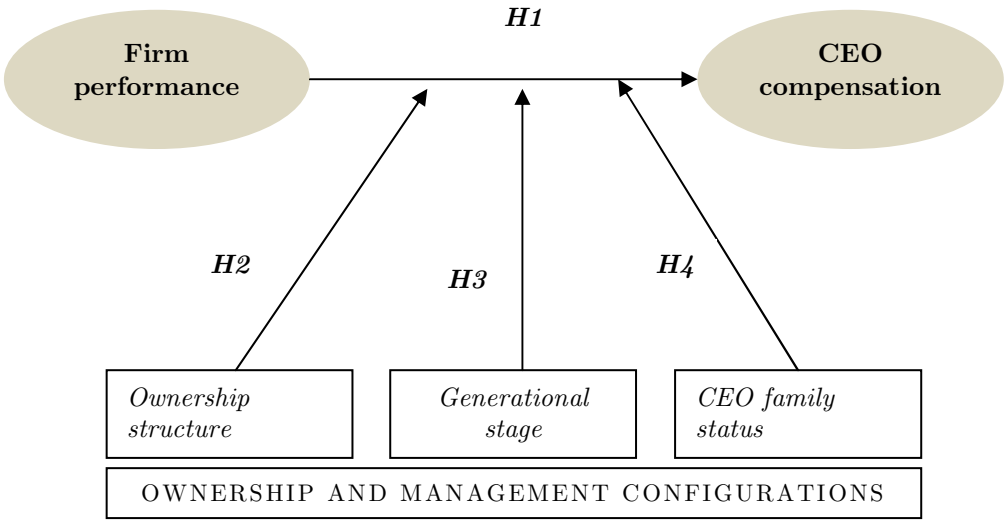

Figure 22 Research Design

Ownership dispersion has a different effect on (1) the 'traditional' agency costs related with diverging interests between the controlling owner and other owners and (2) agency costs associated with self-control and parental altruism. When there is a sole owner, the former agency costs are expected to be minimal whereas the latter could be significant. When ownership slightly disperses, i.e. when the family owner is being accompanied by some owners of the same nuclear family, the net outcome of these two agency effects does not materially change: the probability of agency problems of self-control and parental altruism remains significant and the risk of agency problems of diverging conflicts of interest remains rather minimal. But as ownership further disperses, many of the altruistic features that characterize a private family firm including its 'dark agency effects' will gradually disappear (Lubatkin et al., 2005). As such, ownership dispersion is expected to decrease agency costs related with parental altruism. However, this decreasing effect in agency costs may be weakened by potential emerging conflicts of interest between controlling owners and minority shareholders. Indeed, further

ownership dispersion beyond the nuclear family could change the nature of altruism (Lubatkin et al., 2005) and may drive a wedge between controlling owners and other family owners (Schulze et al., 2003a). Furthermore, as the number of owners increases, the existence of passive family shareholders becomes more likely (Jaffe & Lane, 2004). Consequently, conflicts of interest between controlling owners and these passive family shareholders could arise (Miller & Le Breton-Miller, 2006).

We argue that, contrary to agency problems of self control and parental altruism (e.g. hiring incompetent relatives, allowing free riding), the potential owner-owner agency conflicts could be easily dealt with by family governance (e.g. family council) and corporate governance mechanisms (e.g. controlling board of directors with family shareholders represented). However, pay-for-performance could be used to solve agency problems related to parental altruism and self-control. Therefore, we propose that ownership dispersion will have a diminishing effect on agency costs related to parental altruism and self-control in privately-held family firms. As such, we posit that performance-based pay is a more important instrument when agency costs associated with self-control and parental altruism are highest in private family firms, i.e. when family ownership is more concentrated. Or, stated otherwise:

H2: *Ownership dispersion will moderate the relationship between firm performance and CEO compensation in such a way that firm performance will have a less positive effect on CEO compensation when ownership disperses*

Whilst the former hypothesis focuses on the division of ownership, no matter what stage the firm is situated in, ownership dispersion is often assumed to be entangled with the generational stage. Gersick et al. (1997) distinguish three broad stages of ownership across generations: (1) the controlling-owner stage in which the founder also exercises control rights, (2) a sibling partnership in which ownership is in hands of several members of a

single generation and (3) a cousin consortium in which ownership is further fractionalized when it is passed on to third and later generations.

As a consequence of parental altruism, the controlling-owner stage may suffer from potential moral hazard and free riding behavior of family members on the controlling owner's equity (Schulze et al., 2003b). Although sibling partnerships are not immune for this kind of agency problems, more extended sibling partnerships are expected to anticipate the dysfunctional effects of altruism (Lubatkin et al., 2005). We expect that these dysfunctional effects will further disappear in the cousin consortium stage because more outside family members (not employed by the firm) become shareholder (Jaffe & Lane, 2004) and hence, behave more as rational diversified investors (Schulze et al., 2003a). Moreover, many of the altruistic attributes, which make family firms theoretically distinct, will disappear during the cousin consortium stage. Hence, and in line with the previous hypothesis, we posit that since agency costs associated with self-control and parental altruism will be higher in the controlling-owner stage than in later generational stages (sibling partnership and cousin consortium stage), we expect the relation between firm performance and CEO compensation to be stronger in the controlling-owner stage than in later generational stages. Or, stated differently:

H3: *Generational stage will moderate the relationship between firm performance and CEO compensation in such a way that firm performance will have a less positive effect on CEO compensation in later generational stages compared to the controlling-owner stage*

The relationship between firm performance and CEO compensation might also depend on the CEO's relation with the controlling family, i.e. whether the CEO is a member of the controlling family or a nonfamily CEO. In case of a *family CEO*, traditional agency theory proposes that there is no need for performance-based pay because their interests are aligned to those of

the owners and because their personal wealth is already closely tied to the value of the firm (Jensen & Meckling, 1976; Schulze et al., 2003a). This is what McConaughy (2000) refers to as the 'family control incentive alignment hypothesis': family CEOs derive superior incentives for maximizing firm value and therefore have less need for incentive compensation to align their interests with the firm than do nonfamily CEOs (Gomez-Mejia et al., 2003; McConaughy, 2000).

Yet, surveys by Schulze et al. (2001a) and Chrisman et al. (2007) reveal that private family firms' managers are partly rewarded in the form of cash bonuses. There are several reasons why this may occur. First, contrary to traditional agency theory, private family firms do face significant agency costs associated with altruism (hold-up, adverse selection) and issues of self-control. Because family CEOs have noneconomic goals as well (Schulze et al., 2001), they may behave suboptimal in terms of firm performance. For example, according to Gomez-Mejia et al. (2007), family managers are willing to accept a significant risk to their performance in order to avoid losses of their socioemotional wealth (Reid & Adams, 2001). Hence, it is likely that the other family shareholders will prefer that a portion of the CEO's salary will be tied to firm performance to reduce the possible negative effects on firm performance. Second, including firm performance in the family CEO's compensation contract will give a sign of professional management and increases the firm's attractiveness towards banks, lenders of federal sources and perhaps individual investors or private equity funds (Chrisman et al., 2007; McConaughy, 2000). Finally, even though family CEOs are likely to have a great deal of wealth through share ownership compared to their compensation, performance-based pay might have a sizable impact on the cash available for them to spend, given the illiquidity of their shares (McConaughy, 2000). Therefore, performance-based pay may be a relevant incentive mechanism for the family CEO.

In case of a *nonfamily CEO* significant agency costs are expected to prevail (Lubatkin et al., 2005). After all, as a nonfamily CEO generally has no

(or very low) ownership, his personal wealth is not essentially tied to firm value. Consequently, the owners of the firm will try to ensure that the nonfamily CEO makes effort to maximize firm value and will therefore reward him with performance-based compensation (McConaughy, 2000). A possibility to minimize this owner-manager conflict of interest is thus via an 'optimal contract' which ties CEO compensation to firm performance (Jensen & Murphy, 1990). Nonfamily CEOs, as any other agents, are expected to be risk-averse and one might thus expect them not to be keen on performance-related pay. However, they will have less influence on the pay-setting process compared to family CEOs because they are expected to have less power in the firm and will typically be less entrenched in their position (Shleifer & Vishny, 1997). Moreover, nonfamily CEOs might not necessarily be opposed to receiving performance-related pay because they typically have a short-term focus. After all, a nonfamily CEO will not necessarily stay in the family firm for the rest of his career. Therefore, it is important for him to be able to leave the firm with a successful track record and thus with results of strong short-term performance (Block, 2011). Hence, linking compensation with short-term firm performance will be in line with their short-term focus.

In conclusion, both private family firms with a family CEO as well as those with a nonfamily CEO, have various motives to offer their CEO performance-based compensation. However, the strength of the pay-for-performance relationship is not expected to be similar for both CEO types. While nonfamily CEOs mainly have a short-term focus, family CEOs usually have a longer-term focus because family ties, loyalty and stability will lengthen their horizon (James, 1999). As shorter CEO horizons are found to be related with higher agency costs (Antia et al., 2010), we expect the relation between short-term firm performance and CEO compensation to be weaker for family CEOs, compared to nonfamily CEOs. Thus:

H4: *CEO family versus nonfamily status will moderate the relationship between firm performance and CEO compensation in such a way that firm*

performance will have a less positive effect on CEO compensation for family CEOs than for nonfamily CEOs.

4.3 Data and Methodology

4.3.1 Sample

This study draws on data of the 2003 'Survey of Small Business Finance' (SSBF), which is sponsored by the Federal Reserve Board. This survey provides detailed information on over 4,000 private, non-financial, non-agricultural, small (fewer than 500 employees) businesses in the US economy. The sample was designed to represent the population of about five million small privately-held US firms in 2003. The SSBF database provides us with the necessary information on family firms, including performance, compensation, ownership and management characteristics.

We impose several restrictions on the database. We exclude all firms that do not fit our definition of a private family firm, being 'a non-publicly traded firm which is exclusively (100%) owned by members of the same family (where family refers to spouses, parents/guardians, brothers, sisters, or close relatives)'. Although there exists a lot of different opinions about what exactly defines a family firm (Chua et al., 1999), this definition suits the purpose of our study. According to Astrachan et al. (2002), the employed definition of a family firm should measure what it intends to measure and assists in providing reliable research results. By using this definition, we are able to keep our focus on those firms that are entirely owned by members of the same nuclear family. As a result, there are no nonfamily shareholders that can influence the firm's compensation policy (e.g. individual investors, venture capitalists,...). This is exactly the case where agency theory expects agency costs (and thus, the pay-for-performance relationship) to be irrelevant (Jensen & Meckling, 1976), which we question. In conclusion, this definition provides us with the opportunity to test whether there is a pay-for-performance relationship and more specifically, for which specific types of family firms

there is a pay-for-performance relationship. Next, we exclude all proprietorships, partnerships and S-corporations from our analyses, because we want to compare firms of similar organizational form[18] in order to avoid possible bias in both the compensation and performance measures. Thus, our final sample entirely consists of C-corporations. Finally, we exclude firms with missing data, because they did not know or refused to disclose the information needed to obtain our variables of interest. These restrictions leave us with a final sample of data on 529 privately-held US family firms.

4.3.2 Research design

Our baseline hypothesis tests whether CEO compensation is related to firm performance. A high pay-for-performance sensitivity in an econometric model means that total compensation contracts contain high-powered incentives (e.g. variable pay incentives such as cash bonuses) and therefore are often called high-powered total compensation contracts (Li & Srinivasan, 2011). For example, when all total compensation contracts in a sample only contain fixed salary, there will be probably a weak or even no significant relationship between total compensation and performance. Thus, when a CEO compensation contract contains a high percentage of variable pay, there will be a strong statistical relationship between total compensation and firm performance (ROA), revealing the existence of high-powered compensation contracts.

The subsequent hypothesis examine whether this relation is moderated by the ownership and management characteristics of the firm (number of owners, generational stage and CEO family status). Therefore, interaction terms *Owners*ROA, Generation*ROA* and *FamilyCEO*ROA* are

[18] In contrast with both subchapter S- and C-corporations, proprietorships and partnerships do not offer limited liability and easy transferability of ownership interest. We also exclude subchapter S-corporations because of differences in tax-treatment.

used to test respectively *H2, H3* and *H4.* This yields the following four regression models:

$$(1) \quad \ln(\text{CEOcomp}) = \alpha + \beta_1\,\text{ROA} + \delta\,\text{Controls} + \varepsilon \qquad \text{(H1)}$$

$$(2) \quad \ln(\text{CEOcomp}) = \alpha + \beta_1\,\text{ROA} + \beta_2\,\text{Owners} + \beta_3\,\text{Owners*ROA} + \delta\,\text{Controls} + \varepsilon \qquad \text{(H2)}$$

$$(3) \quad \ln(\text{CEOcomp}) = \alpha + \beta_1\,\text{ROA} + \beta_2\,\text{Generation} + \beta_3\,\text{Generation*ROA} + \delta\,\text{Controls} + \varepsilon \qquad \text{(H3)}$$

$$(4) \quad \ln(\text{CEOcomp}) = \alpha + \beta_1\,\text{ROA} + \beta_2\,\text{FamilyCEO} + \beta_3\,\text{FamilyCEO*ROA} + \delta\,\text{Controls} + \varepsilon \qquad \text{(H4)}$$

While the objective of our study is to investigate the impact of firm performance on CEO compensation, firm performance itself can also be dependent on CEO compensation. According to agency theory, a pay-for-performance contract might also lead to improved firm performance. However, most previous research only considered the impact of performance on pay, without considering the simultaneous effect of pay on performance (Anderson et al., 2000). Yet, ignoring this simultaneous relationship might cause simple OLS regressions to lead to biased and inconsistent coefficients because X_i (the regressor) and u_i (the error term) are correlated and OLS picks up both forwards and backwards effects (Anderson et al., 2000; Bascle, 2008). Simultaneous causality is a form of endogeneity that is common in accounting and finance research (Chenhall & Moers, 2007), and can be adequately addressed by applying instrumental variable methods (Bascle, 2008). Specifically, instrumental variables methods focus on the variations in X that are uncorrelated with the error term (Bascle, 2008).

First, we need to find valid instruments to produce consistent and efficient estimators. That is: the instruments should be relevant and exogenous (Bascle, 2008). In order to instrument for 'ROA', we used sales growth and leverage, following Banghoj et al. (2010). We argue that sales growth is a good instrument for ROA in private family firms, as it is often used as a proxy for firm performance and positively correlated with ROA (Schulze et al., 2003; Maury, 2004). Intuitively, it is very unlikely that a

CEO's present pay can influence the firm's past sales growth and therefore we believe this instrument is valid. We added 'leverage' as an instrument because leverage is often indicated to as an important determinant of ROA (Maury, 2004; Campello, 2006). Again, we do not expect a CEO's pay to influence the firm's leverage. Second, we performed a Hausman test, which confirmed our theoretical predictions that there is indeed an endogeneity issue with the pay-performance relation (p-value of 0.008) and thus that our hypotheses should be tested via an instrumental variables method. In order to produce consistent and efficient estimators, instrumental variables estimation requires that the relevance and exogeneity conditions are fulfilled. The results from the 2SLS regression indicate that our instruments are relevant (seen the Kleibergen-Paap LM statistic of 5.18 with a p-value of 0.07) and exogenous (seen the Hansen J statistic of 0.30 with a p-value of 0.58). Yet, the low first-stage F-statistic (2.85) shows that our instruments have relatively weak explanatory power in the first-stage regression. 2SLS with weak instruments can suffer from finite sample bias and thus yield misleading estimates of statistical significance (Cruz & Moreira, 2005; Hahn & Hausman, 2003; Murray, 2006). Therefore, we use Fuller's modified LIML (Fuller, 1977), which is robust to weak instruments (Bascle, 2008; Stock & Yogo, 2002).

The next section lists the definitions of the dependent, independent and control variables that are used in the present study. A summary is provided in Table 17.

Dependent variable. *CEO compensation* is described in the SSBF questionnaire as total CEO compensation. This measure contains one figure which comprises both base salary and cash bonuses[19]. This dependent variable is also in line with the majority of previous studies investigating the pay-for-

[19] More specifically, the database contains executive compensation that is reported on IRS form on form 1120(A) line 12 (C-corporations). Additionally, the IRS requires corporations to include an estimate of any stock-based compensation as well, and this line should thus reflect 'all' compensation paid to the CEO (Bitler et al., 2005). Our cash compensation measure is thus one figure which comprises both base salary, bonus and stock-based compensation.

performance relation (e.g. Capezio et al., 2011; Iyengar et al., 2005; Ke et al., 1999; Ozkan, 2011; Tosi et al., 2000). For example, in their meta-analysis of 137 CEO pay studies, Tosi et al. (2000) conclude that total CEO compensation was used as a dependent variable to measure the pay-for-performance relation when available. Additionally, the use of total CEO compensation seems to be fully justified in the particular case of private family firms since Schulze et al. (2003: 478) define pay incentives as "tied transfers that make a portion of an agent's pay contingent upon some performance objective, usually firm performance". As explained in the beginning of this Research Design section, it is unnecessary to distinguish the portion of pay that may be incentive-based to test the pay-for-performance relationship, as high-powered compensation contracts (contracts with a significant part of variable pay) will be displayed by a strong statistical relationship between total CEO compensation and firm performance (Li & Srinivasan, 2011).

Following Conyon and Peck (2006), Ke et al. (1999) and Cheng and Firth (2006), we take the logarithm of the CEO compensation variable to reduce the impact of outliers. Additionally, the log transformation is the most common way to correct for nonnormality, especially when the variable has a positive skewness (Hair et al., 2006), which is the case for our variable CEO compensation (*CEOcomp*).

Table 17 Definition of the variables

CEOcomp	Total CEO cash compensation as reported on the IRS form 1120(A) line 12, expressed in USD
ROA	Return on assets, calculated by income after expenses excluding taxes divided by total assets
Owners	The number of shareholders
FamilyCEO	Dummy variable, equals one when the CEO is a member of the controlling family, zero otherwise (nonfamily CEO)

Generation	Dummy variable, equals one when the firm can be classified as a firm in a later generational stage, zero otherwise (controlling-owner firm)
Firm size	The total number of employees in the firm
Firm age	The number of years since the firm was founded
Industry	7 dummy variables, based on 2-digit SIC codes
Risk	Measured by 3 dummy variables based on the D&B credit risk scores (High credit risk, Moderate credit risk and Low credit risk)
Sites	Measured by the number of sites, offices, plants or stores the firm has

Independent variables. *Firm performance* is operationalized through the accounting return measure 'return on assets' (*ROA*, income after expenses excluding taxes divided by total assets) because the majority of studies investigating the pay-for-performance relation use ROA as the measure of firm performance (Banghøj et al., 2010; Basu et al., 2007; Capezio et al., 2011; Finkelstein & Boyd, 1998; Gomez-Mejia et al., 2003; He, 2008; Jensen & Murphy, 1990; Ke et al., 1999; Werner & Tosi, 1995). Using *assets* in the denominator makes this measurement less influenced by poor or outstanding performance than other denominators such as, for example *sales*. This is because sales tend to decrease (increase) when firms are performing poorly (outstanding), which will make return on sales an underestimation (overestimation) of firm performance (Harris & Helfat, 1997).

Ownership structure is measured by the variable *Owners,* which indicates the number of shareholders. We use the natural logarithm of the number of owners to account for the non linear effect of an increasing number of owners. We expect that the relationship is stronger at smaller values of the variable 'number of owners' e.g. increasing the number of owners from 1 owner to 2 owners is expected to have a stronger effect than increasing the number of owners from 9 to 10.

Family CEO is operationalized by the dummy variable *FamilyCEO* which equals one if the CEO is a member of the controlling family and zero if the firm has a nonfamily CEO. As per definition, 'family member' refers to spouse, parent/guardian, brother, sister, or close relative. As the database defines a family firm as a firm which is exclusively owned by members of one family, nonfamily CEOs thus have no ownership share in the firm.

The *generational stage* is measured by a variable indicating whether the family firm was established by the current ownership, purchased, inherited or acquired as a gift. We classify this variable into two groups so that we obtain a dummy variable which proxies for *Generation*. This dummy equals one for firms which are in a later generational stage (inherited or acquired as a gift), whereas the dummy equals zero if the firm can be classified as a controlling-owner firm (established or purchased by the current owners).

Control variables. Consistent with prior studies, we include several control variables in our model to account for other factors that might affect CEO compensation (see reviews of Finkelstein et al., 2009; Gomez-Mejia & Wiseman, 1997; Tosi et al., 2000).

Firm size has proven to be of large impact on CEO compensation. Results of a meta-analysis of Tosi et al. (2000) even show that firm size accounts for more than 40% of the variance in total CEO compensation. Larger firms are assumed to require more talented and costly management (Rosen, 1982) and thus several authors document that larger firms pay their executives more (Baker et al., 1988; Banghøj et al., 2010; Basu et al., 2007; Gomez-Mejia et al., 2003; Ke et al., 1999; Young & Tsai, 2008). We use the natural logarithm of the total number of employees (*Totemp*) as a proxy for firm size, as this measure is less likely to suffer from collinearity problems than 'total sales', which is often used in the literature (Brunello et al., 2001; Ciscel & Carroll, 1980). Analogous to the studies of Schulze et al. (2003a), Wasserman (2006), and He (2008), we add a variable that contains information on *firm age***.** We take the natural logarithm to reduce heteroscedasticity concerns (*Firmage*). In order to control for possible *industry*

effects, we add 7 dummy variables based on the firm's SIC code (mining and construction; manufacturing; transportation and public utilities; wholesale trade; retail trade; insurance and real estate; and services). Firms with a high *credit risk* ranking may be monitored more by financial institutions. As this may impact the level of their compensation and the pay-for-performance sensitivity (Brunello et al., 2001), we include 3 dummy variables which are based on the Dun&Bradstreet credit score: high credit risk (score 0-25), moderate credit risk (score 26-75) and low credit risk (score 76-100)[20]. We also need to control for the *CEO's job complexity*, as higher managerial talent is required when a firm's CEO has to make more complex decisions. According to the managerial talent hypothesis, higher quality management will have higher compensation levels (Finkelstein & Hambrick, 1989; Rosen, 1982). Additionally, Gomez-Mejia et al. (1987) note that complexity is a potentially important omitted variable in their analysis of CEO compensation. In an attempt to capture additional effects of a CEO's job complexity that are not already included in the variable measuring firm size, we add a variable *Sites* that measures the number of sites, offices, plants or stores the firm has.

4.4 Data Analyses and Discussion

4.4.1 Descriptive statistics and correlations

Table 18 shows the descriptive statistics and Table 19 contains a Pearson correlation matrix. Approximately 14% of the firms in our sample are led by a nonfamily CEO and nearly 86% of the firms are in the controlling-owner stage. The mean compensation of the CEO in 2003 is 175,619 USD. The average firm in our sample has 2.47 owners. Approximately one third of our sample consists of single-owner firms, one third of firms has two owners

[20] The SSBF database contains 6 credit risk categories, based on the Dun&Bradstreet credit score. As some categories contain few cases, we re-estimated the regressions using 4 categories (in which we combined categories 1&2 and 5&6), and using 3 categories (high-moderate-low). Regardless of the categorization used (6, 4 or 3 categories), the results stay the same.

and one third of the firms has three or more owners. Our sample firms employ on average 40 employees and have an average return on assets of 0.33.

Table 18 Sample Descriptives

Variable	**Mean**	**s.d.**
1. CEOcomp	175619.50	169662.10
2. ROA	0.33	1.01
3. Owners	2.47	3.03
4. FamilyCEO	0.86	0.34
5. Generation	0.14	0.35
6. Firm size	39.56	43.44
7. Firm age	56.30	10.43
8. Low risk	0.43	0.50
9. Mod. risk	0.42	0.49
10. High risk	0.15	0.35
11. Sites	2.11	3.50

Table 19 Pearson correlations between CEO compensation and determinants

Variable	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
1. CEOcomp										
2. ROA	0.048									
3. Owners	0.230***	-0.031								
4. FamilyCEO	-0.160***	-0.000	-0.235***							
5. Generation	0.110**	-0.052	0.188***	-0.029						
6. Firm size	0.475***	-0.011	0.268***	-0.121***	0.183***					
7. Firm age	0.058	0.028	0.151***	-0.173***	-0.011	0.056				
8. Low risk	0.038	0.014	0.046	0.050	0.091**	-0.021	0.123***			
9. Mod. risk	0.002	-0.038	-0.047	0.034	-0.059	0.002	-0.076*			
10. High risk	-0.056	0.033	0.002	-0.118***	-0.045	0.027	-0.066	-0.361***	-0.356***	
11. Sites	0.179***	-0.001	0.066	-0.032	0.031	0.293***	-0.045	-0.18	0.021	-0.004

Notes. N = 529; all amounts are expressed in US dollars; *, **, *** correlation is significant at a probability level below 0.10, 0.05 or 0.01 level (two-tailed)

Although the Pearson correlation matrix (Table 19) shows no high correlations among the variables, we checked for the possibility of multicollinearity to ensure that our results are not affected by it. We use the 'ivvif' command in STATA, which reports variance inflation factors for the second stage of an instrumental variables method (Roodman, 2005). The maximum value is 1.26, which is well below the threshold of 10 above which multicollinearity might be an issue.

4.5 Results and Discussion

Table 20 reports Fuller's LIML estimations for the impact of firm performance (ROA) on CEO compensation, moderated by the investigated ownership and management characteristics. Robust standard errors are calculated so as to correct for heteroscedasticity. The coefficient of determination, R^2, is not reported because it has no real meaning in models using instruments and it can even be misleading (Wooldridge, 2002). Moreira's CLR (Moreira, 2003) is considered to be the test of choice when checking the validity of a Fuller's LIML regression, because it gets around the weak instruments problem by relying on a conditional approach. Contrary to the other estimators, Moreira's CLR critical values used to yield a correct significance level are not constant, but conditioned (Bascle, 2008; Murray, 2006). By using this approach, it draws correct inferences, independent of the strength of the instruments (Andrews et al., 2007; Bascle, 2008). The discrepancies of Moreira's CLR estimators and those obtained by Fuller's LIML are very reasonable, and thus there is no indication of a finite-sample bias (Yogo, 2004).

Table 20 Regression results – Fuller's LIML

Model	**1**	**2**	**3**	**4**
Constant	10.01641***	10.3015***	10.6722***	10.2791***
	(0.9060)	(0.9005)	(1.0923)	(0.9474)
HYPOTHESES				
Firm performance				
ROA	**0.7217****	**0.7774***	**0.6476****	**1.0945****
	(0.3550)	(0.4555)	(0.3396)	(0.4856)
Ownership dispersion				
Owners [a]		0.2459		
		(0.1645)		
Owners*ROA		-0.3514		
		(0.5908)		
Generation				
Generation			0.3193	
			(0.2300)	
Generation*ROA			-0.9328	
			(0.9995)	
CEO				
FamilyCEO				-0.0807
				(0.2235)
FamilyCEO*ROA				-0.4587
				(0.5079)
CONTROLS				
Firm size [a]	0.4940***	0.4566***	0.5124***	0.4819***
	(0.0430)	(0.0516)	(0.0463)	(0.0424)
Firm age [a]	0.0156	-0.0538	-0.1532	-0.0209
	(0.2257)	(0.2256)	(0.2734)	(0.2261)
High credit risk [b]	-0.3428**	-0.3443**	-0.4217**	-0.3460**
	(0.1582)	(0.1558)	(0.1747)	(0.1582)
Moderate credit risk	-0.0384	-0.03489	-0.0133	-0.0655
	(0.1028)	(0.0969)	(0.1149)	(0.1077)
Sites	0.0167	0.0169	0.0117	0.0178*
	(0.01141)	(0.0108)	(0.0112)	(0.0108)
Industry dummies	yes	yes	yes	yes
N	*529*	*529*	*458*	*529*
Model F statistic	*15.60*	*15.40*	*13.26*	*14.71*

Notes. Dependent variable = ln(CEOcomp); Heteroskedasticity-robust standard errors in parentheses; N = 529 for the models 1, 2 and 4 and 458 for the model 3 (only firms with a family CEO selected in order to distinguish between founder and descendant CEOs); [a] natural logarithm; [b] low risk is the suppressed credit risk category; Moreira's CLR for ROA in Model 1 = [0.10, 2.04] (p-value 0.032); *,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively (two-tailed).

Models 2, 3 and 4 in Table 20 report the interaction models that are used to test the impact of *Owners*, *Generation* and *Family CEO* on the pay-for-performance relationship. Even though the use of interaction models is quite common in different disciplines of research (such as in finance and management literature), the interpretation of these models differs in an important way from linear additive models (Brambor et al., 2006). In an interactive model, the effect of an independent variable X on the dependent variable Y is not any single constant. The effect depends on the coefficients (betas) of the independent variable X and of the interaction term XZ, as well as on the value of the moderating variable Z. For example, the marginal effect of X in the following interaction model:

$$Y = \beta_0 + \beta_1 X + \beta_2 Z + \beta_3 XZ + \varepsilon$$

is $$\frac{\partial Y}{\partial X} = \beta_1 + \beta_3 Z$$

So, the effect of X on Y depends on the value of the conditioning variable Z. We cannot infer whether X has a meaningful conditional effect on Y from the magnitude and significance of the coefficient on the interaction term. For certain relevant values of Z (the moderating variable), the marginal effect of X on Y can be significant even if the coefficient on the interaction term is insignificant. Thus, to correctly interpret these combined effects, the relevant elements of the variance-covariance matrix can be used to recalculate the standard errors, which are displayed in Table 4 and represented graphically in Appendix A. By doing so, we obtain insight into these substantively meaningful marginal effects. For a more detailed technical explanation on the calculation and use of marginal effects, we refer to Brambor et al. (2006) and Kam and Franzese (2007).

All four models in Table 20 strongly support the positive impact of performance (ROA) on CEO compensation (*Hypothesis 1*). This stands in stark contrast with the results of Ke et al. (1999) and Banghøj et al. (2010)

who did not find any significant relationship between ROA and CEO compensation for their sample of 43 private US insurance companies, respectively 125 private Danish companies. It confirms, however, results of Barkema and Pennings (1998), who found a strong positive impact of firm profitability on executive compensation (more specifically, bonus) for a sample of 143 Dutch private firms. Our results, that are based on a large sample that is representative for US private family firms, are also in line with those of Schulze et al. (2001a) and Chrisman et al. (2007), who find that private family firms make significant use of agency cost control mechanisms, such as incentive compensation. In sum, contrary to the predictions of agency theory, which assumes that the agency costs in private family firms will approach zero, our results suggest that these firms do use explicit management compensation contracts with objective performance-based measurements as a governance mechanism.

Model 2 shows the regression results for Hypothesis 2, which predicts a weaker influence of firm performance on CEO compensation as ownership becomes more dispersed. Therefore, we include the interaction variable *Owners*ROA*. So as to infer whether the number of owners has a meaningful conditional effect on the pay-for-performance relationship, we look at the marginal effects and standard errors. We calculate the marginal effects by taking into account the relevant elements of the variance-covariance matrix and recalculate the standard errors as suggested by Brambor et al. (2006: 74). With respect to Hypothesis 2, we present the results of the calculation of these marginal effects in Table 21 (Panel A). A graphical representation is given in Figure 23.

Table 21 Moderating effect of the number of owners (Panel A), generational stage (Panel B) and family CEO (Panel C)

Panel A

Number of owners	*∂y/∂ ROA* [a]	*Std. dev.*	*t-statistic*
1	0.7774	0.4555	**1.7067****
2	0.5338	0.2015	**2.6491*****
3	0.3913	0.3138	1.2470
4	0.2903	0.4574	0.6346
6	0.1478	0.6807	0.2171
8	0.0467	0.8445	0.0553
10	-0.0317	0.9731	-0.0326

Panel B

	∂y/∂ ROA [b]	*Std. dev.*	*t-statistic*
Controlling-owner stage (0)	0.6476	0.3396	**1.9070****
Later generational stage (1)	-0.2852	1.0634	-0.2682

Panel C

	∂y/∂ ROA [c]	*Std. dev.*	*t-statistic*
Nonfamily CEO (0)	1.0945	0.4856	**2.2540*****
Family CEO (1)	0.6358	0.3392	**1.8747****

Notes.[a] ∂y/∂ ROA = 0.7774-0.3514 x ln(owners); [b] ∂y/∂ ROA =0.6476-0.9328 x Generational stage; [c] ∂y/∂ ROA = 1.0945-0.4587 x Family CEO; N=529 in Panel A and C; N=458 in Panel B; *,**,***denotes significance at a probability level below 0.10, 0.05 and 0.01, respectively (one-tailed).

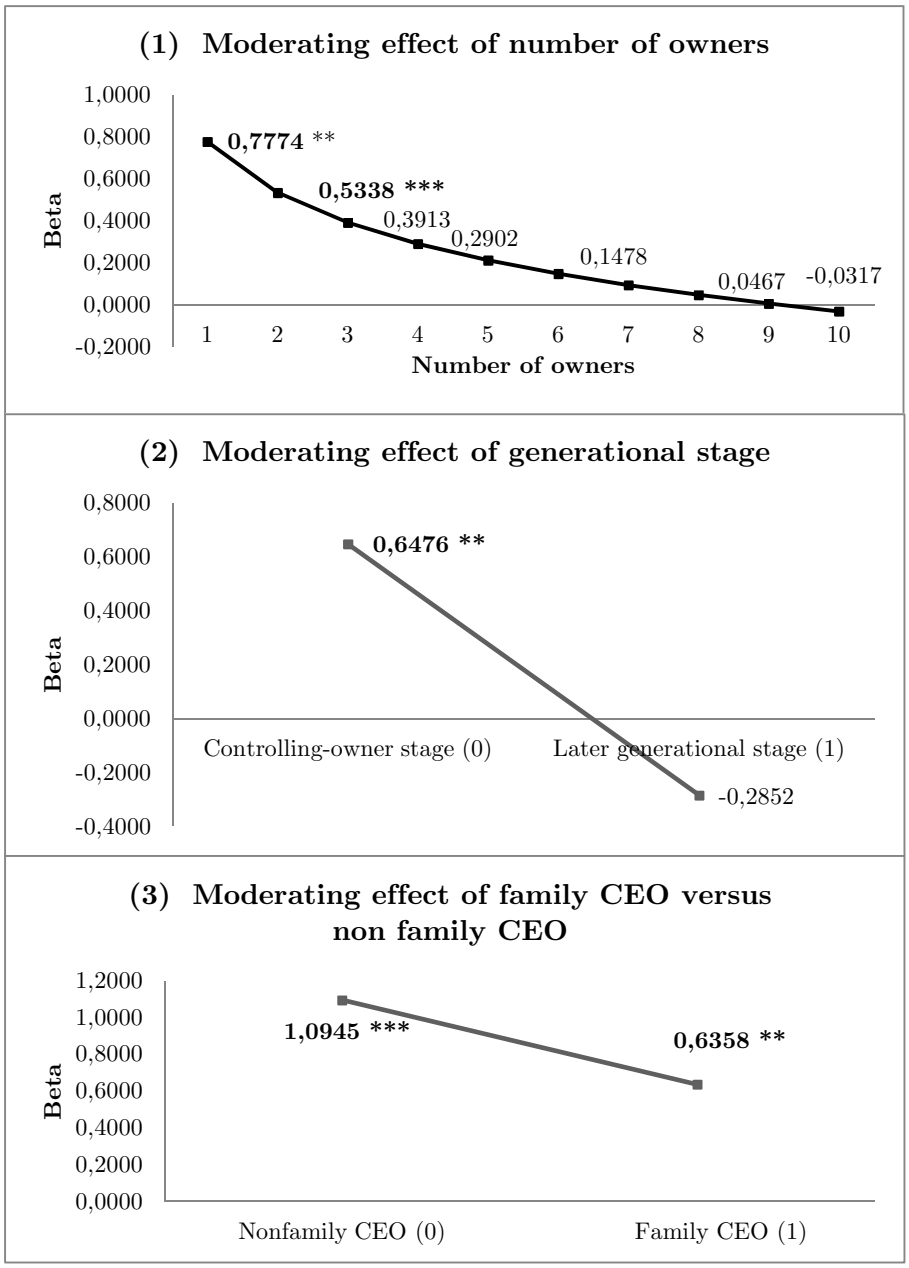

Figure 23 Graphical representation of the moderating effects of the number of owners (Graph 1), generational stage (Graph 2) and family CEO (Graph 3)*,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively (two-tailed).

Panel A in Table 21 and Figure 23 show that the positive relationship between ROA and CEO compensation is only significant if the number of owners varies from 1 till 2. For 3 or more owners, the moderating effect becomes non-significant. We thus find support for Hypothesis 2, indicating that concentrated ownership leads to a stronger pay-for-performance relation in private family firms. This result implies that indeed, performance-based pay might be a more important instrument when agency costs associated with self-control and parental altruism are highest in private family firms (i.e. when family ownership is more concentrated).

Hypothesis 3, discussing the moderating influence of the generational stage, is tested using the interaction variable *Generation*ROA*. Analogous to the method used to interpret the results of hypothesis 2, we interpret the interaction coefficient by looking at the marginal effects and recalculating the standard errors (displayed in Table 21 – Panel B and graphically in Appendix A). Panel B in Table 21 shows that the coefficient of the controlling-owner stage is positive and significant. This result reveals, consistent with our hypothesis 3, that the positive relationship between performance and CEO compensation is only present in the controlling-owner stage. Our findings thus suggest that the higher agency costs associated with parental altruism in the controlling-owner stage will be mitigated by using pay-for-performance contracts.

Hypothesis 4 predicts that the positive pay-for-performance relation will be weaker for family CEOs, compared to nonfamily CEOs. After recalculating the standard errors (Table 21– Panel C, and graphically represented in Figure 23), we can conclude that for both a family CEO and a nonfamily CEO, firm performance has a significant positive effect on CEO compensation. A test of differences of the beta coefficients in Panel C indicates that these beta coefficients are significantly different (p-value of 0.03). Thus, although for both family and nonfamily CEOs performance has a significant positive effect on CEO pay, the pay-for-performance sensitivity for

a family CEO is weaker than for a nonfamily CEO. This is in line with our hypothesis 4, which argues that both private family firms with a family CEO as well as those with a nonfamily CEO have various motives to offer their CEO performance-based compensation. Our findings thus support the hypothesis that the effect of firm performance on CEO compensation will be less strong for family CEOs.

The control variable *firm size* has the expected positive (significant) effect on the level of CEO compensation. Firm age does not seem to have a significant effect on compensation. Firms with high credit risk pay their CEOs significantly less than firms with a low credit risk. Additionally, CEOs working in the transportation, public utilities and retail trade industry earn significantly less than their colleagues in other industries. A CEO's job complexity has a positive, but insignificant, effect on the compensation he receives.

4.6 Summary and Conclusions

This study addresses the effect of firm performance on CEO compensation in privately-held family-controlled firms. Its central finding is that firm performance is positively related to CEO compensation in private family firms. This finding stands in contrast to predictions of traditional agency theory, which claim that pay-for-performance is irrelevant in the case of private family firms due to minimal (or zero) agency costs. Additionally, our study argues that the relationship between firm performance and CEO compensation is contingent on ownership and management configurations. We distinguish several types of private family firms, based on their ownership structure and management position. We find that the positive relationship between firm performance and CEO compensation is only significant if the number of owners is small. This result implies that performance-based pay is a more important instrument when agency costs associated with self-control and parental altruism are highest in private family firms, that is when family ownership is more concentrated. In line with this finding, our results also

suggest that the positive relationship between performance and CEO compensation is only present in the controlling-owner stage. Hence, the agency costs associated with parental altruism appear to be much lower in the later generational stages. Finally, we find that both family firms with a family CEO as well as those with a nonfamily CEO have various motives to offer their CEO performance-based compensation, but that the pay-for-performance sensitivity is stronger for nonfamily CEOs.

As such, our study makes an important contribution to the family business literature. It provides additional evidence that private family firms do indeed face agency costs, because they seem to use performance-based compensation for their CEOs. Although our paper uses an agency framework in order to investigate the compensation decisions in private family firms, other theoretical models such as socioemotional wealth or distributive justice theory may offer some additional explanations for the use of performance-based incentive pay in family firms as well. For example, family firms may reward their family managers with performance-base incentive pay, because it may also increase the justice perceptions of the nonfamily managers (Barnett & Kellermanns, 2006). Additionally, our study also indicates that private family firms cannot be considered as an homogeneous group when studying compensation behaviour, seen the significant moderating effects of ownership and management characteristics. For management consultants and HR managers, this study also provides some interesting implications as there is almost no other research available on the design of CEO compensation contracts in private family firms. For example, our study confirms the need to consider the ownership structure and the CEO family status of the private family firm, in order to design a CEO compensation package which is in line with the type of agency problems the firm faces.

There are a number of limitations associated with this study that should be acknowledged. First, our data are cross-sectional, so we cannot examine the factors that are associated with changes of the pay-for-performance over time. Next, our compensation measure is limited to reported

CEO cash compensation. In some cases, the manager may also have earned some deferred or stock-based compensation. Fortunately, implications from previous work suggest that this limitation should not be a significant problem, as family firms place much less weight on stock-based compensation than do public or nonfamily firms (Achleitner et al., 2010; Park, 2002).

Finally, the results of this study lead to some interesting avenues for future research in this domain. Our understanding about the effects of ownership and management characteristics on the relationship between performance and CEO compensation would be enhanced if they were generalized across different countries. Our results are quite promising and therefore call for larger and more detailed research.

Chapter 5

Pay Dispersion within Top Management Teams of Private Family Firms: a Conceptual Framework[21]

5.1 Introduction

Research on executive compensation has focused almost exclusively on compensation levels of individual executives, mainly CEOs. However, executive work is typically shared among a *team* of managers (Minichilli et al., 2010) and the good or bad functioning of this top management team (TMT) will have an influence on the teams' ability to successfully formulate and implement strategy (Hambrick, 1995). Consequently, firm performance is a reflection of the characteristics and actions of a group of managers (TMT), rather than a single individual (CEO) (Hambrick & Mason, 1984). Pay distribution decisions have been asserted to have meaningful effects on performance (Becker & Huselid, 1992; Levine, 1993; Pfeffer & Langton, 1993). One form of pay distribution is pay dispersion among top managers. We examine pay dispersion among the non-CEO members of the TMT, often referred to as *horizontal* pay dispersion (Henderson & Fredrickson, 2001).

In the literature on pay dispersion, we can distinguish two conflicting theories. From an economic point of view, tournament theory (Lazear & Rosen, 1981) predicts a positive effect of pay dispersion on managerial effort

[21] We thank seminar participants at the IFERA 2011 Conference in Palermo for feedback and discussions.

and, consequently a positive effect on firm performance. By contrast, equity theory (Adams, 1965; Deutsch, 1985) has a more behavioral view on pay dispersion and predicts a negative effect on firm performance due to decreased managerial effort and cooperation.

Empirical results in this field are not conclusive. Several empirical studies found direct positive as well as negative relationships between a firm's TMT compensation structure and firm performance. Therefore, Finkelstein and colleagues (Finkelstein et al., 2009) recently call for conceptual specifications of the possible mechanisms that better explain the relationship between several aspects of TMT pay (such as pay dispersion) and firm performance. We respond to this call by pointing to a possible means of reconciliation of these two opposing views on pay dispersion – tournament and equity theory – by considering important behavioral premises influencing the impact of dispersion on performance. In this paper, we discuss the conditions under which the productive (tournament) or counterproductive (equity) effects of pay dispersion may predominate.

To examine organizations in which distribution of pay can have a considerable impact on the functioning of a team, we focus on an important type of firm: the family firm. With the exception of Ensley and colleagues (Ensley et al., 2007), family firms have been widely ignored in the theoretical debate on pay dispersion. Yet, family firms present a particularly interesting setting to research pay dispersion within TMTs for several reasons. First, family firms are not characterized by agency relations by default, but can also exhibit stewardship behavior (Le Breton-Miller & Miller, 2009). This can make formal contracts and monitoring mechanisms (such as for example pay dispersion) not useful, even counterproductive. Second, in addition to the general challenges in setting TMT pay that all firms encounter, family firms have the added complexity of dealing with the dynamics of the family, as well as the dynamics of the firm (Coleman & Carsky, 1999; Lundberg, 1994). Third, family owned and managed firms represent the majority of firms worldwide (IFERA, 2003). Despite their prevalence and impact on global

economy, only recent research has focused on family firms. Until recently, family firm research has overlooked the importance of family involvement in top management teams. Yet, the dynamics of the TMT are significantly influenced by the inclusion of family managers as well as nonfamily managers (Cruz et al., 2010; Minichilli et al., 2010), but also by the relations among family managers. Therefore, our paper discusses the dynamics of two types of family firm TMTs, using the concept of social capital (Nahapiet & Ghoshal, 1998).

Several authors have already emphasized the need for more knowledge on compensation system design in family firms (Sharma, 2004; Uhlaner et al., 2007) and its effect on the TMT social dynamics (Fredrickson et al., 2010) and firm performance (Carrasco-Hernandez & Sanchez-Marin, 2007; de Kok et al., 2006; Reid et al., 2002). Accordingly, our article addresses these calls and discusses several conditions under which the tournament or equity arguments predominates in order to develop a model that permits accurate, context-based predictions concerning these two views, across various kinds of family businesses.

Our study first discusses the two theories on pay dispersion: tournament and equity. In the sections that follow, we utilize concepts from general agency and stewardship theories, as well as the concept of social capital in order to reconcile these two seemingly opposing views, and suggest the circumstances under which pay dispersion in family firms will have positive or negative effects on firm performance.

5.2 Theories on Pay Dispersion

Although there has not been much research on the pay of TMTs, or the difference in pay within the TMT, there is controversy over the impact of pay dispersion on firm performance. Depending on the theoretical perspective taken, pay dispersion can either enhance (economic perspective) or harm (behavioral perspective) firm performance.

5.2.1 Tournament theory: an economic view of pay dispersion

Tournament theory (Lazear & Rosen, 1981) is based on a game-theoretic view of principal-agent relations. It was originally used to explain the large differences between the salary of a CEO and the pay of the executives directly below him: "On the day that a given individual is promoted from vice-president to president, his salary may triple. It is difficult to argue that his skills have tripled in that one-day period" (Lazear & Rosen, 1981: 847).

Similarly to agency theory, tournament theory seeks to arrange compensation contracts that maximize shareholder value (Anabtawi, 2005). Economics urge to use competition as a means to call forth strong efforts from agents who are otherwise prone to free riding and/or shirking (Jensen & Meckling, 1976). Thus, large differences in pay between members of the TMT can be a manifestation of a pay-for-performance culture, in which managers are disparately rewarded for their contributions and results, thus stimulating effort and, ultimately, improving firm performance (Ehrenberg & Bognanno, 1990; Ensley et al., 2007; Lazear & Rosen, 1981; Siegel & Hambrick, 2005). A compensation policy based on the principles of tournaments, is thus based on the assumption that managers will be motivated when they are individually rewarded for their efforts (Ehrenberg & Bognanno, 1990; Ensley et al., 2007).

5.2.2 Equity theory: a behavioral view of pay dispersion

Equity theory (also referred to as relative deprivation theory or equity fairness theory), is part of the literature on distributive justice (Greenberg, 1987). According to this theory, individuals compare their contribution and pay to that of their (relevant) colleagues. If they perceive that they receive less than they deserve, they feel deprived and individual productivity and performance will decline (Adams, 1965; Bloom, 1999; Pfeffer & Langton, 1993). The members may for example have increased incentives to sabotage

others' activities (Akerlof & Yellen, 1988; Levine, 1991). As a result, team performance also declines because the perceived inequity will undermine cooperation and communication within the team because the members become less committed to organizational goals (Deutsch, 1985; Greenberg, 1987). Even when large pay gaps can be perfectly justifiable, for instance because a members has considerably more capabilities or contributes more than other members of the TMT (such as the CEO), equity theory suggests that large pay gaps will still be received as unjust (Henderson & Fredrickson, 2001). Lowering pay dispersion, on the other hand, is assumed to increase team cohesiveness, which will in turn enhance productivity and, ultimately, firm performance (Levine, 1991). In this view, firms were teamwork is vital and where coordination needs are high, should exhibit smaller pay differences within the team in order to enhance cooperation and communication and thus enhance firm performance (Henderson & Fredrickson, 2001).

5.3 Reconciling the Economic and Behavioral Views in a Family Firm Setting

Both perspectives on pay dispersion have found empirical support in several studies. While some find strong evidence that pay dispersion has a positive influence on firm performance (e.g. Eriksson, 1999; Main et al., 1993), other studies conclude that pay equity is the best pay structure to promote firm performance (Cowherd & Levine, 1992; Pfeffer & Langton, 1993). Therefore, it may be that these two theories are not opposing as such, but rather complementary and that each is more applicable to TMTs to which the other theory is less applicable. For example, while equal pay might lead to social loafing or free riding in some firms (Latane et al., 1979), it might increase perceptions of fairness and reinforce communication and effort in others (Levine, 1991). Tournament and equity theories are thus potential complements in explaining the effects of pay dispersion on firm performance

and that the direction (positive or negative) of the relation is moderated by some specific behavioral premises.

Whereas previous studies almost exclusively focused on the direct effect of pay dispersion on firm performance, this paper attempts to identify possible moderating variables in order to permit accurate, context-based predictions concerning the best way to distribute pay within a specific family firm TMT (see Figure 24). The study of Lee and colleagues (Lee et al., 2008) provides a first indication that agency behavior is a potential moderating variable. They find that the positive effect of pay dispersion on firm performance is stronger when the agency costs due to managerial discretion are higher. We build further on this finding and discuss the conditions under which the productive (tournament) or the counter-productive (equity) effects of pay dispersion may predominate in the context of family firms.

5.3.1 The agency condition

Tournament theory implicitly assumes that managers will exhibit agency behavior and thus argues that pay dispersion is a remedy to moral hazard problems such as shirking and free riding. According to this view, paying managers based on their own contributions to the team will decrease these agency threats by increasing individual motivation and thus improve firm performance. We predict that pay dispersion, being an agency monitoring mechanism, thus can also have positive effects on performance in family firms. Although some evidence is found on agency behavior in family firms (Chrisman et al., 2007; Schulze et al., 2001a), family firm TMT members do not exhibit agency behavior by default. Agency cost controls, such as pay dispersion, will thus only have the desired effect on managerial effort and performance when TMT members have the tendency to act opportunistically (Fong & Tosi, 2007). Therefore we propose the necessary condition that agency behavior must prevail in family firm TMTs for pay dispersion to have the desired positive performance effects.

Proposition 1: When agency behavior prevails in a TMT, pay dispersion will have a positive effect on firm performance.

5.3.2 The stewardship condition

Conversely, equity theory adopts a behavioral approach and expects that managers will behave as stewards and thus will give priority to organizational goals instead of personal goals (Davis et al., 1997; Levine, 1991). When stewardship behavior prevails among TMT members, this may result in a culture in which team members cooperate, often informally, to achieve a common purpose (Arregle et al., 2007; Le Breton-Miller & Miller, 2009). This stewardship culture often relies on informal social controls that are based on mutual trust and a shared vision, rather than on formal controlling contracts (Uhlaner et al., 2007). Furthermore, the intrinsic motivation and commitment to the firm makes controlling compensation policies such as pay dispersion even counterproductive. Indeed, when TMT members behave as stewards and pay dispersion is imposed as an agency cost control mechanism, it may lower the stewards' motivation (Chrisman et al., 2007; Corbetta & Salvato, 2004). Greater pay dispersion will then discourage cooperation because team members will concentrate more on their own performance instead of on organizational goals and negatively affect firm performance.

Proposition 2: When stewardship behavior prevails in a TMT, pay dispersion will have a negative effect on firm performance.

While some studies have found managers in family firms to behave as stewards (e.g.Anderson et al., 2003; Davis et al., 1997), other studies find evidence of agency behavior in family firms (e.g. Chrisman et al., 2007; Lubatkin et al., 2005; Schulze et al., 2001a). This confirms the fact that family firms cannot be treated as an homogenous group (Chrisman et al., 2005;

Westhead & Howorth, 2007). We thus consider family firms as a heterogeneous group and we will attempt to distinguish the appropriate pay distribution for family firm TMTs in different settings. In the next paragraph, we will argue that whether agency or stewardship behavior prevails within the TMT, and thus whether pay dispersion will have a negative or positive effect on firm performance, depends on the level and nature of social capital within the TMT.

5.3.3 TMT social capital as an antecedent to the stewardship vs. agency condition

In this paper, we use TMT social capital (hereafter referred to as SC) as a contextual factor to differentiate among family firms. We adopt an intra-firm perspective of social capital, which suggests that the strength of the relationships between managers can facilitate or thwart the achievement of collective goals and actions (Leana & Van Buren, 1999; Nahapiet & Ghoshal, 1998). We contend that the social capital within the TMT is an antecedent of the stewardship or agency condition. More specifically, we will argue that the level and nature of social capital can vary greatly from one type of family firm TMT to another. Consequently, we shall propose that whether dispersed pay among TMT members positively or negatively affects firm performance, will depend on the TMT's social capital.

Literature distinguishes three dimensions of social capital: structural (i.e. network connections between actors), relational (i.e. the quality of the relations between actors) cognitive (i.e. the group's shared vision and purpose) (Nahapiet & Ghoshal, 1998). In the context of family firm TMTs, *structural SC* will be manifesting as the strength of the social interaction ties among the members of the TMT. Based on structural SC, we can distinguish two settings of TMTs: (1) teams which consist entirely of family managers and (2) teams where both family and nonfamily managers reside. The first TMT setting is expected to have a high level of structural SC because families usually possess

an abundance of internal social network ties (Pearson et al., 2008). However, as ownership becomes more dispersed and the TMT consists of family managers from different (later) generations, the strength of the social ties will decrease. Therefore, structural SC is expected to decrease when ownership disperses. In the second setting, so-called faultlines can occur between the family and nonfamily factions (Minichilli et al., 2010), due to the lack of existent social ties between members of the two factions. Therefore, when both family and nonfamily managers comprise the TMT, structural SC is expected to be lower than in a TMT which consists entirely of family managers.

A family firm TMT's *cognitive SC* consists of its shared vision and purpose. Cognitive SC provides harmony of interest which decreases the possibility of opportunistic behavior (Ouchi, 1980). As family members typically share common culture, values and norms (Chua et al., 2003), cognitive SC is likely to be higher in teams with only family managers, compared to teams with both family and nonfamily factions. However, as ownership becomes more dispersed and generations become involved in the management of the firm, the dynamics among family managers will alter (Gersick et al., 1997; Schulze et al., 2001a). Therefore, cognitive SC is expected to decrease as ownership becomes more dispersed across different generations.

The third dimension of SC, relational SC, is found to be the result of both structural and cognitive SC (Tsai & Ghoshal, 1998) (see figure 1). In turn, relational SC, the quality of the interpersonal relationships, is an antecedent for trusting relations (Nahapiet & Ghoshal, 1998; Tsai & Ghoshal, 1998). These trusting relationships are essential for effective collaboration and communication within the team (Eddleston et al., 2010; Leana & Van Buren, 1999). Moreover, trusting relationships will facilitate commitment to a common purpose (Pearson et al., 2008). In a family firm TMT, trust is not only vital when family and nonfamily managers must cooperate, but also within the group of family managers (Eddleston et al., 2010). As such, we

contend that the relational dimension of SC is an important antecedent to TMT stewardship or agency behavior (see Figure 24). Based on the discussion above, we now formulate several proposition in order to distinguish the optimal compensation strategy for different types of family firm TMTs, using the social capital concept.

5.3.3.1 TMTs with only family managers

One could expect that TMTs which consist entirely of family managers, will result in stewardship behavior, due to the high structural SC. Yet, also these teams can exhibit agency behavior in two situations. First, when cognitive SC is weak due to dispersed ownership across (later) generations, members of different family branches do not share the same values and norms, trusting relationships become less common (and thus relational SC weakens). This decreases the commitment of TMT members to a common purpose. As a result, agency behavior is more likely to prevail because efficient TMT communication and collaboration becomes difficult. Second, when relational SC is very strong due to strong norms of closure (very dense linkages between TMT members), there can be a risk of agency behavior such as free riding. This risk can occur when these norms of closure are accomplished by the desire to maintain the management of the firm following bloodlines, at no matter what cost (Portes, 1998). For example, parental altruism can cause parents to keep their children in management positions of the firm, even when they are not competent or motivated for the job (Lubatkin et al., 2005). This can give rise to opportunistic behavior such as free riding or shirking. We posit that in such cases, pay dispersion will be an appropriate monitoring mechanism to decrease the risk of agency behavior and to increase managerial motivation to act in the best interest of the firm. Formally stated:

Proposition 3 In TMTs which consist exclusively of family managers, very strong or very weak social capital is more likely to induce agency behavior than stewardship behavior. In these types of firms, pay dispersion is expected to have a positive influence on firm performance.

5.3.3.2 TMTs with both family and nonfamily managers

One could expect that in TMTs which consist of both family and nonfamily managers, agency behavior is more likely to prevail because of the existence of faultlines between the family faction and the nonfamily faction. However, also in these teams, stewardship behavior may prevail in some situations. This can be the case when the nonfamily members consider themselves as a part of the family (quasi family) (Karra et al., 2006) and thus possess high feelings of psychological ownership (Pierce et al., 2001), which is likely to strengthen cognitive SC. Especially when the position of the CEO is contestable for both family and nonfamily managers and thus the nonfamily managers also have career prospects inside the firm, these types of family firm TMTs may exhibit stewardship rather than agency behavior.

Proposition 4 In TMTs where family and nonfamily managers need to collaborate, strong social capital may increase cooperation and communication within the team and thus stewardship behavior may be more likely than agency behavior. In these types of firms, pay dispersion is expected to have a negative influence on firm performance

5.4 Conclusion

Two seemingly opposing theories aim to explain the impact of pay dispersion on firm performance. On the one hand, tournament theory employs an economic point of view and predicts a positive effect of pay dispersion on firm performance due to increased managerial effort. On the other hand, equity theory has a more behavioral point of view on pay dispersion and

predicts dispersed pay to decrease managerial effort and cooperation and thus to have a negative effect on performance. We contend that these theories are not opposing as such, but rather that they are complements in explaining the effect of pay dispersion on firm performance. In this paper, we propose that the nature of this relation (positive or negative effect) will depend on important behavioral premises: whether agency or stewardship behavior prevails within the family firm TMT. Furthermore, we introduce the concept of social capital into the pay dispersion debate and formulate several propositions in order to distinguish the optimal compensation strategy for different types of family firm TMTs.

Our paper has potential implications for both family firm practitioners and researchers. For practitioners, the propositions presented in our paper may help to distinguish the appropriate reward systems for managers in different settings of family firms TMTs. For researchers, our paper highlights additional opportunities for research. For example, our framework can be refined by examining the differences between the generational stages of a family firm as defined by Gersick et al. (1997) and it can be expanded by adding additional moderating variables to the pay dispersion–performance relation. Additionally, researchers can subject our propositions to an empirical examination across a wide variety of family firm TMTs.

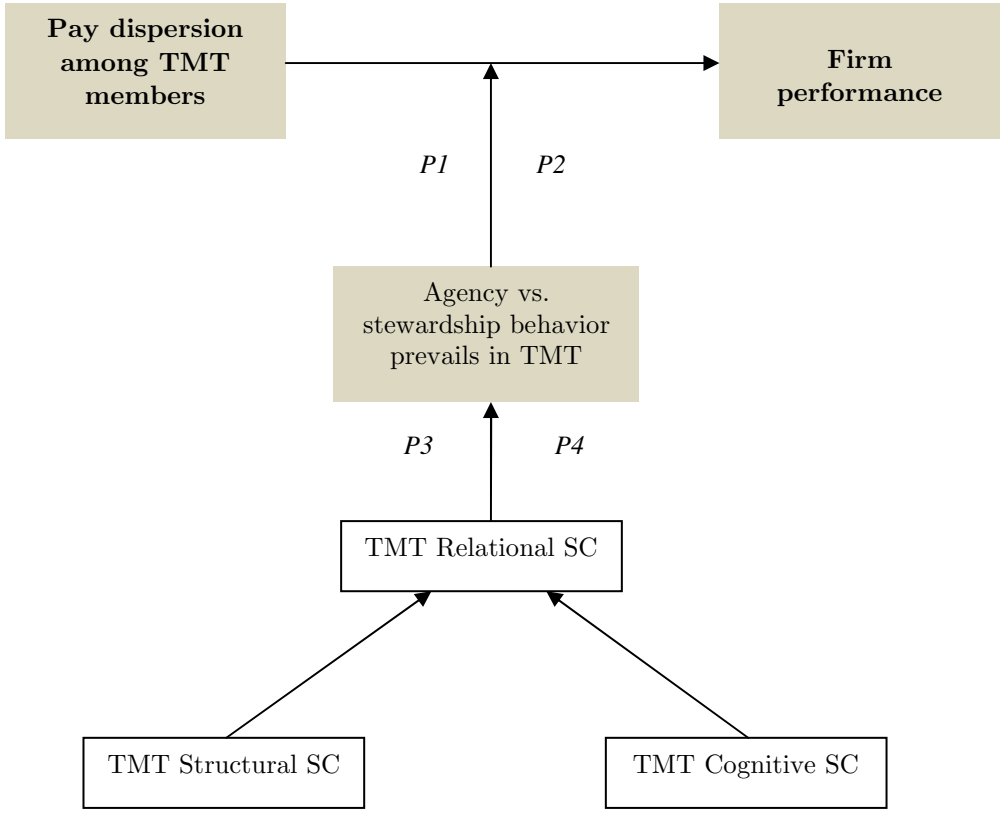

Figure 24 Research Design

Chapter 6

Dividends and Family Governance Practices in Private Family Firms[22]

6.1 Introduction

As from the seminal paper of Miller and Modigliani (1961), a lot of theoretical and empirical research aims at finding explanations of why firms pay dividends. In this stream of research, the influence of family ownership on dividend policies attracts the attention of many researchers (e.g. Chen et al., 2005; Farinha, 2003; Gugler, 2003; Pindado et al., 2011; Setia Atmaja et al., 2009; Yoshikawa & Rasheed, 2010). Yet, none of these studies focuses on privately-held family firms. According to allegations of traditional agency theory, dividends are indeed irrelevant in these firms because of the absence of a principal-agent conflict of interest.

However, in reality, many privately-held family firms do pay out dividends regularly (Gallo, 2004; Gersick et al., 1997; Hoy & Sharma, 2010; Poza, 2009; Ward, 1997). An explanation for the existence of dividends, despite their so-called irrelevance, lies in another type of conflict that may occur in the specific context of private family firms*: the intra-familial principal-principal conflict* (Gersick et al., 1997; Schulze et al., 2001a; Stewart & Hitt, 2012). A common example of an intra-familial principal-principal conflict of interest that is particularly interesting when studying dividends, is

[22] We thank seminar participants at the EIASM 2012 Workshop on Family Firm Management in Jönköping, at the Belgian Financial Research Forum 2012 in Antwerp, and at the IFERA 2012 Conference in Bordeaux; Marc Deloof and Walter Hendriks for feedback and discussions on earlier versions of this chapter.

the one between active and passive family shareholders, who may have diverging interests due to their different role in the firm. Passive family shareholders often prefer to receive dividends in order to reduce the free cash flow available for the active family shareholders, whereas the active shareholders generally prefer to reinvest cash in the firm (Gersick et al., 1997). This incongruity of interests between active and passive family shareholders can have detrimental effects for the family firm and is thus a potentially important agency problem (Eddleston & Kellermanns, 2007).

The mechanisms for making dividends a solution to potential principal-principal problems are clearly different in privately-held vis-à-vis publicly held firms. Controlling shareholders in publicly listed firms face a trade-off between, on the one hand, their preference to maintain control of corporate resources and, on the other hand, a significant decline in the market valuation of the firm when this preference is mirrored in a no or low dividend policy (Faccio et al., 2001). Hence, the stock market will play a disciplining role by forcing controlling managers to abstain from expropriation behavior and to pay out (high) dividends when they want to avoid such a decline in stock price. However, privately-held family firms lack the disciplining role of the stock market, which raises the intriguing question which governance mechanism could take over this role. This article posits that family governance mechanisms can take over the disciplining role of the stock market in forcing or convincing the active family shareholders to adopt a dividend policy when a potential intra-familial principal-principal conflict of interest may occur. After all, family governance practices may stimulate the creation of a shared vision among family shareholders, thereby preventing or reducing harmful conflicts among them.

Despite the fact that the principal-principal conflict exists within private family firms, as numerous theoretical and anecdotal articles and books indicate (e.g. He et al., in press; Hoy & Sharma, 2010; Poza, 2009; Ward, 1997), this type of conflict has long been excluded from the corporate governance discussion (Li & Srinivasan, 2011) and empirical studies on the

topic are rare (Siebels & Knyphausen-Aufseß, 2012). Given these observations, the purpose of this paper is to study the role of dividends in alleviating intra-familial principal-principal conflicts in private family firms. In addition, this study takes into account whether and how family governance practices (e.g. family charter, family forum) moderate the relationship between these conflicts and the propensity to pay dividends. Using a sample of 246 Belgian privately-held family firms, the study indeed shows that the presence of passive family shareholders results in a higher propensity to pay dividends[23] and that family governance practices appear to be an important facilitating mechanism to avoid or mitigate conflicts among family shareholders by paying out dividends. Additionally, the findings support the suggestion that using family governance practices results in a more efficient dividend policy.

This paper makes several contributions to the finance, governance as well as general family business literature. First, analyzing dividend policy in the context of *private* instead of *public* firms allows for a cleaner measurement of the effects of (family) ownership structure on dividend policy because there is no external factor (such as, for example, the stock market) that is influencing the dividend policy. This paper thus builds further on the findings of Michaely and Roberts (2012), which indicate that private firms with dispersed ownership have a different dividend policy than public firms with the same characteristics, suggesting that ownership structure and incentive conflict are important when studying dividend policy. Second, given that prior research on the intra-familial conflict of interest, as well as on family governance practices and dividend policy in private family firms is mainly anecdotal and case-based, this article goes a step further by empirically testing the moderating impact of family governance practices on the relation

[23] In this paper we investigate the *propensity* to pay dividends, and we thus do not examine the *amount* of dividends that are being paid out for two reasons. First, the rather limited sample size and the small percentage of firms that are paying out dividends does not allow for detailed analyses of the dividend payout *rate*. Second, the objective of this paper is to investigate the presence of a dividend *policy*, which can be measured via the propensity to pay dividends.

between agency conflicts and the propensity to pay dividends. As such, the article responds to recent calls for empirical research on these topics (Siebels & Knyphausen-Aufseß, 2012).

The remainder of this article is organized as follows. Section 2 reviews relevant previous literature and formulates hypotheses. Subsequently, sections 3 and 4 cover the methodology and the results. Section 5 discusses the results and concludes.

6.2 Literature Review and Hypotheses Development

6.2.1 Dividends and intra-familial principal-principal conflicts

While businesses find dividends obvious, economists seem to find the existence of dividends mysterious (Easterbrook, 1984). Miller and Modigliani (1961; 1958) declare dividends to be a trivial issue that one can easily ignore, because shareholder wealth will be unaffected by management's decision concerning dividend payouts. Regardless of whether management retains earnings as capital gains or distributes them in the form of dividends, the return to the shareholder will be the same. However, in the real world, most firms pay out dividends regularly (DeAngelo & DeAngelo, 2007), even despite the fact that dividends are less favorable than capital gains because of taxes. This occurrence of dividends, despite their costs, has lead academics to a search for explanations.

The finance literature offers several explanations for the existence of dividends, such as signaling, clientele, agency conflicts, catering and investment opportunities (Baker & Wurgler, 2004; Bhattacharyya, 2007; Easterbrook, 1984; Ross, 1973; Rozeff, 1982). Although none of these theories are entirely satisfactory in explaining why firms pay dividends, recent empirical studies are mainly supportive for the agency cost explanation of dividends (Denis & Osobov, 2008; La Porta et al., 2000; Mancinelli & Ozkan, 2006). On the one hand, dividends may mitigate the owner-manager agency conflict because they reduce the firm's free cash flow. Thus, paying out

dividends will reduce the plausibility that managers will waste the firm's excess cash flow by making low return investments that provide private benefits for managers at the expense of the shareholders (Easterbrook, 1984; Jensen, 1986; Rozeff, 1982). On the other hand, dividends can also mitigate intra-shareholder conflicts because they reduce the possibility of expropriation of corporate wealth by insiders (Faccio et al., 2001; La Porta et al., 2000). In other words, dividends can be a self-imposed disciplining mechanism because they transfer wealth from the discretion of the (owner-)manager to all shareholders on a pro-rata basis (Brav et al., 2003; Faccio et al., 2001).

Additionally, several authors investigate the impact of ownership structure (Hu & Kumar, 2004; La Porta et al., 2000; Michaely & Roberts, 2012; Rommens et al., in press; Short et al., 2002). Concerning the impact of family ownership, most studies seem to agree that family firms are more inclined to pay dividends and have higher payout ratios because they use them to alleviate minority investors' concerns over wealth expropriation (Chen et al., 2005; Gugler, 2003; Pindado et al., 2011; Setia Atmaja et al., 2009; Yoshikawa & Rasheed, 2010). These last mentioned studies all focus on publicly-held (family) firms and the challenge of mitigating the owner-manager as well as the controlling-minority shareholder conflict of interest, while overlooking privately-held family firms and the challenge of within-group alignment. After all, according to classical agency theory, family involvement in both ownership and management should align the interests of owners and managers and thus will lead to minimized, or even zero, agency costs in private family firms (Ang et al., 2000; Fama & Jensen, 1983; Jensen & Meckling, 1976). Therefore, assuming the absence of agency conflicts in private family firms, dividends will be irrelevant because they are more costly to the firm than retaining capital (in terms of taxes) and thus will be useless.

However, in the last decennium several authors (e.g. Chrisman et al., 2007; Lubatkin et al., 2005; Schulze et al., 2003a, 2003b; Schulze et al., 2001a) introduced new insights into the agency problems of private family firms as the "combined influence of private ownership and family management results

in a web of incentives that undermine a family firm's governance and raise the agency cost of fractional ownership" (Schulze et al., 2003a, p. 182). Furthermore, in contrast to what is assumed in classical agency theory, family shareholders are a heterogeneous group, whose members have different interests and goals (Sharma et al., 1997). While some shareholders are employed by the firm and perhaps actively participate in management (hereafter: active shareholders), others do not work in the family business (passive shareholders) (Gersick et al., 1997). These different roles and responsibilities can shape their point of view on the family firm objectives and development, and can give rise to intra-familial principal-principal conflicts (Gersick et al., 1997; Stewart & Hitt, 2012).

Although less recognized than the principal-principal conflict of interests in public family firms, these conflicts seem to be very common in privately-held family firms, as indicated by several theoretical contributions in the family business literature (Gersick et al., 1997; Poza, 2009; Stewart & Hitt, 2012). For example, passive family shareholders are generally less tolerant for financial risk and uncertainty than active family shareholders, because the latter may be prepared to sacrifice personal needs to those of the business, whereas the former may not (Dreux, 1990). This intra-familial principal-principal conflict may aggravate as time passes and ownership becomes more dispersed because active and passive family shareholders are then likely to have a different degree of identification with and involvement in the family firm (Ward, 1997). Thus, even when the firm has no outside (i.e. nonfamily) shareholders and the firm's equity is distributed among family members, conflicts between active and passive family shareholders may arise (Schulze et al., 2003a). Empirical studies on this topic are rare, with the exception of Vilaseca (2002), who finds evidence of the existence of a conflict of interests and objectives among family business shareholders (nonemployed versus members of the management team).

According to anecdotal and case-based literature, dividends may be an instrument to mitigate these intra-shareholder conflicts in private family firms

(e.g. Thomas, 2002; Ward, 1991; Ang et al., 1992; Gallo et al., 2004; Gallo and Vilaseca, 1996). After all, active family shareholders may take exorbitant salaries or excessive perquisites, or invest in low return showcase projects that will advance their career perspectives, at the expense of passive family shareholders. This threat could cause the passive shareholders to insist on greater dividend payouts, even if this is not advantageous from a taxation viewpoint (Ang et al., 1992; Ward, 1992; Ayers, 1990). Another reason for passive family shareholders to demand dividend payouts, is the fact that they consider them as a legitimate reward of their family membership (Gersick et al., 1997). Additionally, passive family shareholders will perceive important differences if the earnings generated by the firm are distributed in the form of dividends or retained in capital, because the shares are not traded in a fluid stock market and thus dividends are the only means of satisfying their structural liquidity needs (Gallo & Vilaseca, 1996; Neubauer & Lank, 1998).

In sum, conflicts of interest between active and passive shareholders likely occur in privately-held family firms and dividend policy is likely to reflect these potential conflicts of interest. Thus, the first hypothesis expects a higher propensity to pay dividends when passive family shareholders are present, in order to mitigate potential intra-familial principal-principal conflicts.

H1: *Private family firms with both active and passive family shareholders have a higher propensity to pay dividends than private family firms with only active family shareholders.*

6.2.2 Family governance practices as a moderating variable

Controlling shareholders generally prefer to keep power over corporate resources which lower propensity-to-pay dividends likely reflects. However, when vulnerability to expropriation problems is high, rational minority shareholders in publicly-held firms will demand dividend payouts in order to address these agency problems. When these dividend calls remain unanswered,

minority shareholders will attach a lower value to the firm and the share price may drop significantly (Faccio et al., 2001). Consequently, the stock market plays a prominent role in convincing the controlling shareholders to pay out dividends. The absence of a disciplining stock market for privately-held family firms raises the question whether family governance mechanisms could replace the stock markets' role in convincing controlling shareholders to commit to a dividend policy. This paragraph introduces family-centric governance solutions as an answer to this question and discusses whether and how these family governance mechanisms moderate the relationship between potential principal-principal conflicts of interest and the propensity to pay dividends.

Intra-familial principal-principal conflicts require different remedies than those that deal with the traditional principal-agent conflict or the ownership-based principal-principal conflicts (between majority and minority owners) in public family firms (Stewart & Hitt, 2012; Young et al., 2008). The governance of a family firm consists of two interacting subsystems: the firm governance and the family governance system (Storey, 1994; Westhead & Cowling, 1998). Apart from the supervision and control of management, private family firms need to establish distinct governance structures that consider the multiple roles that family members play within the family and the firm, which is necessary to prevent or reduce harmful conflicts among family shareholders (Bartholomeusz & Tanewski, 2006; Mustakallio et al., 2002; Neubauer & Lank, 1998). By doing so, these specific family governance structures help to create a shared vision between active and passive family shareholders (Berent-Braun & Uhlaner, 2012; Hoy & Sharma, 2010; Mustakallio et al., 2002; Suáre & Santana-Martin, 2004; Vilaseca, 2002). Family governance practices (hereafter: FGP) can be both formal and informal and may vary over time in line with the generational stage of the family firm (Neubauer & Lank, 1998; Suáre & Santana-Martin, 2004).

A dividend policy is often a topic that leads to disunity and family in-fighting (Gallo, 2004). FGPs provide an excellent opportunity to alleviate conflicts between active and passive family shareholders by enhancing the

communication between shareholders and creating a shared vision among them. By doing so, the firm can turn passive family shareholders into well-informed, committed partners (Gallo & Vilaseca, 1996; Vilaseca, 2002). A family forum (also referred to as family meeting or family council), for example, can be a catalyst for developing a dividend policy which satisfies the needs of both active and passive shareholder groups. A family forum can occur in different compositions, but its main goal is to promote communication among the family shareholders (Brenes et al., 2011).

Additionally, the forum provides a platform on which present and emerging family conflicts can be discussed and resolved before they affect the firm (Brenes et al., 2011; Gersick et al., 1997; Habbershon & Astrachan, 1997; Poza, 2009). Family members can express their different values, expectations and opinions, which are afterwards presented to the top management team (Gersick et al., 1997; Poza, 2009). As such, a family forum can help in discussing the desired balance between the family and the firm and between reinvestment and liquidity needs (Poza, 2009). For example, whereas a family forum gives the opportunity to passive shareholders to express their liquidity needs, it also gives the opportunity to active shareholders to clarify present investment opportunities and thereby indicating what constitutes realistic dividend expectations. Additionally, a *family charter* (also referred to as family constitution or family code of conduct), can facilitate the development of a formal dividend policy as it documents principles and guidelines regarding the relationship of the family to the business. The charter can thus disclose reinvestment requirements and a ratio of reinvestment to distribution in the form of dividends (Poza, 2009). The development of a family charter is usually a highly participatory process involving the entire family (Berent-Braun & Uhlaner, 2012; Brenes et al., 2011; Suáre & Santana-Martin, 2004). As such, the charter represents an important asset to family unity and transparency and helps with developing a patient capital culture (Poza, 2009).

In conclusion, FGPs can facilitate the discussion over dividend policies. Therefore, whether the existence of an intra-familial principal-

principal conflict indeed leads to a dividend payment, may depend on the establishment of FGPs in the firm. After all, as a result of a potential intra-familial principal-principal conflict of interest, shareholders are likely to put their own agendas before anything else and they may exhibit the behaviors of greedy and ungrateful heirs (Poza, 2009). Active family shareholders may try to use excess cash for private benefits and perquisites, or they might favor reinvestment in the firm, as this will probably be more advantageous to them. So as to prevent this rent extraction, passive family shareholders will prefer to receive dividends. However, active family shareholders usually have decision power over corporate resources and the absence of a liquid market for shares tends to take away one of the main disciplining governance mechanisms in establishing a dividend policy. Therefore, the existence of a potential intra-familial principal-principal conflict as such will not necessarily lead to dividend payments. Without any family governance system that enables communication between family shareholders and thus without the development of a shared vision about what is best for the family firm, dividend payments will rather be the result of who has most power to push through his preferences. As the use of FGPs assists in creating a shared vision between family shareholders (Mustakallio et al., 2002), FGPs will facilitate the development of a dividend policy which is satisfactory for both passive and active family shareholders. Dividend payments are therefore more likely to occur in firms with FGPs as a result of the shared vision and the desire to mitigate existing or potential family conflicts and therefore also reducing the threat of shareholder exits.

H2: *The positive relationship between passive family shareholders and the propensity to pay dividends is stronger in firms where family governance practices occur.*

6.3 Method

6.3.1 Sample

The primary source of data is derived from a wider survey, conducted during the period 2002-2003. This survey explores general firm characteristics, as well as board and management composition, strategic, succession and governance issues in Belgian family businesses. In this study, firms are characterized as family firms when they meet one of the following requirements: (1) at least 50 percent of the shares are owned by family members and the family is responsible for the management of the business, (2) at least 50 percent of the shares are owned by family members, the company is not family managed but the CEO perceives the firm as a family business, (3) family ownership is less than 50 percent, the company is family managed, the CEO perceives the firm as a family firm and a venture capital or investment company owns at least 50 percent of the shares.

The survey was mailed to CEOs of 3,400 firms, randomly selected from a family-business database, all of them being privately-owned and employing at least five people. The final response rate was 9.2%, or 311 companies, of which 295 contained sufficient data to be included in the analysis. This response rate is in line with previous studies of privately-held firms that target CEOs (Bammens et al., 2008; Berent-Braun & Uhlaner, 2012; Cruz et al., 2010; Uhlaner et al., 2007). After removing cases with missing values, our analyses are based on a final sample of 247 privately-held family businesses. The possibility of a non-response bias is tested using Kruskal-Wallis and Chi^2 tests, which compare several key firm characteristics (such as firm size, sector and region) between sample and population. No statistical significant differences are found, which suggests that the sample is representative for the population.

The secondary source of data is the 2003 Bel-First database by Bureau Van Dijk, which contains accounting statements of all Belgian firms. By using two different sources of data, the risk of common method bias is

mitigated, since the dependent variable (dividend payout) and several control variables (firm size, leverage, cash, growth and industry) result from a database external to the survey.

6.3.2 Measures

Dependent variable. Consistent with previous empirical research investigating the propensity to pay dividends (DeAngelo et al., 2004; Denis & Osobov, 2008; Fama & French, 2001; Henry, 2011; Sharma, 2011), this study uses a binary dependent variable, *the likelihood of paying dividends* (*DIV*), which equals one when the firm paid out a dividend in 2003, and zero if the firm did not.

Independent variables. The dummy variable *Passive* equals one when the firm has family shareholders who do not work in the firm, and zero when all the family shareholders are active, that is, working in the firm. In order to capture the existence of family governance mechanisms in the firm, the dummy variable *FGP* equals one when the firm has established a family forum and/or a family charter, and zero otherwise[24].

Control variables. Consistent with prior finance research, the analysis includes several firm characteristics that might influence the propensity to pay dividends. First, as higher profits have proven to be positively associated with payout (e.g. DeAngelo et al., 2004; Fama & French, 2001; Sharma, 2011), the variable *ROA* controls for a firm's profitability. ROA (return on assets) is measured as the income before interest, tax, depreciation and amortization, divided by total assets. The natural log of total assets (*Assets)* is included in the model as a proxy for firm size, because larger firms tend to have a higher

[24] We used this dummy ("and/or") as a proxy for family governance practices because the fairly small sample size does not allow for a more detailed breakdown in sorts and numbers of family governance practices.

propensity to pay dividends (Fama & French, 2001; Fenn & Liang, 2001; Sharma, 2011).

According to Jensen's (1986) free cash flow hypothesis, higher cash holdings should be positively related to dividend payouts (DeAngelo et al., 2006; Farinha, 2003). The variable *Cash* contains a firm's cash holdings as a fraction of its total assets. The model controls for financial leverage, measured via long term debt divided by total assets (*Fin. Leverage*), as debt may negatively impact dividends because the firm needs cash to pay for interests (DeAngelo et al., 2004; Sharma, 2011). Additionally, debt covenants and restrictions imposed by debtholders can limit the firm's ability to pay out dividends (Baker, 1989; Farinha, 2003; Hu & Kumar, 2004; Jensen & Meckling, 1976). The natural logarithm of firm age (*Age*) is included as a proxy for a firm's maturity. Older firms are typically in later growth phases, which gives rise to excess cash, and are thus more probable to pay dividends (Sharma, 2011; Yoshikawa & Rasheed, 2010). A firm's investment or growth opportunities are expected to be negatively related to the propensity to pay dividends because these opportunities give a firm a strong incentive to retain cash and thus not to pay out dividends. Consistent with prior research (Carney & Gedajlovic, 2002; Denis & Osobov, 2008; Fama & French, 2001; Naceur et al., 2006), growth rate of assets (dA_t/A_t) is a proxy for a firm's investment opportunities (*Growth*), because greater growth indicates superior investment opportunities (DeAngelo et al., 2004). As the generational phase of a family firm might influence the decision to pay out dividends (Lubatkin et al., 2005), a dummy variable *Generation* is included which equals one for a first-generation family firm, and zero for later generations. Finally, in order to control for industry effects, four industry dummy variables are included: *Primary*, *Construction*, *Wholesale* and *Service*.

6.4 Results

6.4.1 Descriptive statistics and univariate analysis

Table 22 reports average characteristics of the full sample, and of the subsample of dividend payers and non-payers. About 18% of the sample firms are dividend payers. This percentage corresponds to the study of Rommens et al. (in press) whose sample consists of 19% dividend-paying private firms in Belgium. The sample firms have an average dividend payout ratio of 1.07% (dividend-to-assets) or 18.44% (dividend-to-earnings). About 35% of the sample firms have passive family shareholders and 15% of the firms have some sort of FGP in place. On average, the sample firms have assets of 4.9 million euro, are 40 years old and about 79% of the firms are second- and later generation firms.

The last column presents tests of mean differences between dividend payers and non-payers. Consistent with prior literature, the dividend payers in our sample tend to be more profitable, larger, older and have higher cash holdings and lower growth opportunities compared to non-payers. They also tend to have a lower degree of financial leverage and firms of the service industry appear to have a higher propensity to pay dividends. Dividend payers appear to have more often passive family shareholders than non-payers, which corresponds to Hypothesis 1 (on a univariate level). The mean differences between dividend payers and non-payers for *FGP* and *Generation* are not statistically significant.

reports the correlations among the variables on interest in this study. The dependent variable, *DIV*, is significantly positive correlated with *Passive, ROA, Assets, Cash, Firm age* and *Service sector* and is significantly negative correlated with the firm's *Leverage*. The highest absolute correlation between the explanatory variables is 0.54, which is well below the 0.80 threshold above which multicollinearity treats could arise (Gujarati, 2003). Additionally, VIF analyses for all tests show that the highest VIF is 1.66, again considerably less

than the 10 threshold (Gujarati, 2003). Consequently, multicollinearity is not likely to be a concern in this study.

Table 22 Descriptive statistics: dividend payers versus non-payers

	Full sample (n=246)		**Non-payers (n=203)**		**Payers (n=43)**		**Differences**	
	Mean	S.D.	Mean	S.D.	Mean	S.D.	**t-value**[b]	**z-value**[c]
DIV	0.18	0.38						
Payout1	0.01	0.05						
Payout2	0.18	1.89						
Passive	0.35	0.48	0.32	0.47	0.47	0.50	1.82*	1.78*
FGP	0.15	0.36	0.15	0.36	0.19	0.39	0.63	0.63
ROA	6.50	7.47	5.43	7.33	11.58	5.93	5.16***	5.96***
Assets [a]	4,890.08	11,804.57	4,017.06	8,046.00	9,011.51	21,918.67	2.55**	2.61***
Cash	0.14	0.16	0.11	0.14	0.24	0.20	4.88***	4.18***
Fin. Leverage	0.02	0.04	0.03	0.04	0.01	0.01	-3.20***	-3.76***
Firm age	39.85	37.92	36.30	27.49	56.63	66.37	3.26***	2.20**
Growth	0.04	0.21	0.03	0.21	0.07	0.20	1.06	2.04**
Generation	0.21	0.41	0.22	0.42	0.16	0.37	-0.86	-0.86
Primary	0.35	0.48	0.35	0.48	0.33	0.47	-0.36	-0.36
Construction	0.13	0.34	0.14	0.35	0.12	0.32	-0.38	-0.38
Wholesale	0.35	0.48	0.36	0.48	0.30	0.46	-0.77	-0.77
Service	0.16	0.37	0.14	0.35	0.26	0.44	1.83*	1.82*

Notes: N = 246; *, **, *** Correlation is significant at a probability level below 0.10, 0.05 or 0.01 level (two-tailed); Payout1 = dividend-to-total assets; Payout2 = dividend-to-earnings; [a] in 000 EUR;[b] t-value based on a two-sample t test; [c] z-value based on a two-sample Wilcoxon rank-sum (Mann-Whitney) test; FGP=family governance practices

Table 23 Pearson Correlations

Variable	1	2	3	4	5	6	7	8	9
1. DIV	1.00								
2. Passive	.12*	1.00							
3. FGP	.04	.04	1.000						
4. ROA	.31***	.01	-.02	1.00					
5. Assets [a]	.18***	.06	.25***	-.03	1.00				
6. Cash	.30***	.07	-.02	.32***	-.06	1.00			
7. Fin. Leverage	-.20***	.09	-.09	-.12*	-.54***	-.16**	1.00		
8. Firm age [a]	.16**	.10	.11*	-.06	.24***	.01	-.15**	1.00	
9. Growth	.07	.03	.05	.02	.14**	.01	-.08	-.00	1.00
10. Generation	-.06	-.02	-.11*	-.01	-.10	-.04	.05	-.28***	.15**

Notes: N = 246; *, **, *** Correlation is significant at a probability level below 0.10, 0.05 or 0.01 level (two-tailed);
[a] Natural logarithm; FGP=family governance practices

6.4.2 The impact of passive family shareholders on the propensity to pay dividends

Table 24 displays the results of the regression models. Both models represent a multivariate logit model where the probability of paying out a dividend is estimated using the functional form $f(z) = \frac{e^z}{1+e^z}$ where z = DIV.

The first model captures the impact of passive family shareholders on the propensity to pay dividends, while controlling for firm characteristics and industry. The Nagelkerke pseudo R^2 is 29% and the model χ^2 is significant at $p < 0.001$. Of the control variables, firm performance, cash and firm age have significant positive coefficients, while leverage has a significant negative coefficient.

The results show that the presence of passive family shareholders has a significantly positive effect on the probability of paying dividends, supporting Hypothesis 1.

Table 24 Binary logit regression analysis of the propensity to pay dividends

	Model 1	**Model 2**	**Model 3**
Constant	-6.8082***	-6.7714***	-6.2343***
	(2.0650)	(2.1222)	(2.1844)
HYPOTHESES			
Passive	**0.7222***	**0.7209***	0.1449
	(0.4228)	(0.4231)	(0.4870)
FGP		0.0419	-1.6810
		(0.5634)	(1.1304)
Passive*FGP			**3.2732****
			(1.3989)
CONTROLS			
ROA	0.1373***	0.1375***	0.1304***
	(0.0313)	(0.0314)	(0.0321)
Assets [a]	0.1924	0.1871	0.0910
	(0.2103)	(0.2221)	(0.2301)
Cash	2.5192**	2.5150**	3.1470**
	(1.1980)	(1.1988)	(1.2903)
Fin. Leverage	-32.8995***	-32.9450***	-30.1010**
	(12.2413)	(12.2587)	(12.2419)
Firmage [a]	0.5852*	0.5849*	0.6509*
	(0.3195)	(0.3185)	(0.3374)
Growth	0.6837	0.6910	1.4455
	(1.1269)	(1.1307)	(1.1409)
Generation	-0.1996	-0.1966	-0.1540
	(0.5740)	(0.5755)	(0.5915)
Construction	-1.2000	-0.2080	-0.3903
	(0.6891)	(0.6980)	(0.7376)
Wholesale	0.2292	0.2269	0.3860
	(0.5167)	(0.5177)	(0.5358)
Service [b]	1.0511*	1.0521*	1.1473*
	(0.5854)	(0.5853)	(0.5976)
Model LR Chi²	*65.28*	*65.28*	*72.15*
Nagelkerke pseudo R²	*0.2863*	*0.2863*	*0.3165*

Notes: N=246; *,**,*** Denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively (two-tailed); Standard errors in parentheses; [a] Natural logarithm; [b] Primary industry is the suppressed industry comparison category; FGP=family governance practices

6.4.3 The effect of family governance practices

The variable *FGP* enters in the second model in Table 24. The results indicate that the use of family governance practices has no significant direct effect on the propensity to pay dividends. The third model introduces a moderating variable *Passive*FGP* in order to capture the potential moderating effect of family governance practices on the relation between passive family shareholders and the propensity to pay dividends. Model 3 (in Table 24) presents the regression model, with a Nagelkerke pseudo R^2 of 32% and a model χ^2 which is significant at $p < 0.001$.

The coefficient of the interaction variable, which consists of the dummies *Passive* and *FGP*, is significantly positive. This finding supports Hypothesis 2, which indicates that FGPs do not directly affect the propensity to pay dividends, but that they rather are a mechanism that facilitates dividend payouts in alleviating the potential intra-familial principal-principal conflict of interest in private family firms. These results thus support the outcome hypothesis in that private family firms with family governance (FGP = 1) are more likely to pay out dividends to their shareholders when passive family shareholders are present than firms without any family governance mechanism.

In this analysis, we use one-year dividend as the dependent variable. However, one could argue that whether or not a firm pays out a dividend in one particular year may also be the result of some specific event that occurred during that year. Therefore, as a robustness test, we re-performed the analysis using a proxy that covers 3 years (dummy equals one when the firm has paid out a dividend in the period 2000-2003, and zero otherwise). The results again show a significantly positive interaction variable, confirming the robustness of our results.

6.4.4 Additional analysis

Building on the reasoning behind the second hypothesis, FGPs may not only increase the propensity to pay dividends, but meanwhile also lead to

an optimal dividend policy in the sense that dividends will be more aligned with the firm's growth opportunities. For example, when the family firm has very profitable investment opportunities, FGPs are the ideal forum to discuss these opportunities among family members and to convince passive family shareholders that the use of the available cash for these new investment opportunities will be more optimal than paying out dividends. However, when no new profitable growth opportunities are available, active shareholders have less reasons or arguments in favor of keeping excess funds in the firm and a dividend policy could be accordingly agreed upon. In sum, active as well as passive family shareholders might be more willing to reach a shared vision concerning the best use of available funds when they discuss these issues in FGPs.

The regression models in Table 24 already contain a variable that controls for growth opportunities. While the coefficient of this variable is insignificant, Table 25 presents a test of mean differences in order to find out whether a firm's dividend policy is more related to its growth opportunities in the presence of FGPs. Because perfectly capturing a firm's future growth opportunities in one single measure is impossible (DeAngelo et al., 2004), the analysis uses two proxies. Panel A presents the analysis with *asset growth* during 2003 as a measure for growth opportunities, whereas panel B uses the *average growth rate* of assets in the period 2000-2003 (Carney & Gedajlovic, 2002; DeAngelo et al., 2004; Fama & French, 2001; Naceur et al., 2006).

Table 25 gives a preliminary indication that the reasoning behind Hypothesis 2 might be plausible: firms with FGPs show a lower propensity to pay dividends when the growth opportunities are high, and a higher propensity to pay when the growth opportunities are low (i.e. an optimal dividend policy). Firms without any FGP show an opposing trend (i.e. a suboptimal dividend policy). In sum, FGPs thus can align family and business incentives in ways that reduce the intra-familial conflict of interest while encouraging efficiency in decision making. Despite the small amount of observations in each group, and thus the limited statistical significance, these

results indicate that the reasoning above is plausible. Also, according to a recent literature study of Siebels and Knyphausen (2012), theory on family governance practices lacks testable hypotheses and calls for research that exhausts the potential of empirical data in order to develop new propositions. Therefore, an explorative empirical research strategy as the one applied above, is legitimate in this context and thus might raise some important issues that future research may explore in more depth on a larger sample.

Table 25 Additional analysis: link between dividends and growth opportunities for firms with passive family shareholders

	Growth Opportunities [a]		***Differences***
	Non-payers	Payers	*t-value*
Firms with **passive** family shareholders and **with FGP**	0.11	-0.06	*-1.88***
Firms with **passive** family shareholders and **without FGP**	0.05	0.10	*1.56**

Notes: *,**,*** denotes significance at a probability level below 0.10, 0.05, and 0.01, respectively; FGP=family governance practices; Growth Opportunities are measured as the average growth rate of assets in the period 2000-2003. Analyses repeated with asset growth in 2003 as a proxy for a firm's future growth opportunities gave the same results; Firms with passive family shareholders and FGP: N=15; Firms with passive family shareholders without FGP: N=70.

6.5 Discussion and Conclusions

6.5.1 Discussion

The results from the data analysis show that the presence of passive family shareholders results in a higher propensity to pay out dividends. This suggests that dividends may indeed play a role in mitigating principal-principal agency problems. However, dividends are not always an obvious solution to potential principal-principal conflicts of interest. In the absence of

a disciplining stock market, whether the privately-held family firm pays out dividends is likely to be the result of a voluntary action of active family shareholders who usually have decision power. Therefore, the findings indicate that FGPs appear to be an important facilitating mechanism to avoid or mitigate conflicts among family shareholders by paying out dividends. Thus, passive family shareholders seem to be successful in demanding dividends in privately-held family firms when FGPs are present. According to La Porta et al. (2000), dividends can be considered as substitutes (substitute hypothesis) or outcomes (outcome hypothesis) of corporate governance mechanisms. Our results thus indicate that the outcome hypothesis seems to be valid in the case of private family firms: therefore we can consider FGPs to be a mechanism that facilitates dividend payouts as an instrument to alleviate potential intra-familial conflicts of interest between active and passive shareholders.

Considering the fact that the results support Hypothesis 2, an additional analysis investigates the specific impact of the presence of FGPs on a family firm's dividend policy. The results indicate that FGPs will increase the efficiency in decision making concerning dividend payouts since firms with FGPs pay out dividends only when it is appropriate to do so, that is, when the growth opportunities are low. This finding suggests that FGPs indeed are a useful tool for openly discussing dividend and reinvestment preferences while simultaneously aligning the interests and creating a shared vision between active and passive family shareholders. Contrary, when reinvestment in the business is needed, that is when growth opportunities are high, FGPs will be an excellent instrument to express the importance of these opportunities to the passive family shareholders. After all, FGPs are found to have a positive effect on creating a shared vision on what is best for the future development of the firm (Mustakallio et al., 2002). This way, passive family shareholders will feel involved in the decision-making process and they are more likely to understand the need to keep the money in the firm, compared to the case without FGPs.

These results suggest that family governance mechanisms are an essential tool in developing a dividend policy that is efficient in both aligning the interests of active and passive family shareholders, as well as efficient in terms of adapting to the firm's growth opportunities. Therefore, the existence and use of FGPs should be acknowledged as an important facilitator of dividend policies in privately-held family firms.

6.5.2 Conclusions

Despite the fact that, according to traditional agency theory, dividends are irrelevant in private family firms because of the absence of a principal-agent conflict of interest, these firms do pay out dividends regularly. This paper therefore focuses on why and in which cases privately-held family firms pay out dividends.

This study aims at filling two gaps in the finance and governance literature. On the one hand, past research in finance neglects privately-held family firms in the dividend discussion. On the other hand, past research in governance largely ignores an important conflict in privately-held family firms: the intra-familial principal-principal conflict of interest. In an attempt to fill these gaps in literature, this study investigates whether family governance practices have a moderating impact on the ability of dividends to mitigate possible conflicts of interest between active and passive family shareholders. From an analysis of Belgian privately-held family firms, empirical results support the argument that the occurrence of an intra-shareholder conflict of interest increases the propensity to pay dividends. Additionally, the use of family governance practices strengthens this relationship. This result suggests that family governance practices can be seen as a facilitating mechanism for dividend payouts to alleviate the potential intra-familial principal-principal conflicts of interest. In order to gain further insight and to develop interesting propositions for future empirical research, additional analyses indicate that family governance practices might also lead to an optimal dividend policy that

is in line with the firm's growth opportunities, in contrast to firms without family governance practices.

There are a number of limitations to this study, which could provide opportunities for further research. First, using longitudinal data instead of cross-sectional data will allow to investigate the moderating impact of family governance practices on dividend policy over time, which might provide additional interesting insights. Second, the sample consists only of Belgian privately-held family firms. Even though this might seem a limitation of the study, the sample gives us the advantage of having accurate, objective data on privately held firms (obtained from the Bel-First database), which is uncommon in most countries. Third, data from a more detailed survey and a larger sample of family firms could build further on the findings of this study. Future research might then, for example, empirically investigate whether FGPs indeed reduce family conflicts and thus reduce the threat of liquidation. Fourth, dividends may not fully capture the total amount of rent extraction that occurs within a company. Future research might include variables that measure the amount of capital decreases or share repurchases during a particular period. Last, the results give an indication that family governance practices increase the efficiency in decision making concerning dividend payouts. This result could inspire many future research directions, for example, investigating the impact of FGPs on decision making efficiency in other areas.

Chapter 7

Conclusion

7.1 Outline

The purpose of this dissertation is to advance the understanding of private family firm's compensation and dividend policies. By means of five separate studies, this dissertation therefore aims at filling several gaps in the literature. This concluding section summarizes the empirical findings of each chapter and discusses its main theoretical and practical implications. Finally, some suggestions for future research are provided.

7.2 Empirical findings

Findings Chapter 2. The study represented in Chapter 2 aims at filling a part of a vast gap in the literature of HRM in SMEs, by focusing on one specific aspect: the formalization, effectiveness and performance consequences of compensation practices in SMEs. To address these research questions, we executed a survey in cooperation with one of the leading Belgian employers' associations. Our survey provides evidence into the actual application of common formal compensation practices in Flemish SMEs, based on the 'best practices' as described in the literature. The results reveal that the majority of the SMEs have adopted at least one of the formal compensation practices we examined. The assignment of an HR Officer, the use of benchmarking for compensation issues, and the establishment of a written compensation policy for employees appear to be the most frequently implemented compensation practices. Despite recommendations in the corporate governance code for non-

listed firms (Code Buysse II, 2009), very few firms have actually installed a compensation committee. Next, our findings support the suggestion that in the last decennium, family firms have accelerated the formalization of their processes because, in contrast to results in earlier studies, their compensation practices are now more in lines with those of their nonfamily counterparts. This evolution may be due to an increased awareness of family business owners on professional governance and management of their organizations. Our results challenge prior studies which suggest that the formalization of the HR function improves firm performance, as we do not find a significant relationship between the use of formal compensation practices and firm performance. Thus, although small business owners indicate that compensation issues are a major concern for their businesses, and formal HR practices can deal with this (Rutherford et al., 2003), the use of formal compensation issues as such appears to be insufficient for increasing firm performance. This may be explained by the fact that, from a certain point, the formalization of the HR function may erode many of the potential advantages of small businesses (such as, for example, a family atmosphere) (Bartram, 2005). Concerning the effectiveness of their compensation system, both family and nonfamily business owners assess their system to be quite effective. We found no relation between the amount of compensation practices adopted and the effectiveness of the compensation system. However, highly effective compensation systems appear to be associated with high firm performance. Thus, it is rather the quality (effectiveness) than of the quantity (number of practices employed) of compensation practices that is related to firm performance.

Table 26 Summary of results - Chapter 2

Research Question	Answer
RQ1: To what extent do Flemish SMEs adopt formal compensation practices?	*About 80% of the SMEs use at least one of the enquired formal compensation practices. No differences are found between family and nonfamily SMEs*
RQ2: How do CEOs assess the effectiveness of their compensation system?	*Both family and nonfamily SME business owners consider their compensation system to be quite effective. Perceived effectiveness is not related to the degree of formalization.*
RQ3: Do increased formality and/or effectiveness in the compensation function lead to higher firm performance?	*Formalization as such does not lead to increased firm performance. Compensation systems that support the firm's organizational goals (effective systems) do increase performance.*

Findings Chapter 3. Building on the large amount of research on CEO pay in large public firms, we formulate several hypothesis concerning the determinants of CEO pay in privately-held family firms in Chapter 3. We examine the ability of determinants derived from managerialist, agency, managerial power, and human capital theories to explain variations in CEO pay in the context of privately-held family businesses. The central finding of this study is that, as in large publicly-traded companies, firm size and performance are the main determinants of CEO pay in privately-held family firms. This suggests that, although based on different assumptions, the assumptions made about executive compensation in neoclassical theories (agency, managerialism) are also applicable in the context of private family firms. In contrast, our results are not supporting (even contradicting) managerial power predictions. Our measures of CEO power have no -or even the opposite- effect on CEO pay. This indicates that, although managerial power theory enjoys increasing attention (Bartram, 2005), it might not be applicable in a private family firm setting. Finally, after controlling for firm

size, industry, education and tenure, we find that female CEOs earn significantly less than their male colleagues.

Table 27 Summary of results - Chapter 3

Hypothesis	Finding	Comment
H1: CEO compensation is positively related to firm size in private family firms	*Supported*	
H2: CEO compensation is positively related to firm performance in private family firms	*Supported*	
H3: CEO compensation is negatively related to CEO share ownership in private family firms	*Supported*	
H4: CEO compensation is positively related to CEO experience in private family firms	*Not supported*	Not significant positive (CEO tenure) and negative (CEO age) effects
H5: CEO compensation is positively related to CEO education in private family firms	*Supported*	
H6: Compensation for family CEOs is lower than for nonfamily CEOs in private family firms	*Not supported*	Negative, not significant effect
H7: Compensation for founder CEOs Is lower than for descendant CEOs in private family firms	*Not supported*	Negative, not significant effect

Findings Chapter 4. The objective of this chapter was to address the effect of firm performance on CEO compensation in privately-held family-controlled firms. Several hypotheses were formulated, and tested using a cross-sectional sample of 529 private family firms, gathered by the 2003 Survey of Small Business Finance. The central finding of this study is that firm performance is positively related to CEO compensation in private family firms. This finding stands in contrast to predictions of traditional agency theory, which claim that pay-for-performance is irrelevant in the case of private family firms due to minimal (or zero) agency costs. Additionally, our study argues that the relationship between firm performance and CEO compensation is contingent on ownership and management configurations. We distinguish several types of private family firms, based on their ownership structure and management

position. We find that the positive relationship between firm performance and CEO compensation is only significant if the number of owners is small. This result implies that performance-based pay is a more important instrument when agency costs associated with self-control and parental altruism are highest in private family firms, that is when family ownership is more concentrated. In line with this finding, our results also suggest that the positive relationship between performance and CEO compensation is only present in the controlling-owner stage. Hence, the agency costs associated with parental altruism appear to be much lower in the later generational stages. Finally, we find that both family firms with a family CEO as well as those with a nonfamily CEO have various motives to offer their CEO performance-based compensation, but that the pay-for-performance sensitivity is stronger for nonfamily CEOs.

As such, this study contributes to the literature in several ways. First, while traditional agency theorists claim the pay-for-performance relation to be irrelevant in the context of private family firms, we provide empirical evidence that suggests the opposite. Second, we respond to recent calls to investigate the conditions or characteristics under which performance determines executive compensation (Chrisman et al., 2007; Finkelstein et al., 2009) by taking into account ownership and management characteristics of the private family firm. Third, while previous studies used samples of both family and nonfamily firms (Banghøj et al., 2010; McConaughy, 2000), or both private and public firms (Ke et al., 1999), we focus on privately-held family-owned firms. This focus on private family firms should reveal more clearly the differences within this group of family firms. Fourth, existing literature on executive pay in privately-held family firms is scarce, because data has generally not been accessible (Ke et al., 1999; Wasserman, 2006). The SSBF provides compensation information on a group of firms which are all 100 percent family-owned, which is exactly the case where classical agency theorists expect no agency costs. The database also enables us to test the pay-

for-performance relationship in firms with a wide range of ownership and management structures.

Table 28 Summary of results - Chapter 4

Hypothesis	Finding	Comment
H1: Firm performance is positively related to CEO compensation in privately-held family firms	*Supported*	
H2: Ownership dispersion will moderate the relationship between firm performance and CEO compensation in such a way that firm performance will have a less positive effect on CEO compensation when ownership disperses	*Supported*	The positive relationship between firm performance and CEO compensation is only significant if the number of owners is small (i.e. concentrated ownership)
H3: Generational stage will moderate the relationship between firm performance and CEO pay in such a way that firm performance will have a less positive effect on CEO compensation in later generational stages compared to the controlling-owner stage	*Supported*	The positive relationship between firm performance and CEO compensation is only present in the controlling-ownership stage
H4: CEO family versus nonfamily status will moderate the relationship between firm performance and CEO compensation in such a way that firm performance will have a less positive effect on CEO compensation for family CEOs than for nonfamily CEOs	*Supported*	

Findings Chapter 5 In Chapter 5, we aim at identifying the possible mechanisms that could explain the relationship between pay dispersion within the top management team (TMT), and firm performance. This chapter first discusses the two theories on pay dispersion: tournament and equity. While tournament theory proposes a positive influence of pay dispersion on firm performance, equity theory presumes the opposite. We utilize concepts from general agency and stewardship theories, as well as the concept of social capital to reconcile these two seemingly opposing views, and suggest the

circumstances under which pay dispersion in family firms will have positive or negative effects on firm performance.

As a result, we propose that the nature of this relation (positive or negative effect) will depend on important behavioral premises: whether agency or stewardship behavior prevails within the family firm TMT. Furthermore, we introduce the concept of social capital into the pay dispersion debate. More specifically, we propose that the composition of a firm's TMT determines its level of relational social capital (the quality of the interpersonal relationships). In turn, relational social capital is an antecedent for trusting relationships which are essential for effective collaboration and communication within the team (Nahapiet & Ghoshal, 1998; Tsai & Ghoshal, 1998). In a family firm TMT, these trusting relationships are not only vital when family and nonfamily managers must cooperate, but also within the group of family managers (Eddleston et al., 2010). Hence, we propose that whether stewardship or agency behavior prevails within the TMT (and thus, whether pay dispersion will have a positive or negative performance effect), depends on the level of social capital within that TMT. Therefore, we formulate several propositions so as to distinguish the optimal compensation strategy for different types of family firm TMTs.

Table 29 Overview propositions - Chapter 5

Propositions
P1: *When agency behavior prevails in a top management team, pay dispersion will have a positive effect on firm performance*
P2: *When stewardship behavior prevails in a top management team, pay dispersion will have a negative effect on firm performance*
P3: *In top management teams which consist exclusively of family managers, very strong or very weak social capital is more likely to induce agency behavior than stewardship behavior. In these types of firms, pay dispersion is expected to have a positive effect on firm performance*
P4: *In top management teams where family and nonfamily managers need to collaborate, strong social capital may increase cooperation and communication within the team and thus stewardship behavior may be more likely than agency behavior. In these types of firms, pay dispersion is expected to have a negative influence on firm performance*

Findings Chapter 6. The study in Chapter 6 addresses two gaps in the finance and governance literature. On the one hand, past finance research has neglected privately-held family firms in the dividend discussion. On the other hand, past research in governance has largely ignored the important intra-familial principal-principal conflict of interest. In an attempt to fill these gaps, this chapter examined why and in which cases privately-held family firms pay out dividends. From an analysis of 247 privately-held Belgian family firms, empirical results supported the argument that the occurrence of an intra-shareholder conflict of interest increases the propensity to pay dividends. Additionally, the use of family governance practices strengthens this relationship. This result suggests that family governance practices (such as, for example a family forum or a family charter) can be seen as a facilitating mechanism for dividend payouts to alleviate the intra-familial principal-principal conflicts of interest. Furthermore, ad-hoc analyses indicate that family governance practices might also lead to an optimal dividend policy that is in line with the firm's growth opportunities, in contrast to firms without family governance practices.

As such, this chapter contributes to the finance, governance as well as general family business literature. First, the focus on privately-held family firms allows for a cleaner measurement of the effect of (passive) family ownership on a firm's dividend policy than in publicly-held family firms, because there is no external factor (such as a stock market), that is influencing the dividend decision. Second, given that prior research on the intra-familial conflict of interest, as well as on family governance practices and dividend policy in private family firms is mainly anecdotal and case-based, this article goes a step further by empirically testing the moderating impact of family governance practices on the relation between agency conflicts and the propensity to pay dividends. As such, the article responds to recent calls for empirical research on these topics (Siebels & Knyphausen-Aufseß, 2012).

Table 30 Summary of results - Chapter 6

Hypothesis	Finding	Comment
H1: Private family firms with both active and passive family shareholders have a higher propensity to pay dividends than private family firms with only active family shareholders	*Supported*	
H2: The positive relationship between passive family shareholders and the propensity to pay dividends is stronger in firms where family governance practices occur.	*Supported*	Firms with family governance practices also appear to have a dividend policy that is more related to growth opportunities

7.3 Theoretical Implications

This section gives an overview of the main theoretical contributions of this dissertation. First, we discuss the relevance of well-established theories, such as agency theory, for the study of family firm compensation and dividend policies. Subsequently, we discuss the dissertation's contribution to the debate on family firm heterogeneity. Lastly, we discuss some methodological implications.

According to traditional agency theory, no agency costs exist in private family firms due to the absence of a separation between ownership and control. Hence, mechanisms that are likely to alleviate typical principal-agent conflicts of interest, such as dividends or incentive pay, are considered to be irrelevant in private family firms. This general thought is reflected in the scarcity of theoretical or empirical research on these topics in the context of private family firms. This dissertation nuances this so-called irrelevance and examines the specific agency conflicts that appear in private family firms, which were introduced by several authors in the past decennium (e.g. Lubatkin et al., 2007; Lubatkin et al., 2005; Schulze et al., 2003a, 2003b; Schulze et al., 2001a). The results of this dissertation, as summarized above, provide additional evidence that private family firms do indeed face agency costs. First, they seem to use dividends as an instrument to alleviate intra-familial principal-principal conflicts between active and passive family

shareholders. Second, private family firms appear to use performance-based compensation for their CEO's. Furthermore, the results from Chapter 3 on the strong pay-performance relation are confirmed in Chapter 4, where we used a different database from another geographical area, which gives an indication that our findings remain valid in different contexts (in this case: both in the U.S. and Flanders). Performance-sensitive pay is used not only for the nonfamily CEOs (to alleviate the owner-manager conflict), but also for family CEOs (to alleviate agency costs associated with self-control and altruism). Next, we find that predictions made about the *determinants* of executive compensation in neo-classical theories (agency, managerialism) are also applicable in the context of private family firms, as firm size and performance are found to be the main determinants of CEO pay. In contrast, managerial power theory does not seem to hold true in the context of private family firms.

Further, the results of this dissertation indicate that private family firms cannot be considered as a homogeneous group when studying compensation or dividend policies, seen the significant moderating effects of ownership and management characteristics on the pay-for-performance relation and of the presence of passive family shareholders on the propensity to pay dividends. Additionally, in Chapter 5 we propose that different settings of family firm top management teams may need adapted compensation systems dependent on the prevalence of agency or rather stewardship behavior within the top management team. As such, it is not sufficient to simply include a 'family firm' control variable in a regression model when examining compensation or dividend policies. Although this routine is frequently used for investigating a so-called 'family' impact on dividend payouts or executive compensation, family firms represent a heterogeneous group with a variety of agency conflicts occurring in different contexts. This variety should be taken into account when determining which mechanisms (e.g. pay-for-performance, dividend payouts, family governance, formal compensation practices,...) can be

useful to mitigate the specific agency problems that occur in a particular context.

From a methodological point of view, this dissertation has some additional noteworthy contributions. First, by using the appropriate statistical tests and techniques, we control for the possible endogeneity that might distort the pay-performance relation in Chapters 3 and 4. After all, it is not clear whether a firm's performance influences the pay of its CEO, or whether on the contrary CEOs who receive higher pay will perform better, which results in higher profitability. Although endogeneity problems are inherent to many finance and accounting studies (Chenhall & Moers, 2007) and it is essential to make sure that the empirical model is not influenced by it, most researchers neglect this problem. The results of this dissertation reconfirm that it is crucial to investigate endogeneity concerns. As such, apart from theoretical presumptions of endogeneity problems, researchers should use appropriate tests to check whether the problem actually occurs within the present dataset. For example, although we have theoretical presumptions of a reversed causality problem within the pay-performance relation, a Hausman test confirmed the endogeneity problem in Chapter 4, whereas in Chapter 3 no endogeneity problems were found for that same relation. Possible reasons for this contradiction may be that we use different databases (with data from the US versus Flanders), and different performance measures (ROA versus lagged ROA). Thus, the actual manifestation of endogeneity problems may depend on the type of data and variables and should therefore always be tested for and dealt with appropriately. Finally, our findings of Chapter 4 confirm the importance of the calculation of marginal effects for the interpretation of interaction models, as the results show that it is indeed possible that these effects are significant for relevant values of the moderating variable, even if the coefficient of the interaction term is nonsignificant (Brambor et al., 2006; Kam & Franzese, 2007).

7.4 Practical implications

Reading this dissertation can be useful for practitioners as it includes several suggestions of how family firms can use their dividend and compensation policies in order to overcome some of the conflicts of interest they are facing. Apart from that, our findings also have policy implications for regulators and employers' organizations.

Our results indicate that family governance practices can be very useful in the development of a dividend policy which is satisfactory for both active and passive shareholders. That is, the use of a family forum or a family charter can make sure that the family firm's dividend policy is more aligned to its growth opportunities, which is essentially important for a firm's longevity. However, discussing compensation issues in a family forum or charter does not seem to improve firm performance or compensation system effectiveness. Thus, according to the findings of this dissertation, family governance practices such as the use of a family forum or charter can have a positive impact on the development of a dividend policy, but have no impact on financial firm performance or compensation system effectiveness. Similarly, firms that have a compensation committee appear not to perform better, nor have a more effective compensation system than firms who do not. Discussing pay issues in the board even negatively affects firm performance. These findings challenge the value of corporate governance codes which encourage private firms to install formal practices such as, discussing compensation issues in the board or setting up a compensation committee. As such, seen the heterogeneity of private family firms, setting fixed guidelines and recommendations for this group of firms may not be the solution. Throughout this dissertation, all findings indicate that whether a certain dividend or compensation policy will be effective or rather counterproductive for a specific type of firm, depends on the ownership and management structure of that firm. For example, management consultants and HR managers need to consider the ownership structure of a family firm, and the CEO status (family member or not, founder or not), in order to design a CEO compensation

package which is in line with the type of agency problems the family firm currently faces. Additionally, the discussion of Chapter 5 calls attention to the importance of developing appropriate reward systems for managers in different settings of family firm top management teams. As such, whereas a specific strategy (for example, formalized compensation practices) may work perfectly for one firm, it may work counterproductive for another family firm. Employers organizations or special interest groups might take up this task to inform family firms about these issues, for instance by organizing lectures, panel discussions or discuss case studies. This way, family firm owners and managers can be made aware of the fact that blindly following recommendations and 'best practices' not always turns out to be equally effective.

Finally, our findings indicate that CEO pay in private family firms is largely dependent upon firm size. Therefore, stakeholders should make sure that increases in firm size not only occur to justify a CEO's pay increase, but that it actually results in higher firm value.

7.5 Concluding Note and Suggestions for further research

The ultimate goal of family business research should be to develop a theory of the family firm which describes and explains the distinctive nature of this organizational form and to assess differences in organizational processes and policies between family and nonfamily firms, and variations within the group of family firms, while staying focused on the problems faced by family business practitioners (Chrisman et al., 2006; Sharma et al., 2012). As such, this dissertation examines the under-researched, yet essentially important for practitioners, topic of executive compensation in private family firms. Furthermore, it introduces dividend policies into family business research.

As discussed throughout the dissertation (in the concluding sections of each of the preceding chapters), many important challenges remain for future

research. These include, amongst others, to empirically investigate whether family governance practices reduce family conflicts and thus the threat of liquidation, as the results of our study are suggesting. Next, the finding that family governance practices appears to increase the efficiency in decision making concerning dividend payouts, this result could inspire many future research directions. For example, future research may investigate the impact of family governance on decision making efficiency in other areas. Further, more detailed analyses on the costs and benefits of formal compensation practices for private family firms would assist practitioners' decision making regarding their compensation function. Regarding CEO pay, this dissertation focused solely on the antecedents of CEO pay, while the consequences of it might be of crucial importance for private family firms. Future research could therefore examine the impact of executive compensation on family firm growth and longevity. Finally, researchers can subject the propositions of Chapter 5 to an empirical examination across a wide variety of family firm top management teams so as to distinguish the appropriate reward system for managers across the different types of privately-held family firms.

As such, we hope that this dissertation will incite more research on these relevant family business topics.

Appendix

Questionnaire

Algemene Ondernemingsgegevens

1. Hoeveel **werknemers** (in voltijdse equivalenten) telt de onderneming momenteel? ...

2. In welke **sector** is de onderneming werkzaam?
☐ landbouw ☐ industrie ☐ dienstverlening

3. In welk jaar werd de onderneming **opgericht** ? ...

4. In welke **ontwikkelingsfase** is de onderneming te situeren?
☐ startfase ☐ groeifase ☐ maturiteitsfase ☐ consolidatiefase

5. Werd er in 2011 een **dividend** uitgekeerd? ☐ ja ☐ nee

6. Is de onderneming een **familiebedrijf?** ☐ ja ☐ nee

7. Duid in onderstaande tabel aan hoe de **huidige prestaties** van de onderneming zich verhouden tot die van concurrerende ondernemingen.

"de prestaties van de onderneming zijn ... dan die van de meeste concurrerende ondernemingen"

	veel **slechter**						veel **beter**
Omzetgroei	1	2	3	4	5	6	7
Groei in marktaandeel	1	2	3	4	5	6	7
Groei in personeelsaantal	1	2	3	4	5	6	7
Winstgevendheid	1	2	3	4	5	6	7
Return on equity	1	2	3	4	5	6	7
Return on assets	1	2	3	4	5	6	7
Winstmarge op verkopen	1	2	3	4	5	6	7
De mogelijkheid om groei te financieren met winst	1	2	3	4	5	6	7

Topmanagementteam

8. Hoeveel leden telt het topmanagementteam (incl. bedrijfsleider)? .....

9. Welke (familie)generatie(s) maakt momenteel het **management** van de onderneming uit ?
(geteld vanaf de oprichting van de onderneming)
☐ eerste ☐ tweede ☐ derde ☐ vierde
☐ vijfde of later

10. Hoe is het topmanagementteam samengesteld (incl. bedrijfsleider)?
Aantal familieleden: .....
Aantal niet-familiale leden: .....

11. Duid aan op een schaal van 1 tot 5 in welke mate u het eens bent met volgende stellingen: **de leden van het managementteam...**

	volledig mee **oneens**						volledig mee **eens**
...spenderen veel tijd samen	1	2	3	4	5	6	7
...hangen samen als een hechte groep	1	2	3	4	5	6	7
...kunnen elkaar vertrouwen zonder te moeten vrezen dat een manager misbruik van het vertrouwen zou maken indien de opportuniteit zich zou voordoen	1	2	3	4	5	6	7
...houden zich altijd aan gemaakte afspraken en beloftes naar elkaar toe	1	2	3	4	5	6	7
...delen dezelfde ambities en visie	1	2	3	4	5	6	7
...zijn enthousiast in het nastreven van de collectieve doelen en missies van de onderneming	1	2	3	4	5	6	7

Kenmerken van de huidige CEO

(= Algemeen directeur, afgevaardigd bestuurder, zaakvoerder; hierna genoemd "CEO")

12. **De CEO is een** ☐ man ☐ vrouw

13. **Leeftijd van de CEO: ... jaar**

14. Hoogst behaalde diploma van de CEO

☐ lager of middelbaar onderwijs
☐ hoger onderwijs buiten universiteit korte type
☐ hoger onderwijs buiten universiteit lange type
☐ universitair onderwijs

15. **Type** diploma ☐ economisch ☐ technisch ☐ ander: ...

16. **Hoeveel jaren** is de CEO reeds
- actief in deze functie: ... jaar
- actief in de onderneming: ... jaar
- actief in deze industrie: ... jaar

17. De **CEO** is:

☐ eerste generatie familieondernemer
☐ familiale opvolger (2^{de} generatie of meer)
☐ manager van buiten de familie

18. Hoeveel **% aandelen** bezit de CEO ? ... %

Familiale invloed

19. Heeft de familie een **familieforum** (ook genoemd familieraad, familiale vergadering) ingesteld ?
☐ ja ☐ nee
Indien JA, wordt het **verloningsbeleid** besproken in dit forum?
☐ ja ☐ nee
Indien JA, wordt het **dividendbeleid** besproken in dit forum?
☐ ja ☐ nee

20. Heeft de familie een **familiaal charter** opgesteld? ☐ ja ☐ nee
Indien JA, wordt er in dit charter melding gemaakt van vergoedingen?
☐ ja ☐ nee
Indien JA, wordt er in dit charter melding gemaakt van een dividendbeleid?
☐ ja ☐ nee

21. Kunnen managers die **geen** deel uitmaken van de familie ook in aanmerking komen voor de functie van CEO? ☐ ja ☐ nee

Verloningsbeleid

22. Is er een **HR officer** (personeelsmanager) aangesteld in de onderneming? ☐ ja ☐ nee

23. Beschikt de onderneming over een uitgeschreven verloningsbeleid voor **managers**? ☐ ja ☐ nee

24. Beschikt de onderneming over een uitgeschreven verloningsbeleid voor **werknemers** die niet behoren tot het management? ☐ ja ☐ nee

25. Wordt er in het verloningsbeleid **onderscheid** gemaakt tussen **familieleden** en **niet-familieleden**? ☐ ja ☐ nee

26. Druk in onderstaande tabel de samenstelling van het **totale verloningspakket van de CEO in 2011** uit in percentages *(bij benadering, het totaal moet 100% zijn)*
Opmerking 1: inclusief vergoedingen verkregen via een managementvennootschap
Opmerking 2: exclusief vergoedingen van het kapitaal (dividenden)

	% van totale verloningspakket
Basisloon	..... %
Variabele cash verloning *(bonus gebaseerd op individuele en bedrijfsresultaten)*	..... %
Niet monetaire voordelen *(verzekeringen, wagen, andere voordelen in natura)*	..... %
	_ _ _ _ _ _ _ _
TOTAAL	**100 %**

27. Hoeveel bedroeg **het totale bruto jaarloon** (basis jaarloon + variabele cash verloning) **van de CEO in 2011?** (bij benadering)

Opmerking 1: inclusief vergoedingen verkregen via een managementvennootschap

Opmerking 2: exclusief vergoedingen van het kapitaal (dividenden)

_ _ _ _ _ _ _ _ _ _ _ _ _ _ *EUR*

28. Indien u het totale bruto jaarloon van de CEO niet kent of **niet wenst vrij te geven**, kan u hieronder **een indicatie** geven in welke range dit loon zich bevindt. *Opmerking 1: inclusief vergoedingen verkregen via een managementvennootschap Opmerking 2: exclusief vergoeding van het kapitaal (dividenden)*

- ❍ < 25.000 EUR
- ❍ 25.000 - 49.999 EUR
- ❍ 50.000 - 74.999 EUR
- ❍ 75.000 - 99.999 EUR
- ❍ 100.000 - 149.999 EUR
- ❍ 150.000-249.999 EUR
- ❍ 250.000 - 500.000 EUR
- ❍ > 500.000 EUR

29. Indien er een **bonus** aan de CEO wordt uitgekeerd, dan zijn deze gebaseerd op...

- ☐ enkel individuele prestaties
- ☐ zowel individuele- als bedrijfsprestaties
- ☐ enkel bedrijfsprestaties
- ☐ niet van toepassing (geen bonus)

30. Indien er een **bonus** aan de CEO wordt uitgekeerd, dan zijn deze gebaseerd op...
(1) enkel korte termijn prestaties ... (7) enkel lange termijn prestaties

31. Geef in onderstaande tabel aan **in welke mate u het eens bent** met deze stellingen: (1=volledig mee **oneens**; 7=volledig mee **eens**)

Het verloningsbeleid houdt *weinig* rekening met de hiërarchische verhoudingen in de onderneming
Onze onderneming geeft speciale vergoedingen en privileges (als statussymbolen) aan personeelsleden die zich hoger bevinden in de hiërarchie van de organisatie
Onze onderneming probeert het verloningssysteem zo gelijk mogelijk te houden. Er worden zeer weinig extra voordelen of speciale vergoedingen gegeven aan 'elite' werknemers in de onderneming
Interne gelijkheid van loon is een belangrijk doel van ons verloningsbeleid
Onze onderneming streeft naar vergelijkbare lonen in verschillende takken van de onderneming

Onze onderneming hecht meer belang aan interne gelijkheid in loon dan aan externe marktfactoren (zoals bv. salarisstudies, marktconformiteit,...)
In onze onderneming worden individuele verloningsgegevens geheim gehouden
Onze onderneming hanteert formele regels om de werknemers te ontmoedigen om hun loon bekend te maken hun collega's
De administratieve procedures over hoe verloningsniveaus en loonsverhogingen worden vastgelegd, blijven geheim

32. Geef in onderstaande tabel aan hoe de lonen tussen de **leden van het managementteam** zich verhouden: (1=nihil, geen verschil; 7=heel groot)

Het verschil in verloning tussen de CEO en de eerstvolgende manager in rang is ...
Het verschil in verloning tussen de leden van het managementteam onderling (**exclusief** de CEO) is ...

33. Krijgen alle **familiale** managers hetzelfde loon (excl CEO)? ☐ ja ☐ nee

34. Krijgen alle **niet-familiale** managers hetzelfde loon (excl CEO)? ☐ ja ☐ nee

35. Is het verloningsbeleid voor de **familiale** managers gelijk aan dat van **niet-familiale** managers (excl CEO)? ☐ ja ☐ nee

Indien NEE, welke groep wordt bevoordeeld ten opzichte van de andere wat betreft verloning? ☐ familiale ☐ niet-familiale

36. Beoordeel de mate waarin de volgende stellingen over het verloningsbeleid voor **familiale en niet-familiale managers (excl. CEO)** van toepassing zijn op de onderneming: (1= helemaal **niet**; 7= helemaal **wel**)

De jobinhoud en/of het gewicht van de functie zijn belangrijke factoren voor het bepalen van het loon voor **familiale** managers
De jobinhoud en/of het gewicht van de functie zijn belangrijke factoren voor het bepalen van het loon voor **niet-familiale** managers
De bekwaamheid en/of ervaring van de **familiale** managers zijn belangrijke factoren voor het bepalen van hun loon
De bekwaamheid en/of ervaring van de **niet-familiale** managers zijn belangrijke factoren voor het bepalen van hun loon
De jobinhoud is een belangrijker maatstaf dan de ervaring en/of bekwaamheid van een **familiale** manager voor de bepaling van zijn loon
De jobinhoud is een belangrijker maatstaf dan de ervaring en/of bekwaamheid van een **niet-familiale** manager voor de bepaling van zijn loon

37. Beoordeel de mate waarin de volgende stellingen over het verloningsbeleid voor **familiale en niet-familiale managers (excl. CEO)** van toepassing zijn op de onderneming: (1= helemaal **niet**; 7= helemaal **wel**)

Niet-monetaire voordelen vormen een belangrijk deel van het volledige verloningspakket van een **familiale** manager
Niet-monetaire voordelen vormen een belangrijk deel van het volledige verloningspakket van een **niet-familiale** manager
Het pakket van niet-monetaire voordelen is zeer genereus voor **familiale** managers
Het pakket van niet-monetaire voordelen is zeer genereus voor **niet-familiale** managers

38. Hoe is het **verloningspakket** van de **familiale managers** (excl. CEO) bij benadering samengesteld?

- ☐ 100% vast
- ☐ 75% vast, 25% variabel
- ☐ 50% vast, 50% variabel
- ☐ 25% vast, 75% variabel
- ☐ 100% variabel

39. Indien er bonussen aan **familiale managers** (excl. CEO) worden uitgekeerd, dan zijn deze gebaseerd op...

- ☐ enkel individuele prestaties
- ☐ zowel individuele- als bedrijfsprestaties
- ☐ enkel bedrijfsprestaties
- ☐ niet van toepassing (geen bonus)

40. Hoe is het **verloningspakket** van de **niet-familiale managers** (excl. CEO) bij benadering samengesteld?

- ☐ 100% vast
- ☐ 75% vast, 25% variabel
- ☐ 50% vast, 50% variabel
- ☐ 25% vast, 75% variabel
- ☐ 100% variabel

41. Indien er bonussen aan **niet-familiale managers** (exclusief de CEO) worden uitgekeerd, dan zijn deze gebaseerd op...

- ☐ enkel individuele prestaties
- ☐ zowel individuele- als bedrijfsprestaties
- ☐ enkel bedrijfsprestaties
- ☐ niet van toepassing (geen bonus)

42. Geef in onderstaande tabel aan in welke mate u het eens bent met volgende stellingen (1=volledig mee **oneens**; 7=volledig mee **eens**)

Het verloningsbeleid voor **familiale** managers is sterk gefocust op individuele prestaties
Het verloningsbeleid voor **niet-familiale** managers is sterk gefocust op individuele prestaties
Loonsverhogingen voor **familiale** managers worden bepaald door individuele prestaties. Er is een sterke spreiding tussen de loonsverhogingen van sterk en zwak presterende **familiale** managers
Loonsverhogingen voor **niet-familiale** managers worden bepaald door individuele prestaties. Er is een sterke spreiding tussen de loonsverhogingen van sterk en zwak presterende **niet-familiale** managers
Anciënniteit speelt *geen* rol bij loonsbepalingen voor **familiale** managers
Anciënniteit speelt *geen* rol bij loonsbepalingen voor **niet-familiale** managers

43. Geef in onderstaande tabel aan in welke mate u het eens bent met volgende stellingen (1=volledig mee **oneens**; 7=volledig mee **eens**)

Het verloningsbeleid voor **familiale** managers is toekomstgericht. De doelstellingen voor managers zijn gefocust op resultaten op lange termijn (2 jaar of meer)
Het verloningsbeleid voor **niet-familiale** managers is toekomstgericht. De doelstellingen voor managers zijn gefocust op resultaten op lange termijn (2 jaar of meer)
Het verloningsbeleid voor **familiale** managers beloont korte termijn prestaties van de managers (halfjaarlijks of jaarlijks)
Het verloningsbeleid voor **niet-familiale** managers beloont korte termijn prestaties van de manager (halfjaarlijks of jaarlijks)
Het verloningsbeleid voor **familiale** managers erkent dat lange-termijn resultaten belangrijker zijn dan korte-termijn resultaten.
Het verloningsbeleid voor **niet-familiale** managers erkent dat lange-termijn resultaten belangrijker zijn dan korte-termijn resultaten.

44. Geef in onderstaande tabel aan in welke mate u het eens bent met volgende stellingen (1=volledig mee **oneens**; 7=volledig mee **eens**)

Het verloningsbeleid van onze onderneming werkt zeer effectief
De managers zijn zeer tevreden over het verloningsbeleid
De aandeelhouders zijn zeer tevreden over het verloningsbeleid
Het verloningsbeleid lijkt goed geaccepteerd te worden door de werknemers in onze onderneming
Het verloningsbeleid draagt bij aan het behouden, aantrekken en motiveren van de werknemers in onze onderneming

45. Doet de onderneming een beroep op **marktgegevens** mbt verloning van **managers** (bijvoorbeeld salarisstudies, benchmarks) ☐ ja ☐ nee

Indien JA: Worden die benchmarks daadwerkelijk gevolgd? (i.e. leiden ze tot aanpassingen in de verloning?) ☐ ja ☐ nee

Raad van Bestuur

46. Is er in de onderneming een ***actieve* Raad van Bestuur**? ☐ ja ☐ nee

Indien JA: Hoeveel **leden** telt de Raad van Bestuur ? ...

47. Is er in de onderneming een ***actieve* Adviesraad**? ☐ ja ☐ nee

Indien JA: Hoeveel **leden** telt de Adviesraad? ...

48. Gelieve in onderstaande tabel aan te geven hoe de Raad van Bestuur is samengesteld

	Aantal
Bestuurders die tevens deel uitmaken van het managementteam...	
• én tot de familie behoren (= ***uitvoerende familiale bestuurders)***	
• maar niet tot de familie behoren (= ***uitvoerende niet-familiale bestuurders)***	
Bestuurders die <u>geen</u> deel uitmaken van het managementteam...	
• maar wel tot de familie behoren (= ***niet-uitvoerende familiale bestuurders)***	
• en niet tot de familie behoren, maar wel een vertrouwensrelatie hebben, met het bedrijf zoals juristen, bankiers, en accountants (= ***geaffilieerde bestuurders)***	
• tot geen van bovenstaande categorieën behoren, maar wel in het bezit zijn van aandelen van het bedrijf (= ***externe bestuurders met een aandeel in het kapitaal)***	
• tot geen van bovenstaande categorieën behoren, en niet in het bezit zijn van aandelen van het bedrijf (= ***externe bestuurders zonder aandeel in het kapitaal)***	

49. Is de CEO eveneens **voorzitter** van de Raad van Bestuur? ☐ ja ☐ nee

50. Is er een **remuneratiecomité** (ook *vergoedingscomité* of *bezoldigingscomité* genoemd) in de onderneming?
☐ ja ☐ nee

Indien JA:

Uit hoeveel leden bestaat dit comité? ...
Hoeveel van deze leden behoren tot de familie ? ...
Maakt de CEO deel uit van dit comité? ☐ ja ☐ nee
Hoe frequent vergadert dit comité?
Formeel overleg: gemiddeld ... keer/jaar
Informeel overleg: gemiddeld ... keer/jaar
Maakt de voorzitter deel uit van de familie? ☐ ja ☐ nee

Indien NEE:

Plant men een remuneratiecomité in te voeren? ☐ ja ☐ nee
Komt het remuneratiebeleid formeel ter sprake binnen de RvB? ☐ ja ☐ nee
Komt het personeelsbeleid formeel ter sprake binnen de RvB? ☐ ja ☐ nee

51. Hoe frequent **vergadert** de Raad van Bestuur?
- *Formeel overleg: gemiddeld ... keer / jaar*
- *Informeel overleg: gemiddeld ... keer /jaar*

52. In kolom 1 van onderstaande tabel worden een aantal mogelijke **taken** vermeld voor de Raad van Bestuur. Geef aan in welke mate de Raad van Bestuur in uw onderneming deze taken reeds vervult. (1= beperkte mate; 7=grote mate)

Taak / Rol
Formuleren/goedkeuren ondernemingsstrategie
Evalueren/controleren van management prestaties
Dienst doen als klankbord voor de bedrijfsleider bij strategische zaken
Adviseren en bemiddelen bij discussies omtrent strategische topics
De mening van de bedrijfsleider omtrent strategische zaken uitdagen
De bedrijfsleider kritische vragen stellen omtrent strategische beslissingen

Aandeelhoudersstructuur

53. Hoeveel **aandeelhouders** telt de onderneming momenteel in totaal? ...

54. Hoeveel **procent** van de aandelen is in handen van (*bij benadering*):
.....% familiale managers
.....% familieleden (niet behorend tot het management)
.....% niet-familiale managers
.....% investeringsmaatschappijen
.....% werknemers
.....% andere: .....

_____
100 %

55. Is er één persoon die **meer dan 50%** van de aandelen bezit? ☐ ja ☐ nee

56. Zijn er aandeelhouders die **niet** werkzaam zijn in de onderneming? ☐ ja ☐ nee

57. Hoeveel **familiale aandeelhouders** telt de onderneming? ...

58. Hoeveel van de familieleden die aandelen bezitten zijn **tewerkgesteld** in de onderneming? ...

59. Welke **generatie** heeft momenteel de meeste aandelen in handen? *(geteld vanaf het moment van de oprichting)* ☐ eerste ☐ tweede ☐ derde ☐andere, nl: ...

60. Zijn er naast de hierboven aangeduide generatie nog andere generaties in het bezit van aandelen?

☐ ja ☐ nee

***Indien JA**, welke generatie(s)? (in volgorde van belang):* ...

Hartelijk dank voor uw medewerking !

Indien u op de hoogte wenst te worden gehouden over de resultaten van de studie, graag uw hieronder emailadres en/of adresgegevens invullen. U zal dan begin september een rapport ontvangen met de verwerkte resultaten van dit onderzoek.

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