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Institutions Behind Family Ownership and Control in Large Firms

Mike W. Peng and Yi Jiang

University of Texas at Dallas; California State University, East Bay

ABSTRACT There is a major debate regarding the role of concentrated family ownership and control in large firms, with three positions suggesting that such concentration is (1) good, (2) bad, or (3) irrelevant for firm value. Why are there such differences? We theorize that the impact of family ownership and control on firm value is associated with the level of shareholder protection embodied in legal and regulatory institutions of a country. Data from 634 publicly listed large family firms in seven Asian countries (Hong Kong, Indonesia, Malaysia, Singapore, South Korea, Taiwan, and Thailand) are used to test our hypotheses. Overall, this article sketches the contours of a cross-country, institution-based view of corporate governance, and leads to a more informed understanding of the crucial role of institutions behind family ownership and control in large firms.

INTRODUCTION

Family ownership and control refer to one family (through one or several members) serving as a controlling shareholder of a corporation. Are family ownership and control of large firms beneficial for or detrimental to firm value?[1] There is ongoing debate concerning the answer to this question. More than 70 years ago, Berle and Means (1932) advanced a hypothesis suggesting that as firms grow larger, concentrated family ownership and control will *inevitably* be replaced by a separation of ownership and control. Fama and Jensen (1983, p. 306) predict that failure to separate ownership and control 'tends to penalize the organization in the competition for survival'. In other words, concentration of ownership and control in the hands of families may be bad for the value of large firms (Fogel, 2006; Morck et al., 2005).

While it is possible to follow the Fama and Jensen (1983) logic by arguing that 'stubborn' large firms that refuse to separate ownership and control are inefficient, this argument cannot go very far when confronting the evidence that the vast majority of large firms outside the United States and United Kingdom, including those in some of

Address for reprints: Mike W. Peng, Provost's Distinguished Professor of Global Strategy, University of Texas at Dallas, School of Management, Box 830688, SM 43, Richardson, TX 75083, USA (mikepeng@utdallas.edu).

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the most prosperous, developed economies such as continental Europe and Japan, have concentrated family ownership and control (La Porta et al., 1999; Shleifer and Vishny, 1997). Therefore, it seems more sensible to acknowledge the limits of the Berle and Means (1932) hypothesis by conceding that concentrated family ownership and control in large firms may be good for firm value, at least in some cases.

Then, under what conditions do the benefits ('good') of family ownership and control of large firms outweigh their costs ('bad')? This article addresses this important but under-explored question. Advancing an institution-based view (Peng et al., 2008, 2009), we argue that the impact of family ownership and control on firm value may be associated with the level of shareholder protection embodied in legal and regulatory institutions of a country. Thus far, most corporate governance research has focused on stylized US (and to a less extent, UK) firms that separate ownership and control. Consequently, there is value in investigating firms outside the Anglo-American world when advancing research on large firms that still combine ownership and control (Carney and Gedajlovic, 2002; Fogel, 2006; Young et al., 2008). Specifically, this article focuses on a region with extensive concentration of family ownership and control in large firms – Asia (Bruton and Lau, 2008; Bruton et al., 2003; Peng and Delios, 2006) – and examines family firm value during the 1997 Asian financial crisis.

Overall, this study contributes to the existing literature in four significant ways. First, theoretically, we integrate the family business literature and the corporate governance literature and focus on the concentration of ownership and control in large family firms, which have a family and/or its identifiable members as the largest owner(s). Second, we extend the institution-based view by focusing on *how* institutions matter in the context of family corporate governance (Peng et al., 2008, 2009). We endeavour to sketch the contours of a cross-country, institution-based view of family business. Third, by drawing on multiple perspectives (agency theory and resource-based view) typically used in family business research, we show how an institution-based view can enable research on family business to recognize conditions under which different theories demonstrate validity (Meyer et al., 2009; Young et al., 2008). Finally, compared with many family business studies that use single-country data, we empirically take advantage of a large database covering seven Asian countries to study different effects of family ownership and control across countries. Therefore, this article also contributes to the international management literature in general and the Asia management literature in particular (Bruton and Lau, 2008).

THE DEBATE

In Asia, (continental) Europe, and Latin America, the vast majority of large, publicly traded firms are family owned and controlled (Ahlstrom et al., 2004; Carney and Gedajlovic, 2002; Claessens et al., 2000; de Miguel et al., 2004; Faccio et al., 2001; Gedajlovic and Shapiro, 1998, 2002; La Porta et al., 1999; Silva and Majluf, 2008; Thomsen and Pedersen, 2000). Even in the United States, 'shareholdings are not so diffusely owned as is often supposed' (Demsetz, 1983, p. 390). In the 1990s, families were present in one-third of the Standard and Poor's 500 firms and accounted for 18 per cent of equity (Anderson and Reeb, 2003). Theoretically, there is a major debate regarding

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the role of family in large firms, with three positions: such concentrated ownership and control are (1) good, (2) bad, or (3) irrelevant for firm value (De Vries, 1993; Eddleston and Kellermanns, 2007). To be sure, given the complexity, the debate is not about family ownership and control of large firms being absolutely good or bad. 'Good' and 'bad' are just shorthand descriptions of whether or not the benefits outweigh the costs associated with family ownership and control.

Among the three positions, first, some agency theorists (Anderson and Reeb, 2003; Demsetz and Lehn, 1985) and some family business scholars (Arregle et al., 2007; Gomez-Mejia et al., 2007; Habbershon and Williams, 1999) extend their endorsement for the efficiency gains of family owned small firms to the context of large firms – in short, large family firms are good. Second, other agency theorists (Fama and Jensen, 1983) and other family business researchers (Schulze et al., 2001) argue that large firms that refuse to separate ownership from control would be less efficient than firms with dispersed ownership – in other words, bad. In addition, a third group of scholars find no value difference between founder managed and professionally managed firms (Daily and Dalton, 1992; Willard et al., 1992), and family businesses with multiple family members serving as owners do not outperform in market value (Miller et al., 2007), implying that family ownership and control are irrelevant for firm value. Most existing theories on the determinants of firm value (e.g. the five forces model) are silent on the ownership and control issue, implicitly endorsing the 'irrelevant' perspective.

Each side of this debate has a set of valid theoretical logic and empirical evidence in support of its view (De Vries, 1993; Villalonga and Amit, 2005). Lubatkin et al. (2007) advocate a balanced perspective between the overly optimistic view (family firms are good) and the overly pessimistic view (family firms are bad). We agree. Our study is designed to shed further light on the debate, by acknowledging the validity of all sides and then endeavouring to address the more interesting question: under what conditions are family ownership and control good or bad for firm value?

FAMILY OWNERSHIP AND FIRM VALUE

Agency theory focuses on the incentive of the large shareholder. To put it simply, 'one does not steal his own money'. During the 1997 Asian financial crisis, maintaining a large ownership forces the blockholders to be not well diversified, in which case ownership involves private *costs* to the large shareholder (Dyck and Zingales, 2004). The large shareholder thus bears the costs of intervening in a company's affairs alone (Maug, 1998). Shleifer and Vishny (1986, p. 462) argue that large shareholders may pay for the improvements of firms themselves since they are the 'largest consumers of the public good'. Because of the concentrated ownership involved, family owners – who are the largest shareholders – have great incentives to increase firm value.

From a resource-based view, the benefit of having a large shareholder can be argued from a different perspective. When the largest shareholder is involved in firm decision making, it is crucial that he/she provides key resources and adopts appropriate strategies to increase firm value. During a financial crisis when external resources are limited, the largest shareholder and his/her involvement in the firm may become a rare resource, which cannot be imitated by other firms. The benefits that arise from the substantial

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collocation of decision rights and wealth effects that come with block ownership (Holderness, 2003) are shared with minority shareholders. Minority shareholders recognize that the large shareholder provides crucial resources to the company in a crisis situation, and thus will value such support. From both agency theory and resource-based view, large family shareholder ownership may be beneficial to firm value, which indicates that family ownership is 'good'.

Institutions

Like their counterparts elsewhere, most stylized modern US and UK corporations started with concentrated family ownership (Chandler, 1990). Over time, they evolved to diffuse ownership (Berle and Means, 1932). An interesting puzzle is why this evolution is not observed in the rest of the world (Roe, 2002). While there are many explanations, a leading explanation is an institutional one (Gedajlovic and Shapiro, 1998; La Porta et al., 1998; Young et al., 2008). In brief, better formal legal protection of investor rights in the United States and the United Kingdom, especially the rights of *minority* shareholders, encourages founding families and their heirs to dilute their equity to attract minority shareholders and delegate day-to-day management to professional managers. Given reasonably effective investor protection, minority shareholders are increasingly attracted, and founding families themselves (such as the Rockefellers) may over time feel comfortable becoming minority shareholders of the firms they founded.

On the other hand, when formal legal and regulatory institutions are dysfunctional, founding families *must* run their firms directly. In the absence of effective investor protection, bestowing management rights to non-family, professional managers may invite abuse and theft – in other words, rampant agency problems. By default, founding families are not willing to hire outside managers – unless they allow these managers to marry into the family (Burkart et al., 2003). In addition, prospective minority shareholders may be less willing to invest without sufficient protection, thus forcing concentrated ownership to become the default mode. Overall, there is evidence that the weaker the formal legal and regulatory institutions protecting shareholders, the more concentrated ownership rights become (Heugens et al., 2009; La Porta et al., 1998; Young et al., 2008).

Using a sample of large US firms that are owned by families, Anderson and Reeb (2003) find that family ownership is beneficial to firm performance. However, they are careful in noting that the results may be contingent upon the particular institutional frameworks governing large family firms in the United States. Anderson and Reeb (2003, p. 1324) specifically suggest that their findings may only hold in 'well-regulated and transparent markets' and that in Asia, their results may not hold. While this interpretation is consistent with the generally understood, coarse-grained differences in institutional frameworks between the United States and Asia, it is interesting to engage in a finer-grained exploration *within* Asia, as discussed next.

Family Ownership and Institutions

Family shareholders are affected by country-specific institutions (North, 1990). An institution-based view addresses the embeddedness of firms in a nexus of formal and

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informal institutions (Peng et al., 2008, 2009). Despite a growing consensus that 'institutions matter', comparative institutional analysis of corporate governance remains in its infancy (Aguilera and Jackson, 2003).

An institution-based view suggests that the relation between family ownership and firm value may vary under different institutional environments. Following the proposition advanced by Rediker and Seth (1995) and Walsh and Seward (1990) that firm value depends on the efficiency of a *bundle* of governance mechanisms, we argue that external governance mechanism may substitute for internal mechanisms in contributing to the quality of corporate governance. Shareholder protection is rooted in the legal structure of a country (La Porta et al., 2002), which is an external governance mechanism of firms. An institutional setting with strong protection of shareholder rights requires less internal mechanisms to formulate and execute strategies, because the bundle of external and internal governance mechanisms is still efficient to keep firm value (Gedajlovic and Shapiro, 1998; Walsh and Seward, 1990).

Family ownership, an internal corporate governance mechanism, is supported by agency theory and resource-based view to be beneficial to firm value. However, the internal mechanism may be partially substituted by institutional development (an external mechanism). In an environment with more developed legal and regulatory institutions, when the external mechanism helps to govern corporations, the incentive and power from the family owner is less important in maintaining firm value. Under these circumstances, family ownership may be 'irrelevant' for firm value. Whereas in countries with less developed legal and regulatory institutions, the largest shareholder plays a more important role in maintaining firm value, which indicates that family ownership may be 'good' (Heugens et al., 2009).

Hypothesis 1: The positive relationship between family ownership and firm value is weaker for firms in countries with more developed legal and regulatory institutions.

FAMILY CONTROL AND FIRM VALUE

On a worldwide basis, the separation of ownership and control hypothesized by Berle and Means (1932) and articulated by Fama and Jensen (1983) 'is actually an exception rather than the rule around the world', and 'most corporations around the world [outside the United States and the United Kingdom] are controlled by a family or the state' (La Porta et al., 1999, p. 498).[2] Similarly, Morck et al. (2005, p. 657) comment that the separation of ownership and control typical of large US firms is 'the rarest of curiosities in most of the rest of the world'. Overall, there is a significant mismatch between the Berle and Means (1932) hypothesis on the inevitability of the separation of ownership and control for large firms and evidence from most areas of the world.[3]

Family firms keep control in the hands of the family primarily through two mechanisms: (1) appointing a family member as CEO; and (2) pyramiding. While the practice of CEO appointment is straightforward, pyramiding requires some elaboration. A pyramid occurs when a family controls other firms through a chain of ownership. In other words, a family owns and controls a firm through another firm. Through such pyramiding, it is common for a firm's ultimate shareholders to have formal control rights

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that are greater than ownership (cash flow) rights. For example, a family owns 50 per cent of the shares of Company X, which owns 40 per cent of Company B, which in turn owns 30 per cent of Company C. The family ends up with 6 per cent ($50\% \times 40\% \times 30\%$) of the ownership (cash flow) rights of C, but 30 per cent of its control rights (Faccio et al., 2001, p. 56). Pyramid structures are the predominant mode of corporate organization outside the United States (Morck, 2005).

Family CEO

Some streams of agency theory and resource-based view make the case that having a family CEO may be detrimental. Agency theorists argue that family CEOs, as inside shareholders, may have incentives to adopt investment policies that benefit themselves and their families, but reduce the payout to outside shareholders (McConnell and Servaes, 1990). Some family CEOs may be unqualified and incompetent. Even qualified family CEOs, if not strictly disciplined, may deviate from shareholder wealth maximization (Carpenter et al., 2003; Gomez-Mejia et al., 2003).

A branch of resource-based view argues that the appropriate resources, such as family ties, are necessary but insufficient to achieve a competitive advantage, and that 'familiness' must be managed effectively (Eddleston and Kellermanns, 2007; Eddleston et al., 2008; Sirmon and Hitt, 2003). Specifically, altruism commonly found in family firms – the selfless regard for the well-being of other family members – may *hurt* firm value (Schulze et al., 2003). Deeply altruistic, family members subscribe to a curious mix of rationalities, juxtaposing contradictory economic and altruistic (non-economic) motivations. Thus, family relations may make agency conflicts '*more* difficult' to resolve (Schulze et al., 2001, p. 102; emphasis in original), because relations between principals (family owners) and agents (family CEOs) are likely based on emotions, sentiments, and informal linkages, which may result in less effective monitoring and disciplining of family managers. Thus, altruism, especially parents' failure to discipline underperforming adult children serving as family CEOs, creates agency problems (Schulze et al., 2003).

Finally, family squabbles – the opposite of altruism – may add other complications to make family CEOs ineffective. Family management can incur significant costs, such as sibling rivalry, generational envy, non-merit-based compensation, and irrational strategic decisions (Gomez-Mejia et al., 2001). Family CEOs may enter into power competition with other family members, and have incentives to enhance the CEOs' own power and prestige rather than to create profits. In addition, after the founding generation passes away (a very likely scenario given the large size of the firm now), inter-generational squabbles often harm a family business that has now become a sibling partnership (Chandler, 1990; Gomez-Mejia et al., 2003). The family CEO in a sibling partnership usually lacks the undisputed authority and influence over other siblings as a parent would, because typically the CEO is neither the founder of the firm nor the biological head of the family (Schulze et al., 2003). These arguments suggest that family CEO may be 'bad' for firm value.

Other streams of agency theory and resource-based view, however, suggest that there are advantages in appointing a family member as the CEO. Advocates of agency theory

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argue that family CEOs are significantly beneficial (Anderson and Reeb, 2003), because 'family members have many dimensions of exchange with one another over a long horizon that lead to advantages in monitoring and disciplining' the family CEO (Fama and Jensen, 1983, p. 306). Such interest alignment – and family ties – between principals (family owners) and agents (family CEOs) reduces agency costs (Westphal, 1999). So firms with family CEOs may outperform firms with non-family CEOs (who may even be professionally more qualified) (Lee et al., 2003).

Similarly, the resource-based view, when applied in the context of family firms, yields a converging prediction (Barney, 2001). Although primarily working in the context of small firms, family business researchers have long argued that 'familiness' – embedded in a kin network such as common interest and identity, goal congruence, trust, and reciprocity – provides valuable, unique, and hard-to-imitate sources of competitive advantage (Durand and Vargas, 2003; Habbershon and Williams, 1999; Sirmon and Hitt, 2003). Compared with professional managers, family CEOs may have competitive advantages in gaining access to unique resources. In emerging economies with weak market-supporting institutional frameworks, access to resources is often not through formal channels (such as banks) but often through informal, private networks (such as business groups) (Peng, 2003). A business group is 'a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated action' (Khanna and Rivkin, 2001, p. 47). Business groups are ubiquitous in emerging economies and are often controlled by well connected families (Chang, 2006; Cuervo-Cazurra, 2006; Mursitama, 2006; Peng and Delios, 2006). With wide-ranging family connections, a family CEO may have more advantage in accessing resources that otherwise would not be available to the firm (Arregle et al., 2007). Thus, these arguments suggest that a family CEO is 'good' for firm value.

Pyramid Structure

The primary theory critical of the pyramid structure is agency theory (Morck, 2005). Some of the intra-group activities described above may be labelled as 'expropriation' of minority shareholders. Jensen and Meckling (1976) argue that the tendency of controlling shareholders such as families pursuing their private benefits at the expense of minority shareholders increases when the controlling shareholders own less equity in a pyramid structure. Through pyramiding, one family can control multiple public firms with many minority shareholders. When several firms rescue one firm in the pyramid through asset injection, minority shareholders of the firms that transfer resources may resent these activities that reduce the value of their shares (Chung, 2006; Dyck and Zingales, 2004).

In emerging economies where markets for corporate control usually do not operate effectively because of a lack of formal market-supporting institutions, expropriation of minority shareholders can take the form of: (1) tunnelling (transferring resources from firms in which a controlling family has few cash flow rights to ones in which it has substantial cash flow rights) (Bertrand et al., 2002; Lu and Yao, 2006); and (2) related transactions (buying and selling among intra-group firms at above- or below-market

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rates) (Chang, 2003; Johnson et al., 2000). Although tunnelling is usually illegal, related transactions are often legal. Because prospective minority shareholders realize that controlling families' interests diverge from theirs, they in response may discount such shares or refuse to invest, leading to a higher cost of capital and a lower level of value for pyramid firms (Lins, 2003; Young et al., 2008).

In contrast, the resource-based view suggests that a pyramid structure may be 'good' for firm value. With a pyramid structure, a family controls multiple firms, each becoming a member of an informal business group (Peng and Delios, 2006). Other members of such a group in the pyramid may provide useful information, access to finances, and important social interactions (Khanna and Rivkin, 2001; Li et al., 2006). If the focal firm suffers from performance problems, other member firms may come to rescue it by injecting resources such as assets and talents (Chang and Hong, 2000; Gedajlovic and Shapiro, 2002). Relative to independent firms without such pyramid/group affiliations, these connections of pyramid firms may add value. Proponents of the resource-based view address controlling shareholders' contribution as boundary spanners of the organization and its environment. Specifically, pyramid firms can gain access to other pyramid firms' resources (Hoskisson et al., 2003) and share the group's reputation capital (Chang and Hong, 2000; Ma et al., 2006). Thus, abilities to do so may become valuable, unique, and hard-to-imitate resources (Guillen, 2000; Peng et al., 2005). How pyramid firms derive benefits from their affiliations is not through costly formal contracting, but through relational contracting, social networks, and family ties. This may be especially the case in Asia (Bruton et al., 2003; Li, 2007; Peng and Delios, 2006). As suggested by the literature on relational contracting and social networks in emerging economies (Meyer et al., 2009; Peng, 2003, 2004), non-pyramid firms outside these networks may have a hard time accessing these highly idiosyncratic and informal relationship- and family-based assets.

Overall, it seems difficult to tell a *priori* whether the benefits of family control – through family CEO or pyramid structure – in large firms outweigh the costs, or vice versa (De Vries, 1993; Villalonga and Amit, 2005). This debate thus calls for further examination of other mechanisms that affect family control. It seems imperative that we probe into the roots of institutions that underpin corporate governance.

The Institutional Context of Family Control

For large family-controlled firms, according to La Porta et al. (2002, p. 1148), 'the central problem is not the failure of the Berle and Means (1932) professional managers to serve dispersed shareholders, but rather the expropriation of minority shareholders by controlling shareholders'. These conflicts are labelled 'principal–principal' conflicts – as opposed to principal–agent conflicts – by Young et al. (2008). We are not arguing that all controlling families will expropriate minority shareholders. Indeed, some controlling shareholders may develop a reputation for treating minority shareholders fairly (Gomes, 2000). What we are proposing is that reputation, based on informal norms, may be a poor substitute for formal institutions such as legal protection of minority shareholder rights. During the 1997 Asian financial crisis, when controlling families themselves suffered huge losses, even some of the most reputable controlling families expropriated

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minority shareholders in order to 'make up' their losses (Johnson et al., 2000). Thus, more control may afford controlling families more opportunities to expropriate minority shareholders, which hurts firm value.

While individual families may vary in their propensity to expropriate minority shareholders (e.g. some may be more 'greedy' than others), recent research finds that cross-country differences in the scale and scope of expropriation systematically vary according to the differences in minority shareholder protection afforded by legal and regulatory institutions (Dyck and Zingales, 2004; La Porta et al., 2002; Lee and Oh, 2007). Other research recognizes the benefits of shareholder control, but concludes that whether its benefits outweigh the drawbacks is unclear (Morck et al., 2005). We propose that in countries with more developed legal and regulatory institutions to protect investors, having more family control – through a family CEO or pyramid structure – may be beneficial. This is because in countries with better investor protection, families may be more effectively monitored and disciplined. In other words, a more developed legal and regulatory institution makes expropriation of minority shareholders less efficient (La Porta et al., 2002), thus the resource provision benefits of a family CEO and/or pyramid structure may outweigh the costs of principal–principal conflicts. Under these circumstances, despite the potential drawbacks associated with family control, on balance, it may still add value.

Some research indicates that expropriation of minority shareholders is made easier where rules and regulations fail to address the financial manoeuvres of the blockholder and the legal systems are more prone to corruption (Young et al., 2008). In countries with less developed legal and regulatory institutions to protect investors, having a pyramid structure (often set up by the controlling family) or a family CEO (often appointed by the controlling family) may increase the amount of expropriation of minority shareholders. This problem may become especially severe as the number of 'tiers' of the pyramid increases, which reduces controlling families' cash flow ownership levels (Dyck and Zingales, 2004; La Porta et al., 2002). Further, in such countries with underdeveloped investor protection institutions, controlling families usually have a relatively 'free hand' in expropriating minority shareholders (Bertrand et al., 2002).

Overall, invoking an institution-based view (Heugens et al., 2009; Peng et al., 2008, 2009), we argue that although controlling families may have incentives to expropriate minority shareholders, the net effects of the benefits and costs of family control is conditioned on the institutional context. More developed institutional environments may help to discipline family CEOs and reduce the opportunity of expropriating minority shareholders through pyramid structures. In other words, institutions may curb the negative effects related with family control. Specifically:

Hypothesis 2: The negative relationship between a family CEO and firm value is weaker for firms in countries with more developed legal and regulatory institutions.

Hypothesis 3: The negative relationship between a family pyramid structure and firm value is weaker for firms in countries with more developed legal and regulatory institutions.

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METHODOLOGY

Sample and Variables

Our data sources are: (1) Asian Corporate Governance Archival Data Center (which primarily draws on Worldscope and World Bank data sources); and (2) Worldscope Database. Ownership data are collected for the year 1996, before the 1997 Asian financial crisis. Ownership of each company is traced to its ultimate owner. How much cash flow rights share, in percentage of total outstanding shares the owner has, is identified (see Claessens et al., 2000). Family firms are recognized as firms having a family as the largest shareholder. A 5 per cent control rights share is used as a cut-off. Firms in seven Asian countries, Hong Kong, Indonesia, Malaysia, Singapore, South Korea, Taiwan, and Thailand, are included in this study. After excluding 63 firms with missing data, we have 634 family firms in the sample.

Dependent Variable

Firm value. The 1997 Asian financial crisis was triggered in Thailand in July 1997 and spread to other Asian countries quickly. We try to capture the firm value effect during and immediately after the crisis. The dependent variable, firm value, is measured by the percentage of cumulative stock return (buy and hold return) from 1 January to 31 December 1998 (or the last trading day of the year). The stock prices are all in US dollar values. A stock market-based measure is used as the firm value indicator for three reasons. First, unlike performance measures based on accounting data, market-based performance measures are not influenced by firm-specific financial reporting idiosyncrasies. Second, for a cross-country study such as ours, using stock market data eliminates the problems with accounting data that could be distorted by different accounting and tax systems across countries. Third, the use of a market-based performance measure is consistent with an important principle in corporate governance – that is, a firm should maximize its *market* value. Data of stock returns are obtained through Worldscope.

Independent Variables

All our independent variables lag the dependent variable, and are measured before the Asian financial crisis to avoid confounding effects associated with the crisis (Joh, 2003).

Family ownership. Family ownership is measured through the fraction of shares owned by the family shareholder, with the minimum threshold of 5 per cent ownership rights. This measure has been used in Europe (Thomsen and Pedersen, 2000). Most studies in Asia (Claessens et al., 2000) also find a large percent of cash flow rights in the hands of the largest shareholder.

Family CEO. A firm with a family member as the CEO is coded as 1, and 0 otherwise.

Pyramid structure. A firm with a pyramid structure is coded as 1, and 0 otherwise.

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Table I. Legal and regulatory institutions

Countries	*Efficiency of judicial system*	*Rule of law*	*Corruption*	*Average*
Singapore	10	8.57	8.22	8.93
Hong Kong	10	8.22	8.52	8.91
Malaysia	9	6.78	7.38	7.72
Taiwan	6.75	8.52	6.85	7.37
South Korea	6	5.35	5.3	5.55
Thailand	3.25	6.25	5.18	4.89
Indonesia	2.5	3.98	2.15	2.88

Source: La Porta et al. (1998).

Institutional development. We measure institutional variables based on La Porta et al. (1998), whose index has been widely used and validated in recent cross-country studies on shareholder protection and governance (Dyck and Zingales, 2004; Johnson et al., 2000; Schneper and Guillen, 2004). Table I represents country scores in the index for (1) efficiency of judicial system, (2) rule of law, and (3) corruption, which are three broad institutional measures crucial for the protection of investors (La Porta et al., 1998). Judicial efficiency is the assessment by Business International Corporation of 'the efficiency and integrity of the legal environment as it affects business' (La Porta et al., 1998, p. 1124). Rule of law, assessed by International Country Risk Services, focuses on the law and order tradition in the country. Corruption is the extent of corruption in the government – particularly the extent to which businesses have to pay bribes (La Porta et al., 1998). All of these measures are calculated well before the 1997 Asian crisis. We use the average of the three scores in the index for each country to measure the legal and regulatory institutional development.

Control Variables

Debt-to-assets ratio. Firms with a high leverage ratio may experience more difficulties during economic downturns since highly leveraged firms might have more difficulty obtaining external financing during a crisis. Therefore, the debt-to-assets ratio in 1996 is controlled.

Firm risk (beta). Risky firms generally have a high default risk and are therefore more vulnerable to external shocks. We would expect riskier firms to experience a larger drop in firm value. Firm risk is measured by beta, computed by regressing a firm's monthly stock return on the corresponding country index return in 1996.

Accounting transparency (ADR). In general, foreign firms with a listed American Depository Receipt (ADR) have higher disclosure quality. Thus, we include an ADR dummy to

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examine whether increasing accounting transparency leads to better stock price performance during the crisis.

We also control for firm age, market-to-book ratio, and capital-to-assets ratio. We include dummy variables for 12 broad industries and country variables.

The Model

We use ordinary least square regression (OLS) to examine the relation between firm ownership and control structure and firm value. One issue of OLS is the potential endogeneity of the regressors. If the governance variables are not exogenous, then their estimated coefficients may be inconsistent or unclear. Demsetz and Lehn (1985) show that ownership and firm value can be jointly determined. In our study, since we use the lagged independent variables to capture firm characteristics in 1996, which is before the financial crisis, the possibility of endogeneity is not likely to be significant. La Porta et al. (1999) report that ownership structures for large Asian firms are relatively stable over time. Since the Asian financial crisis started in July 1997, our dependent variable – firm value in 1998 – tries to capture the effect of family ownership and control during and immediately after the financial crisis.

The three independent variables that represent ownership and control structures are included in the regressions. In order to test the moderating effect of institutional development, we then interact the institution variable with the other three independent variables. Multicollinearity does not appear to be a significant problem, because the average variance inflation factor for each country is less than 10. Heteroscedasticity is corrected using robust (Huber–White–Sandwich) standard errors.

FINDINGS

Table II reports the descriptive statistics. Table III documents the regression results with four models. Model 1 focuses on the main effects of family ownership and control on firm value. Model 2 focuses on the interaction between family ownership and institutional development to test Hypothesis 1. Hypotheses 2 and 3 are tested in Models 3 and 4 that examine the interaction between family control and institutional development.

Model 1 does not show a significant impact of family ownership, family CEO, or pyramid structure, which indicates that family ownership and control may be 'irrelevant' for firm value. Hypothesis 1 is not supported since the interaction term in Model 2 is not significant. It seems that the institutional impact on the relation between family ownership and firm value is 'irrelevant'. Model 3 shows a significant impact of family CEO and the interaction of family CEO and institutional development on firm value. Family CEO has a negative effect, but the interaction term has a positive effect on firm value. Model 4 also shows a significant impact of pyramid structure and the interaction of pyramid structure and institutional development on firm value. Pyramid structure is negatively related with firm value, but the interaction term is positively related with firm value. Overall, we find that the interactions of family control and a country's institutional development have significant impacts on firm value. The negative effect of family CEO and family pyramid structure on firm value is weaker in countries with more developed

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Table II. Descriptive statistics and correlations

Variables (n = 634)	*Mean*	*SD*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*
1. Stock return	7.97	61.67										
2. Family ownership	24.20	11.91	–0.03									
3. Family CEO	0.83	0.37	–0.04	0.03								
4. Pyramid structure	0.46	0.50	–0.07	–0.36**	0.20**							
5. Institutions	6.82	2.09	0.02	–0.01	–0.07	–0.07						
6. Firm age	28.93	17.49	–0.02	0.05	–0.05	–0.02	0.09					
7. Debt-to-asset ratio	29.25	21.27	–0.03	–0.05	0.02	0.002	–0.33**	–0.04				
8. Capital-to-asset ratio	61.21	21.83	–0.08	0.03	–0.04	0.07	0.19**	–0.08*	–0.28**			
9. Stock risk beta	0.95	0.93	0.10*	–0.02	0.01	–0.02	–0.06	0.05	0.06	–0.02		
10. Market-to-book ratio	1.87	1.97	0.04	0.03	0.003	0.03	0.12**	–0.03	–0.12	–0.04	0.03	
11. ADR	0.18	0.57	–0.02	–0.03	–0.15**	–0.12**	0.25**	0.01	–0.06	0.08*	–0.02	0.01

* $p < 0.05$; ** $p < 0.01$.

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Table III. Effects of family ownership and control on firm value

	Model 1	*Model 2 Hypothesis 1*	*Model 3 Hypothesis 2*	*Model 4 Hypothesis 3*
Family ownership	−0.43	−1.79	−0.43	−0.38
	(0.25)	(0.93)	(0.25)	(0.24)
Family CEO	−4.87	−5.62	−110.72*	−3.68
	(9.22)	(9.32)	(54.34)	(8.86)
Pyramid structure	−11.33	−10.12	−10.11	−68.97*
	(6.51)	(6.28)	(6.38)	(33.33)
Institutions	1.71	−3.18	−11.74	−4.27
	(2.06)	(4.08)	(7.32)	(4.37)
Family ownership × institutions		0.20		
		(0.11)		
Family CEO × institutions			15.10*	
			(6.82)	
Pyramid × institutions				8.30*
				(4.20)
Age	−0.13	−0.14	−0.12	−0.12
	(0.13)	(0.13)	(0.13)	(0.13)
Debt-to-assets ratio	−0.10	−0.08	−0.12	−0.12
	(0.13)	(0.13)	(0.13)	(0.13)
Capital-to-assets ratio	−0.12	−0.11	−0.15	−0.15
	(0.11)	(0.11)	(0.11)	(0.11)
Stock risk beta	5.55*	5.49*	6.16*	5.82*
	(2.57)	(2.58)	(2.54)	(2.54)
Market-to-book ratio	0.08	0.24	0.44	−0.02
	(1.00)	(0.97)	(0.93)	(1.02)
ADR	−3.18	−2.84	−1.61	−2.39
	(4.35)	(4.34)	(4.26)	(4.23)
Constant	38.39	72.64	127.89*	76.74
	(32.81)	(45.84)	(63.32)	(44.26)
N	634	634	634	634
F	4.74	4.58	4.91	5.01
R^2	0.082	0.088	0.113	0.097

Notes: Numbers in parentheses are White's heteroscedasticity-consistent robust standard errors. Industry dummies and country dummies are included in the models but are not reported due to space constraints.
* $p < 0.05$; ** $p < 0.01$.

legal and regulatory institutions. It indicates that whether family control in large firms is good, bad, or irrelevant is *systematically* correlated with the legal and regulatory institutions governing shareholder protection, thus supporting Hypotheses 2 and 3.

DISCUSSION

Contributions

Overall, two sets of theoretical and empirical contributions emerge. First, theoretically, we make and substantiate the case that the benefits and costs of family ownership and

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control vary systematically according to the level of institutional development. While different streams of agency theory and resource-based view have argued for both the positive and negative sides of family ownership and control, our study goes one step further to explore the institutional context for these arguments. Thus, we advance an institution-based view to address the question under what conditions family ownership and control are good or bad for firm value (Peng et al., 2008, 2009). This institution-based view of family business may help reconcile Anderson and Reeb's (2003) 'good' findings in the United States and Chang's (2003) 'bad' findings in South Korea. It is neither that controlling families are uniformly 'good' or 'bad', nor that American families are less 'greedy' than Korean families. Rather, it is the different institutional frameworks American and Korean families have to face that make a difference. In large US firms, controlling families' tendency to expropriate minority shareholders may be constrained by independent directors whose power is supported by the legal and regulatory frameworks (Anderson and Reeb, 2004), whereas in large Korean firms, this might be difficult. Overall, we show that national institutions can be conceptualized in a way that captures variations across countries, which then can be used to explain why family ownership and control are 'good', 'bad', or 'irrelevant' in different countries. More broadly, our study joins the recent work of Heugens et al. (2009), La Porta et al. (1998, 1999, 2002), Peng et al. (2008, 2009), Roe (2002), Schneper and Guillen (2004), Young et al. (2008), and others in sketching the contours of a cross-country, *institution-based view* of corporate governance. This theory enriches the debate, by suggesting that findings from numerous single-country studies need to be qualified with an explicit discussion on the enabling and constraining forces of the institutional frameworks.

Empirically, cross-sectional studies have sought to solve the puzzle of contradictory findings of family business by making a finer-grained distinction between families, such as lone founder families and other families (Miller et al., 2007). Our research aims to address the same puzzle, but looks at a bigger picture. We conduct a cross-country analysis to explore the institutional contexts of family business. Perhaps the strongest message out of our study is that given the wide ranging diversity in institutional frameworks within Asia (see Table I), efforts to generate models of 'Asian corporate governance' or 'Asian family firm' (Lemmons and Lins, 2003) may be counterproductive. Specifically, countries with better developed legal and regulatory institutions enable more of the benefits of family control to outshine their drawbacks. In contrast, families in countries with less developed institutions may have more opportunities to engage in expropriation. Overall, this article has overcome a major drawback identified by Bruton and Lau's (2008, p. 643) recent review of the Asian (and international) management literature: reporting data from only one Asian country or comparing one Asian country with a mature market economy (typically the United States). Our cross-country findings, thus, add a great deal of rich understanding across Asia.

In summary, this article contributes to the literature by *theoretically* arguing that the net balance of the benefits and costs of family control in large firms is systematically linked with the legal and regulatory institutions governing investor protection, and *empirically* documenting this case through a large sample of firms throughout Asia.

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Limitations and Future Research Directions

The limitations of our study suggest a number of avenues for future research. First, while it seems helpful to build a cross-country, institution-based view of corporate governance, we have barely scratched the surface of institutions affecting corporate governance.[4] Our study, which focuses on the various institutional developments across Asian countries, may not be generalizable to the institutional contexts in other countries. Future cross-region research may explore institutions in a wider range of countries. In addition, while our focus on the legal and regulatory institutions is a useful first step, it is important to note that institutions also include other formal and informal aspects such as competition policies and cultural and societal norms (Aguilera and Jackson, 2003; Young et al., 2008). In emerging economies, the formal laws on books may look increasingly like those found in the West, but the actual implementation, driven more significantly by informal norms and cognitions, may remain ineffective (Peng, 2003, 2004; Wright et al., 2005). These dynamics thus necessitate our expansion to capture these complexities in future work.

A second limitation is that we may have painted a coarse-grained picture of 'family firms', by not differentiating various types of families. Intuitively, it seems plausible that firms owned and controlled by the first generation (parents) may exhibit more altruism, and that firms owned and controlled by the second or third generations (sibling partnerships) may have more dysfunctional squabbles (Schulze et al., 2003). In the United States, Anderson and Reeb (2003, p. 1303) document that it is firms with founder CEOs that outperform those with professional CEOs, and that second- and third-generation family CEOs have no effect on market value. Miller et al. (2007) find that only family businesses with a lone founder outperform the rest. However, the efforts to control for family generations in our data have been frustrated by our inability to unambiguously identify these different generations in seven countries with such a large sample. Systematic exploration of this effect has to wait for further research.

Finally, it will be useful to longitudinally track the changing role of families over time (Yeung, 2006; Yoshikawa and McGuire, 2008). It is possible that firm value changes over time, and measurements other than stock return may represent firm value better in a long run (Peng et al., 2005).

CONCLUSIONS

Despite the Berle and Means (1932) hypothesis, most large firms outside the Anglo-American world have 'stubbornly' continued to concentrate ownership and control in the hands of families. Given the simultaneous existence of the benefits and costs of having a family CEO and a pyramid structure, the crucial issue boils down to under what conditions the 'good' outweighs the 'bad' (Heugens et al., 2009; Villalonga and Amit, 2005). Addressing this question, we have proposed an institution-based view to study family business and documented that whether controlling families in large firms are 'paragons' or 'parasites' systematically depends on the differences in the legal and regulatory institutions that protect shareholders in the seven Asian countries we study. In other words, this article demonstrates *how* institutions matter in the crucial context of corporate governance concerning family ownership and control (Peng et al., 2008, 2009; Young et al., 2008).

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From a policy standpoint, our findings have important implications for corporate governance reforms in Asia (and perhaps elsewhere) (Fogel, 2006; Morck, 2005; Yeung, 2006). Calls for reforms in the aftermath of the 1997 Asian financial crisis made by Western advisors and media as well as international organizations such as the International Monetary Fund and the World Bank to reduce family ownership concentration, introduce more outside shareholders, professionalize management, and break pyramid structures need to be embraced with caution.[5] In countries with more developed institutions (such as Singapore), having a family CEO or pyramid structure may provide a better internal control mechanism and better access to resources, thus the benefits of family control may outweigh the costs. However, in countries with less developed institutions (such as Indonesia), more control through family CEO or pyramid structure may afford controlling families more opportunities to expropriate minority shareholders. In conclusion, reforms may be needed, but actions need to be substantiated by an in-depth understanding of the complex dynamics associated with family ownership and control in large firms.

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NOTES

[1] In this article, 'large firms' are defined as publicly listed corporations. Concentrated family ownership and control are regarded as uncontroversially optimal for small firms. The reasons range from more hands-on and less bureaucratic management to reduced principal–agent conflicts (Fama and Jensen, 1983; Miller et al., 2008). Discussion of small firms is outside the scope of this article, which focuses on *large* firms.

[2] For example, in Canada, a country very close to the United States and United Kingdom culturally and geographically, more than 380 of the 400 largest publicly traded corporations have *concentrated* ownership and control in the hands of a single family (Gedajlovic and Shapiro, 1998, p. 536).

[3] La Porta et al. (1999) suggest that families and the state are the two major owner groups of corporations around the world. In this article, we choose to focus on family ownership and control. There is a separate literature on state ownership and its spin-off, privatization, which is outside the scope of the present article.

[4] While the institutional origins variables advocated by La Porta et al. (1998) have been influential, there is some debate regarding their validity. For example, Rajan and Zingales (2003, p. 14) find the La Porta et al. (1998) measures to be only accurate in the post-World War II era.

[5] This is similar to the caution we need to embrace when dealing with other theoretically and intuitively sensible but empirically ambiguous suggestions in reforming corporate governance in emerging economies, such as appointing outside directors to corporate boards (Peng, 2004).

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