

Conditions to the performance of privately held family firms under a descendant CEO

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Abstract

A recent stream of research investigates family firm characteristics that could have an influence on performance measures. One such specific characteristic is the CEO position in a family firm. Although there are some results that suggest that descendants perform better than their founder CEO counterparts, the majority of studies suggest that descendant CEOs do not have the same degree of positive influence on family firm performance as founder CEOs have. The findings are, however, slightly different on the degree of negative impact on family firm performance. Therefore, there might be situations in which a descendant is detrimental for the performance of a family firm but also other occasions when there might be advantages connected to a descendant CEO in charge of a family business. This study investigates whether the board of directors has a moderating effect on the descendant CEO's influence on private family firm performance. As performance has several dimensions, we choose to measure performance variability as a proxy for entrepreneurial behavior. Our findings suggest that when a private family firm is lead by a descendant CEO, a vigilant and empowered board of directors will lead to more innovation and entrepreneurial behavior.

1. Introduction

During the last decade, much research has been done on the performance of family firms. Previous research comparing performance of family firms with non-family firms has resulted in various outcomes. Some empirical studies find evidence that family firms outperform non-family firms (e.g. Anderson and Reeb, 2003), but suggestions for the contrary are also commonly made (e.g. Faccio et al., 2001 and Levinson, 1971). Therefore, current research focuses on explaining why some family firms perform better and others do not. Recent family business literature on performance thrives to analyze the “family effect” on firm performance. Since family firms are a heterogeneous group of firms (Dyer, 2006), it is valuable to identify those characteristics of family firms that influence performance. One aspect that has received a lot of attention, is the management of a family firm and more in particular, the influence of the CEO (e.g. Anderson and Reeb, 2003; Barontini and Caprio, 2006 and Villalonga and Amit, 2006). Two distinctions are commonly made when discussing the family firm’s CEO, namely, a family CEO versus a non-family CEO and a founder versus a descendant CEO. In this study, we focus on the latter distinction.

Earlier research on the performance of descendant-led public family firms has resulted in contradicting outcomes. Anderson and Reeb (2003) find in their study on public family firms that only founder CEOs have a positive influence on market performance. The results of Barontini and Caprio (2006) are similar, suggesting that descendant CEOs are not beneficial to accounting nor market performance. Research by Villalonga and Amit (2006) suggests that when the CEO position in a family firm is taken by a descendant, firm value is even destroyed. McConaughy et al. (1998) and Sraer and Thesmar (2007), on the other hand, find that descendants have a positive effect on firm performance and that they are even more efficient than their founder-counterparts. These contrasting results suggest that there must be conditions under which descendants are beneficial to the family firm and others that are not.

This paper contributes to the family business literature by scrutinizing conditions that influence the effect that a descendant CEO has on performance in private family firms. We give possible explanations for the question why some studies find that descendant CEOs are detrimental to company performance while other studies don't acquire evidence for this or even obtain opposite results. A recent study by Bennedsen et al. (2007) relates some characteristics about the CEO and the industry to the relation between the CEO and the performance level. Their results suggest that descendant CEOs are particularly detrimental for family firms when they operate in fast growing industries and industries that require a highly skilled labor force. There is, however, no research done yet on the possible influence of governance issues on the effect of a descendant CEO. This paper studies how the board of directors can play a moderating role in the relation between the type of family CEO and the performance of a private family firm. Hence, the board of directors may perform two important roles in private family firms, namely control and service that can offset the possible disadvantages of a descendant CEO.

First of all, when a descendant becomes CEO, ownership is likely more dispersed as compared to a controlling owner company. If ownership is somewhat equally distributed among siblings, one loss adverse sibling can prevent others from putting the company's resources to their best and desired use (Schulze et al., 2003). The descendant CEO will generally lack the ability to push through his decisions which might leave him in the necessity to compromise and carry out second-best, middle-of-the-road decisions (Schulze et al., 2003). This is also empirically supported by Bennedsen et al. (2007) as descendants perform the worst in fast-growing industries where decision-making can't wait. In this situation, the board of directors can fulfil his service role and assist siblings in making the best straightforward decision. Hence, the board of directors can function as an institution where conflicts are mediated (Donaldson and Preston, 1995).

A second category of problems that manifests in descendant-led private family firms, are agency threats resulting from parental altruism, combined with the problem of self-control. Moral hazard is likely strengthened in private family firms led by a descendant

CEO. That is, parents, who are generally important shareholders, will likely be generous to their son or daughter, which makes free-riding for them easier (Schulze et al., 2003). Hold-up is also more severe when a descendant is CEO as he will more likely put his own nuclear household first, which makes it harder for other shareholders to rely on him (Schulze et al., 2003 and Lubatkin et al., 2005). Adverse selection and sorting manifests as family firms are more likely to hire a family member even if this person doesn't have the same degree of qualities as a non-family member candidate (Schulze et al., 2001 and Lubatkin et al., 2005). The appointment of a new CEO will not likely be an exception to this conduct. The same problems are likely to occur in relation to promotion opportunities. Family members are preferred to non-family members, thereby demotivating non-family members to perform their best and giving related employees no incentive to work harder since a possible promotion is not based on their personal performance. Finally, private family firms are not able to offer the same terms as their public counterparts since they are less willing to offer stock options because of the consequential dilution of ownership (Schulze et al., 2001). Therefore it is likely that descendant CEOs and employees in a descendant-led private family firm don't have the same qualities as CEOs and personnel of non-family firms. Bennedsen et al. (2007) has empirically supported this idea stating that the education and experience of family successors is generally lower than their non-family counterparts. Here again the board of directors can play a moderating role. First of all, the board can perform its control role and install criteria for the appointment of a successor (van den Heuvel et al., 2006), thereby diminishing the chance of an incompetent descendant to lead the family firm. Secondly, directors on the board can aid the descendant CEO with know-how needed to make strategic decisions.

The above argumentation leads us to the assumption that the board of directors has a moderating effect on performance of descendant-led private family firms. Performance, however, has several dimensions, especially in family firms (e.g. Chrisman et al., 2004). Apart from thriving to enhance financial performance, family firms generally have non-financial objectives too (Sharma, 2004 and Westhead and Howorth, 2006). Performance can thus, for example, be measured as the degree of innovation (e.g. Gudmundson et al.,

1999) or corporate entrepreneurship (e.g. Kellermanns and Eddleston, 2006a) as well as financial performance. Therefore we look at a performance measure largely overlooked in family business. That is, we use performance variability as it is an important dimension of performance for a number of reasons. First of all, in order to explain the effect of a CEO on performance we can look at variables lying in between these two measures. The influence a CEO has on decision-making might be an important element in this relation. Performance variability has been previously said to be affected by this CEO power (Adams et al., 2005). Furthermore is it likely that firms that are more innovative and show a higher degree of corporate entrepreneurship have a higher degree of performance variability. Finally is performance variability a good measurement for the willingness of family firms to take risks (Gómez-Mejía et al., 2007).

In conclusion, this study enhances the family business literature on family firm performance by addressing the question why some descendants succeed in improving the performance of their family firm while others do not. We hereby identify the board of directors as a moderator between the type of CEO and financial performance. Furthermore, whereas prior research on the effect of founder or descendant CEOs has focussed on public family firms (e.g. Anderson and Reeb, 2003; Barontini and Caprio, 2006 and Villalonga and Amit, 2006), we address to their private family counterparts which are far more prevalent (Johannisson and Huse, 2000). We finally extend the family business literature by adding a new factor to consider when evaluating different types of family firms. Since family firms are often characterised as being too strategically conservative (Kellermanns et al., 2008), it would be valuable to see to what degree they do act entrepreneurial and innovative. Performance variability can therefore serve as a valuable indicator of performance as it is likely that being innovative and taking risks will be coupled with higher performance variability. Moreover, performance variability itself is seen as an important dimension of performance in the finance literature (Cheng, 2008). Finally, this study also adds to the board literature since we examine the board's moderating effect on management. Gedajlovic et al. (2004) advocate that in founder-controlled firms the majority of decisions are made by the founder, implying that the board of directors will not be of great influence in this type of firms. Our results,

however, suggest that in descendant-led firms, a vigilant and empowered board can be beneficial to the firm. This paper thereby provides a better insight in the situations in which the board creates value.

2. Literature review and theoretical development

2.1 The descendant CEO

When comparing the performance level of a descendant-led and a founder-led family firm, agency theory can provide a valuable framework (Chrisman et al., 2004). Agency theory finds its origin in the existence of conflict of interest between the principal (owner) and the agent (manager) (Jensen and Meckling, 1976). Since the owner and manager in family firms are the same (family), agency costs were long expected to be close to zero (Fama and Jensen, 1983 and Eisenhardt, 1989). But recently, this view has been questioned. Schulze et al. (2001 and 2003) followed by other scholars such as Gómez-Mejía et al. (2001), Chrisman et al. (2004), Lubatkin et al. (2005) and Steijvers et al. (2008) argue that the original idea of family firms minimizing agency costs, doesn't paint the whole picture. It appears that altruism in family businesses doesn't nearly reduce agency problems, but also has a so called dark side that should be taken into account as well. Parental altruism as follows, reduces the appliance of self-control amongst private family firms. It is clear that this ability to self-restraint is a major determinant of the level of performance for privately held firms since according to Jensen (1994), self-control problems are the second major source of agency costs in addition to conflicts of interest. Expanding on this negative influence of altruism, self-control problems can be further split up into moral hazard, hold-up and adverse selection threats.

Moral hazard is more likely in private family firms because of unrestrained control over company resources, secure employment, perquisites and privileges (Schulze et al., 2001). Moreover, there is an increased risk for hold-up since managers are often also owner and therefore have the possibility to use their power resulting from their rights of ownership and control to force other agents to accept changes that are not in the best interest of these last ones (Schulze et al., 2001 and Lubatkin et al., 2005). Adverse selection is also

strengthened in private family firms as family managers are more likely to hire family members even at the expense of more qualified outsiders (Schulze et al., 2001).

When a heir becomes CEO, these agency problems are even reinforced. This provides us with a number of possible reasons why descendants might be less effective in running the family business as compared to founder CEOs. The first enforced agency problem in descendant-led family firms is moral hazard. That is, parents who are generally important shareholders of the firm, are likely biased in the judgement of their children (Schulze et al, 2003), which makes free-riding for descendant CEOs more likely. Furthermore, the agency costs of hold-up might also be higher in descendant controlled family firms. Founder CEOs will generally act in the best interest of the business and the long-term family wealth, as they view the firm as their life work (Gedajlovic et al., 2004 and Schulze et al., 2001). When there are several siblings who share equal control and decision rights, the problem of hold-up is strengthened as the sibling selected as CEO will more likely put his nuclear household first (Schulze et al., 2003). This, of course, makes it harder for the other shareholders to rely on them (Lubatkin et al., 2005). When the descendant is the only child, there might still be disagreements with other family members from older or later generations (Levinson, 1971 and Miller et al., 2003). Only in the situation when there is no father-son conflict and there are no other siblings apart from the CEO, there is likely no difference in hold-up problems between descendant and founder CEOs.

Secondly, it is commonly assumed that family successors don't have the same managerial qualities as their father who started the business (e.g. Bennedsen et al., 2007 and Morck et al., 2000). There is the problem of adverse selection in private family firms that arises when family owners systematically choose for a family member CEO, even at the expense of more qualified non-family members (Schulze et al., 2001 and Lubatkin et al., 2005). Bennedsen et al. (2007) find empirical results suggesting that descendant CEOs are substantially lower educated. That is, they less frequently attend college or graduate programs and stay for a shorter period of time at school. A connection can be made with the findings by Bloom and Van Reenen (2007), suggesting that succession by

primogeniture (the eldest son becomes CEO) leads to bad management as the CEO selection is not based on his managerial qualities. This could result in a lower firm performance as descendants may not be competent enough to make good strategic decisions.

Another topic that is essential to consider when studying descendant controlled family firms, is conflict. When the founder has transferred his power to one son or daughter, conflicts might arise between siblings and between different generations (Levinson, 1971). There are different types of conflict, namely task conflict, process conflict and relational conflict (Jehn and Mannix, 2001). Task conflict, which is similar to cognitive conflict, involves disagreements about the tasks or the strategies pursued (Jehn, 1997). Differences about who is responsible for certain tasks are categorized as process conflict (Jehn and Mannix, 2001). Finally, relationship conflict involves personal issues such as dislike among people working together (Jehn and Mannix, 2001). Although cognitive conflict and process conflict are found to be beneficial in some situations (Jehn and Bendersky, 2003 and Kellermanns and Eddleston, 2004), relationship conflict is unlikely to have positive effects on the working of a family firm (Jehn and Mannix, 2001 and Eddleston and Kellermanns, 2007). Moreover, when a descendant is head of the family firm, generational ownership dispersion is generally higher compared to founder-led family firms, hereby taking abstract of the situation where a later generational CEO is controlling owner (Gersick et al., 1997). In this situation task and process conflict can split the family branches into competing camps (Kellermanns and Eddleston, 2004 and 2007), which results in delayed decision-making. What's more, when a conflict is not resolved or turns into a crisis, it can paralyze an organization (Harvey and Evans, 1994).

There is also the possibility of strategic inertia in family firms which has been discussed thorough by Schulze et al. (2002). They suggest that the inability of active decision-making in private family firms results from (1) a higher risk because of concentrated ownership (2) opportunistic behavior caused by altruism and (3) a lack of self-control. Strategic inertia is even strengthened when a descendant is head of the family firm. First of all will a descendant CEO generally put his own nuclear household first (Schulze et al.,

2003), making consumption more attractive than investment (Schulze et al., 2002). Secondly, when the founder serves as CEO of the family firm, he is generally assumed to have a near absolute decision power (Gedajlovic et al., 2004). It is thus easier for him to react fast to opportunities in a changing environment, and consequently hold a greater degree of entrepreneurship. Moreover, founders of family firms are obviously entrepreneurial since they were the ones that recognized the opportunity to start a business in the first place (Aldrich and Cliff, 2003 and Gedajlovic et al., 2004). For descendant CEOs it is much harder to jump into new opportunities since they don't have the same amount of decision power as their precedents. Hence, a descendant has less authority and influence than his father since he is neither founder of the firm, nor head of the family (Schulze et al., 2003). Yet, corporate entrepreneurship is particularly important in later generational stages of a family firm since it is necessary for the continuity of the firm and the creation of jobs and wealth for family members (Kellermanns and Eddleston, 2006a).

In conclusion, family firms led by a descendant CEO face several problems that may lead to a lower performance level. First of all, the agency problems moral hazard, hold-up and adverse selection are stronger when a descendant leads the family firm as compared when the founder is still CEO. Moreover, descendant CEOs are confronted with an increased probability of conflict, combined with generally larger generational ownership dispersion, leading to delayed decision-making.

2.2 The moderating role of the board of directors

The board of directors can be a valuable support for a descendant CEO. The board of directors in small privately held companies is often portrayed as a passive, paper or rubber-stamp entity (Gabrielsson, 2007). An empowered, vigilant board can, however, assist the family firm in making crucial decisions (Fiegener, 2005 and Huse, 2000) and help the family firm renew and explore new market opportunities (Zahra, Neubaum and Huse, 2000). The board can do this by fulfilling two broad roles, namely control and service (e.g. Huse, 2005; van den Heuvel et al., 2006, Corbetta and Salvato, 2004). In order to judge whether a board creates value for a firm, a distinction needs to be made

between board task needs or expectations, and actual board task performance (Huse, 2005). A board is value adding when this actual board task performance is aligned to the board role expectations (Huse, 2005). We therefore consider a board to be empowered to the degree in which the actual task performance matches the expectations about the service and control role. While the control role is derived from an agency perspective, the service role is drawn from multiple theoretical frameworks such as resource dependency, network or social capital theory (van den Heuvel et al., 2006).

Since managers of family firms are no exception when it comes to acting opportunistically from time to time (Schulze et al., 2001 and 2003; Lubatkin et al. 2005; Chrisman et al, 2004 and Gómez-Mejia et al., 2001), the controlling role of a well functioning board will generally have an important influence on the performance of family businesses (Anderson and Reeb, 2004). Moreover, there is in family firms an important difference between the controlling family shareholders and minority shareholders (Faccio et al., 2001). The controlling role of the board exists in minimizing potential goal conflicts between these shareholder groups and restraining self-serving behaviour of managers (Eisenhardt, 1989). The service role of the board can be described as the provision of a number of important resources (e.g. Hillman et al., 2000 and Pfeffer and Salancik, 1978). Pfeffer and Salancik (1978) state that the resources provided by the board can be put into four categories; (1) advice and counsel, (2) reputation and legitimacy, (3) communicating with the outside world and (4) acquisition of financial resources. As growth in family firms tends to slow because of administrative, financial and other resource constraints (Chandler, 1990), an additional supply of resources can help the family firm face up to the market demands. An empowered board can, through fulfilling these two roles assist the descendant CEO of a family firm in a number of ways.

In performing his controlling role, the board can lower the agency costs of conflict in descendant-led family firms. In sibling partnerships, which are likely led by a descendant CEO, siblings are more concerned about their own nuclear household than about the family or firm as a whole (Schulze et al., 2003). The board of directors can monitor the actions of siblings and the descendant CEO (Fama and Jensen, 1983 and Ng and Roberts,

2007). They can provide an independent vision on the conflict and assist in taking the right decision. Moreover, outside directors on the board can assist in coping with increasing firm complexity as multiple generations become active in the family firm (Voordeckers et al., 2007). When needed, for example when a conflict has resorted in crisis, the board incorporated with outside directors, can function as an independent arbitrator (Whisler, 1988).

In addition, by executing his service role and hereby providing various resources, the board of directors can again be a valuable tool for descendant-controlled family firms. A first valuable resource to descendant-led family firms can be described as the advice and council role. Hence directors with relevant experience can accelerate decision-making and moreover enhance the quality of the decisions themselves (Grundeir and Talaulicar, 2002). In the light of corporate entrepreneurship, an empowered board can compensate for the lower decision power of the descendant. Outside directors on the board can assist the descendant CEO with industry specific expertise (Anderson and Reeb, 2004) that can enlarge product innovation.

Secondly, it is for a descendant more difficult to obtain the same amount of respect, reputation and legitimacy as the founder CEO had. The reputation and legitimacy of a firm led by the founder is generally higher. Hence, the founder has demonstrated his entrepreneurial insight to discover a business opportunity and the capability of starting up a firm (Aldrich and Cliff, 2003 and Gedajlovic et al., 2004). A descendant CEO, on the other hand, needs to prove himself by other means. He needs to acquire acceptance and credibility from employees that used to work for his father (Sathe, 1985). This credibility and respect can be obtained by two means, namely by gaining experience in the family firm itself or by achieving success in other businesses. Successions from father to son, however, usually already takes place when the descendant is still young compared to managers in a non-family business (Bennedsen et al., 2007). Therefore it is unlikely that descendant CEOs enjoy the same amount of reputation as other managers. From this perspective, an empowered board of directors with a well established representation of

outside directors can offer an enhancement of legitimacy and image for the family firm led by a descendant (Gabrielsson and Huse, 2005 and Ng and Roberts, 2007).

Finally, communication to the outside world is of particular importance in private family firms. These usually small firms don't have the influence to control their environment (Borch and Huse, 1993). Therefore, Borch and Huse (1993) state, it is necessary for these firms to be flexible and adjust to changes in the surrounding world. This communication with the environment can be achieved through informal strategic networks (Pfeffer and Salancik, 1979). Since descendant CEOs usually do not have the same amount of decision power as founder CEOs have (Gedajlovic et al., 2004), rapid reacting to market changes is more difficult for them. Therefore, this resource will again be more essential in this type of family business as compared to founder controlled firms.

We can conclude that agency theory as well as the resource based view support the idea that in descendant-led family firms, a vigilant and empowered board of directors can lead to better performance. There are several dimensions to performance. We use performance variability as an indicator for the CEO's influence on decision-making (Adams et al., 2005), the degree of innovation, corporate entrepreneurship and risk taking (Gómez-Mejía et al., 2007). The above argumentation, consequently, leads us to the following hypotheses:

Hypothesis 1: A descendant CEO has a negative effect on performance variability in private family firms.

Hypothesis 2: A descendant CEO has a positive effect on performance variability in firms with a highly vigilant and empowered board. That is, the effect of a descendant CEO in private family firms is moderated by the degree in which the board of directors is vigilant and empowered.

3. Method

3.1 Sample

The empirical data used in this paper are derived from a wider survey exploring the general characteristics as well as management issues, board composition, governance, family features and succession of Flemish family business. All firms in the sample are privately owned and employ at least five people. A survey was mailed to the CEOs of 3400 firms which were randomly selected from a family-business database. The firms used in this paper were categorized as family firms while they answered to one of the following descriptions: (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 per cent, 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 per cent of the shares. Of 311 returned surveys, 295 contained sufficient data to be included in the analysis.

3.2 Measures

3.2.1 Dependent variable

Our dependent variable measures firm performance. Performance consists of several dimensions (Chrisman et al., 2004) such as financial performance, innovation (e.g. Gudmundson et al., 1999) and corporate entrepreneurship (e.g. Kellermanns and Eddleston, 2006a). As an indicator for performance, we use performance variability in our analyses. We chose this variable for a number of reasons. First of all is performance variability itself an important dimension of performance which has been largely overlooked in previous research (Cheng, 2008), especially in family business literature. Next, performance variability has been found to be affected by the decision power of the CEO (Adams et al., 2005). This is an important element to measure as it is commonly said that descendant CEOs don't have the same amount of decision power as founder CEOs have (Gedajlovic et al., 2004). Thirdly, family firms are frequently found to be less

innovative (Gudmundson et al., 1999). Innovation and entrepreneurial behavior are nonetheless very important for the family firm's survival and growth (Kellermanns and Eddleston, 2006b). Considering this and the fact that performance variability is in earlier research used as a measurement for the willingness of family firms to take risks (Gómez-Mejía et al., 2007), a higher performance variability would be beneficial to firm performance as this would indicate that the family firm is trying out new things. We therefore use *performance variability* as an indicator for the performance of descendant-led private family firms. Similar to Adams et al. (2005) and Cheng (2008) we measured firm performance variability as the standard deviation of the firms annual NROA (net return on assets) over the period 2000-2004.

3.2.2 Independent variables

The *type of CEO* was measured as a dummy variable. Value one indicates that the family business is led by a descendant CEO, whereas the value zero indicates that the founder is still head of the family firm. Since there were only eight firms in the sample that had a non-family CEO, we excluded these from the sample.

3.2.3 Moderating variables

A large number of board members and representation by outside directors are important characteristics of board empowerment in small privately held companies (Gabrielsson, 2007). We therefore use the *number of directors* and *outside directors* as indicators for a vigilant and empowered board. The *number of directors* on the board was measured as a continuing variable. However, since our sample contained only five firms with more than eight board members, we excluded these from our analyses as they could misrepresent results. *Outside directors* on the board was measured as a dummy variable. That is, this variable takes on value one when there is at least one outside director on the board.

3.2.4 Control variables

We employ several variables in our analysis to control for industry and firm characteristics. Analogous to previous research on the effect of the type of CEO on performance (e.g. Anderson and Reeb, 2003 and Barontini and Caprio, 2006), we include

firm size into our regression. *Firm size* was calculated as the natural log of the book value of total assets. We controlled for the *industry* effect by grouping our sample into four dummies based on their SIC-codes. We finally included the percentage of *family ownership* in our model as it is said to influence the value of a family firm (Villalonga and Amit, 2006).

3.3 Results

Table 1 and 2 show the means, standard deviations and correlation coefficients of the variables used in our models.

 Insert table 1 and 2 about here

We tested our hypotheses in six models, presented in table 3. In the first model we controlled for firm size, industry and the degree of family ownership. All of our control variables had a significant influence.

 Insert table 3 about here

In the second model, we added the dummy variable descendant to the independent variables. Contrary to our expectations, our results suggest that a descendant CEO has a positive effect on performance variability. Our first hypothesis is therefore not supported. The third model includes also the moderator outside director. The presence of outside directors has a direct effect on performance variability suggesting that outside directors are positively related to performance variability. The presence of the interaction effect descendant * outside director was tested in model 4. Our second hypothesis states that an empowered board of directors has a moderating effect on the performance of a descendant. As the presence of outside directors is a prerequisite of an empowered board, model 4 provides statistical support for this proposition.

In our fifth model, we test whether the number of directors has an effect on the performance variability of a firm. This model shows that there is a positive effect. Next,

our last model tests whether the number of directors has a moderating effect on the relation between the descendant CEO and performance variability. The results suggest that the number of directors on the board has in fact a significant moderating influence on performance variability, which again supports our second hypothesis.

Insert figure 1 about here

Both interaction effects are plotted in figure 1 and 2. Figure 1 shows, in accordance with our second hypothesis, that the highest performance variability can be found in family firms led by a descendant where there is an empowered board of directors, here measured by the presence of outside directors. As previously argued, this can be interpreted as a higher influence of the descendant CEO on decision-making (Adams et al., 2005), resulting in a higher possibility to act entrepreneurial, a higher level of innovation and a greater willingness to take risks (Gómez-Mejía et al., 2007). A vigilant and empowered board of directors is therefore found to moderate the relation between a descendant CEO and the performance variability of a private family firm.

Insert figure 2 about here

Figure 2 shows a similar pattern as figure 1. In this figure the empowerment of the board is measured by the number of board members. Here again a descendant CEO has a positive effect on performance variability when the board of directors is vigilant and empowered. This is again in line with our second hypothesis, saying that an empowered board has a positive influence on the performance variability in family firms led by a descendant.

4. Discussion

We put forward that there are descendants that have a positive effect on firm performance as well as descendants that have a negative effect. Earlier research done by Bloom and Van Reenen (2007) suggests that when CEOs are selected by primogeniture this negatively influences firm performance. Moreover, Bennedsen et al. (2007) find that the education level of descendant CEOs is usually lower¹. However, when descendants do have a higher education and are elected based on their competence, they might be beneficial to the performance of the private family firm. This paper therefore investigates whether there are conditions to the performance level of descendant-led private family firms.

First of all, we examine the degree in which descendant CEOs can influence the firm's innovation level and entrepreneurial behavior measured by performance variability. Regarding this direct effect, we find that a descendant CEO has a significant effect on performance variability. It is however somewhat surprising that this effect is positive since earlier research suggests that the performance variability in descendant-led private family firms is lower than in founder-controlled firms (Adams et al., 2005 and Gedajlovic et al., 2004). However, when the moderators outside directors and number of board members are added to the model, descendants alone no longer have a significant influence on performance variability. The moderators itself, measuring board empowerment have a significant effect on our performance measure. This supports the idea that descendant CEOs only have a positive effect on performance when they are assisted by an empowered board. Both outside directors and a large board result in higher performance variability, even if the effect of a large board is only marginally significant. These results indicate that an empowered board is beneficial to the family firm in terms of stimulating innovation and entrepreneurial behaviour.

¹ In line with the research done by Bennedsen et al. (2007), descendants CEOs do seem to be lower educated than the non-family CEOs in our sample. The descendant CEOs in our sample, however, have a higher education level compared to there founder counterparts.

The interaction between a descendant CEO and an empowered board is positively related to performance variability. This can be interpreted as family firms led by a descendant CEO accompanied with an empowered board to have the highest level of decision power (Adams et al., 2005), innovation, corporate entrepreneurship and willingness to take risks (Gómez-Mejía et al., 2007). From an agency perspective this means that an active, large board with representation by outside members can offset the negative consequences of conflict. Our results suggest that an empowered board can play an arbitrator between competing siblings or between quarrelling generations. Further research can reveal which of these conflicts are the most severe in descendant-led private family firms and whether both can be moderated by the board of directors. Furthermore, our findings support the idea that an empowered board can provide the resources needed by descendant CEOs to implement decisions without delay and in this way influence performance. It might therefore not be necessary for family firms to avoid descendant CEOs. However, in order to promote decision power, innovation, corporate entrepreneurship and risk taking, it would be beneficial to install an active and empowered board of directors. This might not have been important in an earlier stage of the family firm where the founder had enough decision power to be innovative and entrepreneurial, but for a descendant-led firm necessary in order to sustain growth.

Further research should investigate whether this greater performance variability of the descendant also leads to a better performance and growth in the long run. Since the board of directors is of greater importance in descendant-led firms, it would be interesting to detect whether there is a change in composition and board tasks after a familial succession. Additionally, further research should clarify which composition and size is optimal for private family firms with descendant CEOs. Finally it could be valuable to investigate whether there are also differences between family CEOs and non-family CEOs with respect to performance variability. In connection to this, there could also be a difference in performance variability of descendant CEOs in sibling partnerships compared to descendant CEOs in cousin consortiums. Hence, Kellermanns et al. (2008) suggest that a higher generational involvement results in an increased entrepreneurial

orientation. It would be interesting to see whether the type of CEO or the board of directors has an impact on these findings.

4.1 Limitations and implications

We have employed a cross-sectional design to test our hypotheses. Our data was gathered through surveys collected in 2003, but our performance variability was calculated as the standard deviation of the performance of the years proximate to this date. Therefore changes in the situation of the family firm, apart from our explanatory variables, might have influenced our performance variability as well, thereby causing a bias in our results. However, less than ten percent of the firms in our sample had a change of CEO during this four year period, making such a bias less likely.

Moving to the implications, this is the first study to examine how board characteristics moderate the relation between the type of CEO and private family firm performance. Our results, in accordance with agency theory and the resource based view, suggest that a vigilant and empowered board can enhance performance when the private family business is led by a descendant CEO. This study thereby adds to both family business and board literature.

5. Conclusion

It is commonly suggested that family businesses should move to professional management as soon as possible (Levinson, 1971). This paper however suggest that this does not necessarily mean that family firms should avoid descendant CEOs. They should, however, install a strong, active and empowered board of directors, when there wasn't already one at the founder-controlled stage. In this way the firm enhances its ability to make and implement decisions, be innovative, entrepreneurial and risk taking and thereby react to market opportunities and sustain growth. Further research can enhance and refine our findings on the moderating effect of an empowered board on the performance of descendant-led private family firms.

Table 1: Correlation matrix, means and standard deviations

| Variables | Mean | SD | 1. | 2. | 3. | 4. | 5. | 6. | 7. | 8. | 9. |
|-------------------------------------|-----------|-----------|-----------|------------|------------|---------|------------|----------|----------|---------|----|
| 1. Firm size | 7.53396 | 1.067841 | 1 | | | | | | | | |
| 2. Primary | 0.3652968 | 0.4826164 | 0.1624* | 1 | | | | | | | |
| 3. Construction | 0.1369863 | 0.3446206 | -0.0905 | -0.3023*** | 1 | | | | | | |
| 4. Wholesale | 0.3424658 | 0.4756216 | -0.0432 | -0.5475*** | -0.2875*** | 1 | | | | | |
| 5. Family ownership (%) | 97.54398 | 10.17251 | -0.0278 | -0.1131 | 0.0622 | 0.1282† | 1 | | | | |
| 6. Outside director | 0.1415525 | 0.3493892 | 0.1264† | 0.1272† | -0.0475 | -0.0998 | -0.4239*** | 1 | | | |
| 7. Descendant | 0.7123288 | 0.4537141 | 0.0053 | 0.0212 | -0.0402 | 0.076 | -0.0069 | -0.0892 | 1 | | |
| 8. Descendant * Outside director | 0.086758 | 0.2821249 | 0.1598* | 0.0694 | -0.0284 | -0.0857 | -0.3476*** | 0.759*** | 0.1959** | 1 | |
| 9. Firm performance variability | 4.964676 | 4.78394 | -0.1888** | -0.0507 | -0.0261 | -0.0972 | 0.0895 | 0.1156† | 0.0467 | 0.176** | 1 |

†: p < 0.10, *: p < 0.05, **: p < 0.01, ***: p < 0.001

Table 2: Correlation matrix, means and standard deviations

| Variables | Mean | SD | 1. | 2. | 3. | 4. | 5. | 6. | 7. | 8. | 9. |
|---|-----------|-----------|-----------|------------|------------|---------|----------|-----------|-----------|---------|----|
| 1. Firm size | 7.53396 | 1.067841 | 1 | | | | | | | | |
| 2. Primary | 0.3652968 | 0.4826164 | 0.1624* | 1 | | | | | | | |
| 3. Construction | 0.1369863 | 0.3446206 | -0.0905 | -0.3023*** | 1 | | | | | | |
| 4. Wholesale | 0.3424658 | 0.4756216 | -0.0432 | -0.5475*** | -0.2875*** | 1 | | | | | |
| 5. Family ownership (%) | 97.54398 | 10.17251 | -0.0278 | -0.1131 | 0.0622 | 0.1282† | 1 | | | | |
| 6. Number of directors | 3.406393 | 1.2174 | 0.2834*** | 0.1304† | -0.0907 | -0.0520 | -0.1574* | 1 | | | |
| 7. Descendant | 0.7123288 | 0.4537141 | 0.0053 | 0.0212 | -0.0402 | 0.076 | -0.0069 | -0.0892 | 1 | | |
| 8. Descendant * Number of directors | 2.43379 | 1.874246 | 0.1526* | 0.0674 | -0.0569 | 0.0281 | -0.0431 | 0.5038*** | 0.8271*** | 1 | |
| 9. Firm performance variability | 4.964676 | 4.78394 | -0.1888** | -0.0507 | -0.0261 | -0.0972 | 0.0895 | 0.1156† | 0.0467 | 0.176** | 1 |

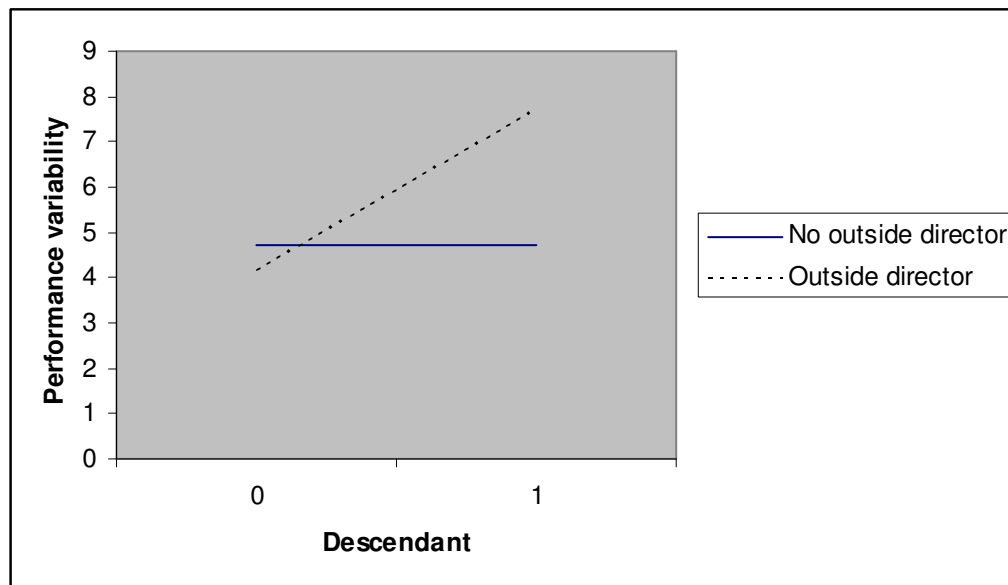
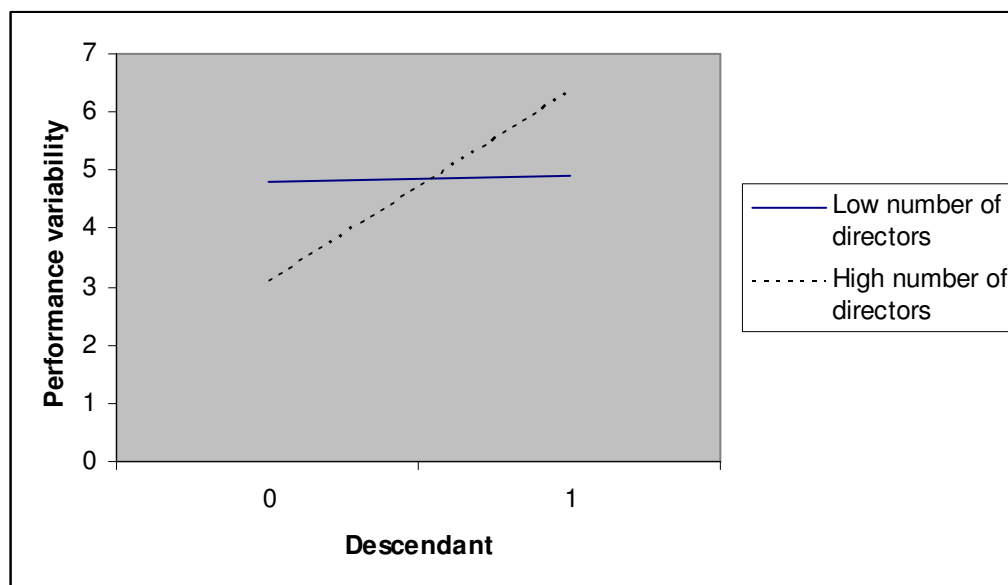
†: p < 0.10, *: p < 0.05, **: p < 0.01, ***: p < 0.001

Table 3: Results of regression analysis

| Variables | Family firm performance variability | | | | | |
|----------------------------------|-------------------------------------|---------------------------|----------------------------|----------------------------|--------------------------|--------------------------|
| | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 | Model 6 |
| <i>Controls:</i> | | | | | | |
| Firm size | -0.854817† (0.452533) | -0.8612672† (0.452447) | -0.9826488* (0.441475) | -1.046549* (0.440148) | -1.003071* (0.463974) | -1.02579* (0.462069) |
| Industry ^a : | | | | | | |
| Primary | -2.58069† (1.350961) | -2.667944† (1.368805) | -2.850404* (1.327087) | -2.616517† (1.329593) | -2.720145* (1.343719) | -2.624873† (1.331905) |
| Construction | -3.130861* (1.481520) | -3.148166* (1.497850) | -3.166131* (1.452382) | -3.085431* (1.457661) | -3.08307* (1.471521) | -3.125959* (1.467095) |
| Wholesale | -3.358084* (1.443257) | -3.480083* (1.478877) | -3.502148* (1.447513) | -3.292587* (1.446852) | -3.471117* (1.449948) | -3.368126* (1.448091) |
| Family ownership (%) | 0.0534898* (0.0227232) | 0.0540538* (0.023428) | 0.0990371*** (0.026307) | 0.1004582*** (0.027877) | 0.0620658* (0.024767) | 0.0550387* (0.024666) |
| <i>Independent variable:</i> | | | | | | |
| Descendant | | 0.8214242† (0.654185) | 1.08273 (0.665109) | 0.4320725 (0.738286) | 0.8170552 (0.65526) | -2.341279 (1.634752) |
| <i>Moderators:</i> | | | | | | |
| Outside director | | | 3.08604** (0.876492) | 0.8585952 (1.096820) | | |
| Number of directors | | | | | 0.475546† (0.267067) | -0.2335144 (0.310204) |
| <i>Interaction effect:</i> | | | | | | |
| Descendant * Outside director | | | | 3.558168** (1.504080) | | |
| Descendant * Number of directors | | | | | | 0.9232469* (0.405917) |
| R ² | 0.0957 | 0.1013 | 0.1415 | 0.1566 | 0.1137 | 0.1228 |
| F | 0.1024 | 0.1668 | 0.0042** | 0.0021** | 0.159 | 0.0511† |

N= 205, †: p < 0.10, *: p < 0.05, **: p < 0.01, ***: p < 0.001

^a The service industry is the suppressed comparison category.

Figure 1: Descendant and Outside director**Figure 2: Descendant and Number of directors**

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