

# Do families shape corporate governance structures?

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## ABSTRACT

*This paper provides empirical evidence of family firm corporate governance structures, by examining a set of corporate governance characteristics of 132 non-financial Spanish listed firms. Results show that family firm boards present differential characteristics and that different patterns of family ownership configurations do not affect family firm corporate governance structures. We find that Spanish family firm boards are smaller than those in non-family firms. Family firm directors own a larger fraction of firm shares and have longer Chairman tenure than non-family firms, and family firms use fewer voluntary board committees – such as nomination and remuneration committees and executive committees. Besides, family firm boards and committees are biased towards insiders. Whether these differential characteristics affect other minority non-family shareholders negatively remains an open question.\**

**Keywords:** family firms, corporate governance, board composition, board committees

## INTRODUCTION

In the USA, family ownership constitutes approximately 35% of large<sup>i</sup> publicly traded firms (Anderson & Reeb 2004; Villalonga & Amit 2006); in East Asia, more than two-thirds of firms are controlled by a single shareholder – managers of closely held firms frequently being relatives of the controlling shareholder family (Claessens et al. 2002); and in Western Europe, the majority of publicly held firms remain family controlled (Faccio & Lang 2002).

Given the significant role family firms play in the global economy, gaining a better understand-

ing of the factors that influence their management practices, corporate governance structures and performance is particularly important (Chrisman et al. 2006). Family influence on firm corporate governance structures and performance has been analyzed from different perspectives: agency theory (Fama & Jensen 1983); resource-based view (RBV) (Habbershon & Williams 1999; Carney 2005, Le Breton-Miller & Miller 2006); or stewardship theories (Davis et al. 1997; Sundaramurthy et al. 2003). In this paper we refer mainly to the agency theory.

Traditionally, agency theory assumes that

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<sup>i</sup> Nevertheless we must take into account the effect of size. As Donkels and Frohlich's (1991) remark, for large firms family ownership may not be synonymous with family control whilst in smaller companies, ownership controlled by families is still a key characteristic.

agency costs are not likely to occur in family businesses with a single shareholder, where the family also manages the firm (Fama & Jensen 1983). However, as firms grow and go public, ownership structures may be a combination of family ownership and non-family ownership; thus agency costs may be incurred with divergence in interests between family and non-family shareholders. Consequently, from an agency point of view, family firm corporate governance structures become extremely important when other large shareholders and minority non-family shareholders coexist with family shareholders, which is the case for publicly listed family firms.

Family business corporate governance structures should adapt to this situation by establishing specific corporate governance structures that take into account the three systems model in order to govern family firm relations (Davis & Taguiri 1989): the family, other firm shareholders, and managers. Moreover, although family firm corporate governance structures should reflect their idiosyncratic features, family firm corporate governance structures should ensure minority shareholder returns by restricting opportunistic behaviours by managers and families. Implementing good governance practices should in this sense be considered as a 'good family dynamic' (Martin de Holan & Sanz 2006).

Recent literature suggests that corporate governance structures should better 'fit' family firm peculiarities (Corbetta et al. 2004; Lane et al. 2006; Voordeckers et al. 2007). Empirical analyses of family firm governance structures are needed to better understand family firm peculiarities. Most family firm governance studies have analysed the impact on firm performance of: who 'manages' the firms (by examining whether the firms are family or professionally-managed); who 'controls' the firms (by examining whether the firms have a family Chairman or not); and/or by differentiating between founders or descendants as either managers or directors (Anderson & Reeb 2003; Barth et al. 2005; Jayaraman et al. 2000; Schulze et al. 2001; Sacristán & Gómez

Ansón 2006; Sraer & Thersmar 2004). A few papers from Anglo-Saxon countries (Anderson & Reeb 2004; Bartholomeusz & Tanewski 2006; Klein et al. 2005; Ricart et al. 1999; Villalonga & Amit 2006), analyze other corporate governance variables, such as: board size, board composition, and board committees. The results of these studies shed some light on the idiosyncratic characteristics of family firm corporate governance structures. Villalonga and Amit (2006) show that family ownership creates value, only when the founder serves as the CEO of the firm or as its Chairperson. In Greece, Bartholomeusz and Tanewski (2006) conclude that family firms rely more on internal control mechanisms than non-family firms, while in Canada, Klein et al. (2005) suggest that family firms are apparently penalized for having independent boards.

Our paper aims to analyse to what extent family firm corporate governance structures differ from that of non-family firms and whether different family ownership configurations (i.e. use of pyramidal structures) affect family firm corporate governance structures. This study contributes to the corporate governance and family firm literature in several ways. First, the paper presents a comprehensive review of family firm corporate governance structures. Second, we present empirical evidence about the influence of family ownership on corporate governance structure in a Continental European country (Spain – where family controlled firms account for more than 50% of publicly listed firms, Sacristán & Gómez 2007). Third, as family firm corporate governance studies consider that family firms are not all alike, we address whether different family ownership structures affect firm corporate governance structures, by analyzing whether family use of pyramidal structures determine differential corporate governance structures.

The results suggest that there are significant differences between family and non-family firm corporate governance structures, but that different family ownership configurations do not influence family firm corporate governance structures. The study shows that family firm cor-

porate governance structures are characterised by insider family control.

Section 2 discusses the Spanish institutional setting and provides theoretical background on the relationship between family ownership and firm corporate governance structures. Section 3 presents the methodology and the variables of the study; section 4 describes the results of the analyses and section 5 presents conclusions and implications of the paper for researchers and practitioners.

## **2. THEORETICAL BACKGROUND**

Corporate governance is related to legal protection of investors and to cultural traditions (La Porta et al. 1998, 1999; Ellul et al. 2006). According to Bukart et al. (2003), with low shareholder protection, the founder's ability to control expropriation from managers will be too limited, and therefore managers remain within the family even when someone else may run the firm more efficiently. This argument leads to a prediction of a negative relationship between investor protection and ownership concentration, consistent with empirical evidence (La Porta et al. 1998, 1999, 2000). The law and finance literature also helps explain why 'family firms' – in which the founder family is a shareholder or even the manager over several generations – are an enduring phenomenon in French civil law countries, as is the case of Spain. Spanish firms have a high family ownership concentration with a high incidence of family pyramidal structures (La Porta et al. 1997, 1998, 1999; Faccio & Lang 2002; Sacristán & Gómez Ansón 2007).

### **2.1. Family firm corporate governance structures**

Shelifer and Vishny (1997) emphasize the importance of studying the characteristics of family firms in order to understand the economic efficiency of corporate governance mechanisms. As already pointed out, given their differential characteristics, family firm corporate governance structures should differ from non-family ones. These differences may not necessarily affect firm performance negatively.

The underlying logic of the traditional agency theory argument is that manager and shareholder interests may diverge and that the board is a mechanism for aligning those interests through the monitoring and the ratifying of managerial decisions (Hillman et al. 2000). The above description refers to the 'classical' agency problem (Type I agency problem, Villalonga & Amit 2006). In family firms, families are the large shareholders and they may also appoint firm managers; thus, there may be not so many agency problems between managers and large shareholders, but another type of agency problems caused by the coexistence of minority and large shareholders (Morck & Yeung 2003). When large shareholders are present, i.e. families or individuals, they may have an incentive to extract private benefits of control at the expense of minority shareholders (Type II agency problem, Villalonga & Amit 2006). Specifically, in family firms, 'managerial entrenchment' may be caused by the pursuit of family interests.

Since family firm agency problems are different from those of widely held firms, one may also expect family firm corporate governance structures to be different. In family firms, the interests of managers and owners may be aligned and the corporate governance devices designed for widely held firms may prove inefficient in family businesses (Barney & Hansen 1994; Jaskiewicz & Klein 2007).

Corporate governance differences between family and non-family firms may actually relate to different characteristics of the board of directors. Lester and Cannella (2006) suggest that boards may serve more than the traditional governance function of counselling, evaluating and controlling company management. They perceive the board of directors as a resource used by family firm owners to assist family executives (less so than to monitor them) and to reduce within-family agency costs. In addition, family members – as large owners – will be less threatened by the market for corporate control and may be more keen to develop board interlocks.

### **Executive vs independent directors**

The board of directors is comprised of: inside (or executive) directors and outside directors (nominee directors, those representing large shareholders, and independent directors). For family firms, a CEO near retirement may add inside directors in order to facilitate his or her succession process (Hermalin & Weisbach 1988) and a board dominated by insiders could facilitate transition in family firms and enhance firm performance. The results for Canada (Klein et al. 2005) support this prediction. Family firms seem to be penalised for having boards that are independent of company management. Moreover, outside directors may reduce the influence of the board due to their lack of knowledge about the firm and its environment. Consequently, family firm boards should be characterized by a balance between independence and interdependence (Corbetta et al. 2004). In any case, in family firms, family control may be exercised through different ways: by controlling the board of directors; and/or by assuming the members' executive functions. Accordingly, we propose the following hypothesis:

*H1: Family firms will present a lower proportion of independent directors in favour of nominee and executive directors than non-family firms.*

Other board characteristics – such as board size, duality, CEO or Chairman tenure, and the existence and composition of board committees – may also affect the monitoring role of the board.

### **Board size**

While there are arguments in favour of and opposed to small boards (Jensen 1993; Kose & Lemma 1998; Rosenstein & Wyatt 1990), empirical evidence indicates that smaller boards enhance firm performance (Yermack 1996; Eisenberg et al. 1998; Fernandez et al. 1998). For family firms, Lane et al. (2006) suggest that small boards may be more desirable, as larger boards may inhibit full family participation and individual responsibility; the smaller board size that

characterises family firms may support this. Other explanations of smaller family firm boards include: family firms becoming intimidated by boards, setting up boards which may be merely cosmetic; and board member remuneration being an expense most family firms would be reluctant to bear.

Thus, we should expect:

*H2: Family firm boards will be smaller than non-family firms' ones.*

### **Duality**

Whether the CEO also holds the post of Chairman of the board may also influence the independent judgement of the board. This may result in conflicts of interests (Brickley et al. 1997; Dalton & Kesner 1987; Shivedasani & Yermack 1999) as the CEO may have incentives to 'capture' the board and reduce its monitoring role in order to ensure that he can keep his job and increase his private benefits of control (Hermalin & Weisbach 2001). Theoretical arguments may, nevertheless, be different for family firms. If the main role of the board is to assist managers, not to monitor them, duality may not be necessarily harmful. Within family firms, if the CEO and the Chairman are both family members, or even if they are the same person, the conflicts of interests may be less severe and duality may ease family firm governance. Thus, a *family* CEO could be considered a *strength* for a family firm. For instance, Bennedsen et al. (2006) consider that family CEOs could perform better than other managers because they are exposed to higher non-monetary rewards associated with firm success. Moreover, they may have hard-to-obtain, firm-specific knowledge, higher levels of trust from key stakeholders and could have a broader focus. However, family CEOs might not maximize shareholder wealth due to the existence of conflicts of interests between family and firm objectives, and they may be selected from a small pool of managerial talent (Bukart et al. 2003).

Due to the power exercised by families as large shareholders in family firms, we should expect

duality to be present to a larger extent within family firms. Moreover, duality could be correlated with the generation in charge of the firm. At the founder stage, duality would be expected to be quite common with CEO and Chairman of the firm as founder; while as generations pass, and specially, after the third generation, the presence of duality would be less pronounced.

Thus, we should expect:

*H3a:* Family firms will present more duality than non-family firms.

*H3b:* Duality in family firms will decrease as the family business moves through the generations.

### ***CEO or Chairman tenure***

Defined as the number of years a Chairman or CEO has occupied the post since his/her appointment, tenure may also be relevant from a corporate governance perspective. For family firms, longer CEO or Chairman tenure could suggest a long-term commitment to the firm (Ellul et al. 2006), frequently cited as a positive aspect of family firms. Longer tenures facilitate lengthy investment time horizons and provide investment incentives and stewardship (Le Breton-Miller & Miller 2006:733). On the other hand, longer CEO and Chairman tenure may contribute to CEO or Chairman entrenchment.

Given the greater power and involvement of families in family firm governing bodies, we should expect that:

*H4:* Family firm CEO and Chairman tenures will be longer than non-family firm tenures.

### ***Board committees***

Committees may also enhance board efficiency. Empirical studies show that the existence of internal committees (Klein 1998; Kose & Lemma 1998) may influence the boards' monitoring role and that, for example, audit committee independence increases with board size and board independence (Klein, 2002). Most Codes of Best Practice actually recommend the exis-

tence of a large set of independent directors on board committees, especially on audit, nominating, and remuneration committees. Families may be less eager to establish board committees owing to the smaller size of family firms and also to their lower will to establish monitoring devices. Moreover, if boards are overrepresented by family nominee and executive directors, in family firms, board committees will also be expected to reflect this fact, especially in relation to nominee directors.

We summarise these arguments in the following hypotheses:

*H5a:* Family firms will establish fewer voluntary committees (nominations and remuneration, strategy, or executives committees) than non-family firms.

*H5b:* Family firm board committees will be mainly controlled by family directors, and as a consequence they will have a lower degree of independence (fewer independent directors in favour of family nominees and executive directors) than those of non-family firms.

## **2.2. Family firm ownership structures and corporate governance**

Family firms display different forms and tendencies in different institutional environments; Gnan et al. (2004) consider it impossible to define a universal type of family firm. We define two types of family firms which differ mainly in their ownership structures – that is, in the way families hold their shares – which we name Type I and Type II family firms.

### ***Type I family firms (FF1)***

Under this criterion, a firm is considered a family firm when it is owned directly or indirectly by an individual or a family who is the firm's *main owner*. That is, if a family or individual hold more shares than the rest of the other significant shareholders, with a minimum threshold of 10%, the firm is considered as a family firm under the FF1 definition. This definition of a family firm based on

ownership criteria<sup>ii</sup> has already been used in the literature, with variations in the level of the threshold chosen by different authors (Anderson & Reeb 2003; Maury 2005; Villalonga & Amit 2006).

#### *Type II family firms (FF2)*

Pyramids are mechanisms that facilitate the expropriation of minority shareholder wealth (La Porta et al. 1998). As a result, the control rights of large shareholders may exceed their cash flow rights and large shareholders may have incentives to extract private benefits from control. Families, as large shareholders, may abuse their dominant position and extract private benefits at the expense of minority shareholders, especially in the presence of weak protection for minority shareholders (La Porta et al. 1998).

For the purpose of this paper, we define a second type of family firm. FF2 family firms are firms whose controlling shareholder (the largest shareholder) is not apparently an individual or a family – or is not a firm which is owned indirectly by a family through indirect ownership – but rather a firm whose controlling shareholder (with a threshold of 10%) is a non-financial firm, and that when following the ownership structure backwards, the family is at the end of the chain of control.

From an agency point of view, as pyramids may trigger governance problems – increasing the possible expropriation of minority shareholders' wealth and managerial entrenchment (Morck & Yeung 2004) – corporate governance structures may differ for Type I and Type II family firms. Therefore, we propose the following hypothesis:

*H6: FF2 firms will have, to a larger extent, corporate governance structures that may enhance insider entrenchment and opportunistic behav-*

iour (larger board size, less board independence, fewer board committees, more duality, and longer Chairman tenure) than FF1 firms.

### 3. DATA AND VARIABLES

#### 3.1. Sample

Our initial database comprises all companies quoted on the Electronic Market of the Madrid Stock Exchange at the end of 2004. Observations for financial companies<sup>iii</sup> (SIC codes 60–64) were excluded from the initial database owing to their different regulatory and governance characteristics. Foreign companies listed on the Madrid Stock Exchange, for which we were not able to follow their ownership control chains were also excluded. We also excluded from the sample those companies that had not filled in the Annual Corporate Governance Report at the Spanish Supervisory Agency (Comisión Nacional del Mercado de Valores [CNMV]). After applying these filters, the number of non-financial companies included in the sample stood at 132 (67.34% of the non-financial firms traded on the Madrid Stock Exchange).

Firm accounting data were supplied by the Madrid Stock Exchange. We manually collected data on significant shares and board composition from the data filled in by the companies at the Spanish Supervisory Agency and the companies' Annual Corporate Governance Reports for the year 2004.

FF1 firms amount to 31 cases out of the 132 sample firms. They belong mainly to the real estate industry (65 SIC code): 22.5% of FF1 firms. FF2 firms amount to 35 cases and belong mainly to holdings and other investment offices industries (67 SIC Code): 17.14% of FF2 firms. When taking into account both types of family

ii Although we only measure ownership to define FF1 firms and not the presence of the family in the board of directors, these two concepts are related. Ownership or control rights implies chairs in the board of directors. Therefore, to define a firm as a FF1, taking into account other criteria, for example, family presence on board, does not add anything new, as families also controlled the board of directors.

iii Several studies report the differences between financial and non-financial firms (Prowse 1997; Stoney & Winstanley 2001; Macey & O'Hara 2003).

firms simultaneously (FF), the number of family firms amounts to half of the sample firms: 66 cases. Again, family firms belong mainly to the real estate industry (16.66%), to the holdings and other investment offices industry (67 SIC code, 12.12%) and to the food and kindred products industry (20 SIC code, 10.6%). Non-family firms (NFF, 66 cases), come mainly from the holding and other investment offices industry (67 SIC code, 14.85%) and to the electric, gas and sanitary services (49 SIC code, 12%). These data reveal the importance of family firms among Spanish listed firms as already pointed out by previous studies (Galve & Salas 1993; La Porta et al. 1999).

**TABLE 1: DESCRIPTION OF VARIABLES**

Variables	Description
<b>PANEL A: OWNERSHIP STRUCTURE</b>	
Owncon	Continuous variable that measures the stock held by the four largest shareholders excluding directors' holdings
Dirowsns	Continuous variable that measures the percentage of stock in the hands of the board of directors
Freefloat	Continuous variable that measures the stock ownership in the hands of minority investors (100% - OWNCON)
<b>PANEL B: CORPORATE GOVERNANCE VARIABLES</b>	
<i>Board of Directors' Composition</i>	
Bexdir	Percentage of executive directors (insiders) over total number of directors
Bmaindir	Percentage of directors representing major shareholders (outsiders) over total number of directors
Bindpdir	Percentage of directors representing independent shareholders (outsiders) over total number of directors
Bodir	Percentage of grey outside directors over total number of directors
Boutdir	Percentage of outside directors (BMAIN+BINDP+BODIR)
Binsmaindir	Sum of insiders and nominee directors over total number of directors
<i>Other Corporate Governance Variables</i>	
Bsize	Number of directors
Dual	Dummy variable that adopts value 1 if the CEO and Chairperson is the same person and 0 otherwise
Chairtenure	Continuous variable that measures the number of years the Chairperson has been occupying the post (2006 minus first appointment year)
Famceo	% of family firms where the CEO is a family member
Famchairman	% of family firms where the Board Chairperson is a family member
<i>Board Committees Existence</i>	
Excom	Dummy variable that measures whether the executive committee exists
Auditcom	Dummy variable that measures whether the audit committee exists
Nomcom	Dummy variable that measures whether the nominating and remuneration committee exists
Strategycom	Dummy variable that measures whether the strategy committee exists

(Continued)

**TABLE 1: DESCRIPTION OF VARIABLES** (*Continued*)

<b>Variables</b>	<b>Description</b>
<b>Board Committee Composition</b>	
Mainexdir	Number of main shareholder directors on the executive committee over total directors on the executive committee
Indpexdir	Number of independent directors on the executive committee over total directors on the executive committee
Exexdir	Number of executive directors on the executive committee over total directors on the executive committee
Otexdir	Number of others directors on the executive committee over total directors on the executive committee
Mainauditdir	Number of main shareholder directors on the auditing committee over total directors on the auditing committee
Indpauditdir	Number of independent directors on the auditing committee over total directors on the auditing committee
Exauditdir	Number of executive directors on the auditing committee over total directors on the auditing committee
Otauditdir	Number of other directors on the auditing committee over total directors on the auditing committee
Mainnomdir	Number of main shareholder directors on the nominating committee over total directors on the nominating committee
Indpnomdir	Number of independent directors on the nominating committee over total directors on the nominating committee
Exnomdir	Number of executive directors on the nominating committee over total directors on the nominating committee
Otnomdir	Number of other directors on the nominating committee over total directors on the nominating committee
Mainstrdir	Number of main shareholder directors on the strategy committee over total directors on the strategy committee
Indpstrdir	Number of independent directors on the strategy committee over total directors on the strategy committee
Exstrdir	Number of executive directors on the strategy committee over total directors on the strategy committee
Otstrdir	Number of other directors on the strategy committee over total directors on the strategy committee

**PANEL C: FAMILY FIRM VARIABLES**

FF1	Dummy variable that adopts value 1 if a firm is owned directly or indirectly by an individual or a family who has more shares than the rest of the significant shareholders together (over the 10% threshold), and zero otherwise
FF2	Dummy variable that adopts value 1 if there is a pyramidal structure and the ultimate owner (when following chains of control) is a family or an individual who has more shares than the rest of the significant shareholders together, and zero otherwise
FF	Dummy variable that adopts one if the firm is considered a family firm either by criteria one (FF1) or criteria two (FF2) and zero otherwise
NFF	Dummy variable that adopts one when the firm is not a family firm and zero otherwise
Generation	Dummy variable that adopts for family firms value one if the family firm is on the second or subsequent generation and zero otherwise (first generation)
Nff1	Inside the FF1 firms, NFF1 is a dummy variable that adopts value 1 if a firm is not defined as an FF1 firm and zero otherwise
Nff2	Inside the FF2 firms, NFF2 is a dummy variable that adopts value 1 if a firm is not defined as an FF2 firm and zero otherwise

(Continued)

**TABLE 1: DESCRIPTION OF VARIABLES** (*Continued*)

Variables	Description
Famex	Percentage of family executive directors (insiders) over total number of executive directors
Fammaint	Percentage of family directors representing major shareholders (outsiders) over total number of main directors
Famindp	Percentage of family directors representing independent shareholders (outsiders) over total number of independent directors
Famot	Percentage of family grey outside directors over total number of grey directors
Famacom	Number of family directors on the audit committee over total directors on the audit committee
Famnomcom	Number of family directors on the nominating committee over total directors on the nominating committee
Famexcom	Number of family directors on the executive committee over total directors on the executive committee
Famstratgcom	Number of family directors on the strategy committee over total directors on the strategy committee
Size (AT)	Firmtotal assets in thousand euros

the two types of firms defined under the criteria (FF1 and FF2). A family firm is defined as a firm whose main largest shareholder (either direct, indirect or through a pyramidal structure) is a family. NFF firms include all the firms that do not fit within this definition.

The significance of possible differences in the corporate governance structures of family versus non-family firms and FF1 and FF2 family firms (in mean values<sup>iv</sup>) was tested using the non-parametric tests (Mann-Whitney U tests). A Chi-squared test was run to test statistical differences for dichotomous variables.

## 4. RESULTS

Table 2 provides descriptive statistics for the whole sample. The mean size of the firms in the sample is 1,881,035 euros. On average, for all sample firms, the four largest shareholders (OWNCN) hold 50.71 % of firm shares. This figure highlights the high ownership concentration of Spanish quoted companies as already reported by previous studies (Sacristán & Gómez 2007; La Porta et al.

1999). Director ownership (DIROWSNS) stands at 23.2% (mean value) with a maximum of 95.75%. Boards of directors are mainly comprised of nominee directors (42%), followed by independent directors (32%), and executive directors (22%). In sum, outsider directors represent 77% of Board. The mean board size is 10.27 directors. Duality is present in about half of the sample, and Chairman tenure is average 13 years. Regarding Board committees, almost all the firms have a mandatory audit committee (98%), more than 60% have a nominating and remuneration committee (66% of the firms) and less than 50% have an executive committee (42% of the firms), but only 11% of sample firms have a strategy committee. The composition of Board committees also reflects the importance of nominee directors within Spanish firms. Nominee directors are highly represented within the executive committee (23% of members) and nominating and remuneration committee (35% of members), while independent directors are the main group within the auditing committee (44% of members).

<sup>iv</sup> Differences in corporate governance structures for the sub-samples of firms (in median values) were also tested. The results are similar as when using median differences and are therefore not reported.

<sup>v</sup> Although not shown, as expected, a lot of the variables that have been analysed are strongly correlated. Size is positively correlated with the existence of the Nominating and Remuneration committee and with the existence of the Executive committee. Size is also positively related to board size and free float but negatively related to the proportion of insider directors.

**TABLE 2: DESCRIPTIVE STATISTICS**

Variable	n	Mean/% (dichotomous variables)	Median	SD	Min	Max
<b>Ownership Structure</b>						
Owncon	131	50.71%	52.26%	23.49	0.07%	99.33%
Dirowns	132	23.22%	11.27%	2.5	0	95.75%
FreeFloat	131	49.29%	47.74%	23.49	0.67%	99.9%
<b>Board of Directors Composition</b>						
Bexdir	132	22%	18%	16%	0	67%
Bmainmdir	132	42%	41%	26%	0	100%
Bindpdir	132	32%	33%	21%	0	89%
Bodir	132	3.5%	0	9.7%	0	60%
Boutdir	132	77%	81%	16%	33%	100%
Binsmainmdir	132	64%	66%	22%	0	100%
<b>Other Corporate Governance Variables</b>						
Bsize	131	10.27	10	4.181	3	21
Dual	132	55%	1	0.50	0	1
Tenure	132	13.05	9	11.69	2	64
<b>Board Committee Existence</b>						
Excom	131	42%	0	5%	0	1
Auditcom	131	98%	1	12.3%	0	1
Nomcom	131	66%	1	47.4%	0	1
Strategycom	131	11%	0	32%	0	1
<b>Board Committees Composition</b>						
Mainexdir	92	23%	0	29%	0	1
Indpexdir	92	13%	0	20%	0	75%
Exexdir	92	20%	16%	24%	0	1
Otexdir	92	2.6%	0	13.2%	0	1
Mainauditdir	127	41%	33%	30%	0	1
Indpauditdir	127	44%	40%	29%	0	1
Exauditdir	127	9.5%	0	14.4%	0	40%
Otauditdir	127	4.7%	0	14%	0	67%
Maintnomdir	103	35%	33%	30%	0	1
Indpnomdir	106	34%	33%	31%	0	1
Exnomdir	106	9%	0	16%	0	67%
Otnomdir	106	4.1%	0	13%	0	67%
Mainstrdir	119	3.8%	0	14%	0	75%
Indpststrdir	119	3.9%	0	14%	0	75%
Exstrdir	119	1.7%	0	8.2%	0	67%
Otstrdir	119	1%	0	3.8%	0	0
<b>Others</b>						
AT	132	1,881,035	259,064	5,655,265	2,161	51,497,250

## 4.2. Family firm corporate governance structures: Differences between family firms and non-family firms

Following hypotheses 1 to 5, we analyse possible differences between family and non-family firm corporate governance structures (Table 3).

The results suggest no significant differences in firm ownership concentration or free-float, although family firm directors do own a larger fraction of firm shares (as a mean). Family firm director ownership amounts to an average 33.53%, while for non-family firms it is 12.90% - significant at  $p < 0.01$ . Differences found in director ownership between family and non-family firms are in line with US results (Anderson & Reeb 2003; Villalonga & Amit 2006), revealing that family firm directors, especially nominee and inside directors, hold significant stakes in firm shares.

The proportion of internal or executive directors (BEXDIR) is also different for FF and NFF firms. On average, family firm boards have more executive directors (27%) than non-family firms (17%), significant at  $p < 0.01$ . This result supports H1 which predicts that family firms should present a lower proportion of independent directors.

What is surprising, and contradicts H1, is that family firms have fewer nominee directors (on average, 38%) than non-family firms (47%), significant at  $p < 0.05$ . This difference may be partially due to the fact that family influence may not only be reflected in the figures of nominee directors. Family members may be part of firm management teams, and consequently be represented within the Board as executive directors. The results show that the joint proportion of executive and nominee directors is similar for family and non-family firms. Furthermore, the proportion of independent directors does not differ for family (30%) and non-family firms (33%). Summing up, family firms have more executive directors (that is, insiders) and conse-

quently fewer outside directors (BOUTDIR) (on average, 72% for FF versus 83% for NFF), significant at  $p < 0.01$ . These results are similar to those reported for S&P 500 firms in the US by Ali et al. (2007). For the UK, Hillier and McColgan (2004) also report statistical differences for outside directors between family and non-family firms.

Our results suggest no under-representation of independent directors among family firm boards or over-representation of nominee directors, but an under-representation of outside directors. Family firm boards seem to be more dominated by insiders, who are most likely family members but do not present a lower proportion of independent directors in favour of nominee directors as was proposed in Hypothesis 1.

Relating to board size, the mean value of board size (BSIZE) stands at 10 directors, which is lower than the maximum of 15 directors established by the Spanish Unified Code of Best Practice (2006). This figure is similar to the one reported for the US by Barnhart et al. (1994) and Yermack (1996) (about 12 directors). For the UK, Franks & Mayer (1997) report a mean board size of 8 directors<sup>vi</sup>. While family firm boards comprise an average 9.27 directors, non-family firms comprise an average 11.29 directors; significant at  $p < 0.05$ . A similar result was obtained by Hillier and McColgan (2004) in the UK. In contrast, Batholomeusz and Tanewski (2006) did not find differences in board size between FF and NFF. Our results suggest that family firm boards are smaller than non-family firms, as proposed by Hypothesis 2, probably in part because of the smaller size of family firms, but this may not be the only reason. Family control of the board may not be as easy as board size increases, and families may be reluctant to increase the number of directors so as to retain control.

CEO duality (DUAL) accounts for 55% of cases for the whole sample. Although as a mean,

<sup>vi</sup> Nevertheless, one has to consider that, given the smaller size of Spanish listed firms, board sizes are larger than for the comparable company in the US.

duality in family firms is slightly higher (59%) than in non-family firms (52%), the difference is not statistically significant. These results do not support H3a.

TABLE 3: DIFFERENCES BETWEEN FAMILY (FF) AND NON-FAMILY FIRMS (NFF) (MEAN VALUES)

Variable	FF mean (n = 66)/% (dichotomous variables)	NFF mean(n = 66)/% (dichotomous variables)	Mean difference	DIFFFNFF Mann Whitney-U (Z) /Chi-squared (dichotomous variables)
Owncon	51.38%	50.03%	1.35%	-0.377
Dirowsns	33.53%	12.91%	20.62%	-4.93***
FreeFloat	48.62%	49.97%	-1.35%	-0.38
Bexdir	27%	17%	10%	-4.028***
Bmaindir	38%	47%	-9%	-1.985**
Bindpdir	30%	33%	-3%	-0.25
Bodir	4%	3%	1%	-0.72
Boutdir	72%	83%	-11%	-4.13***
Binsmaindir	65%	63%	2%	-0.05
Bsize	9.27	11.29	-2%	-2.93**
Dual	59%	52%	5%	0.76
Tenure	16.24	9.86	6.38	-3.29***
Excom	34%	50%	-16%	3.51*
Auditcom	100%	97%	3%	2
Nomcom	57%	76%	-19%	5.2**
Strategycom	12%	11%	1%	0.094
Mainexdir	15%	30%	-15%	-2.45**
Indpexdir	9%	16%	-7%	-1.80*
Exedir	25%	17%	8%	-0.54
Otexdir	1%	4%	-3%	-0.35
Mainauditdir	40%	43%	-3%	-0.59
Indpauditdir	42%	46%	-4%	-0.54
Exauditdir	13%	6%	7%	-3.07**
Otauditdir	5%	5%	0	-0.06
Mainnomdir	32%	38%	-6%	-0.95
Indpnomdir	34%	35%	-1%	-0.32
Exnomdir	8%	10%	-2%	-0.36
Otnomdir	4%	4%	0%	0
Mainstrdir	5%	3%	2%	-0.74
IndpStrdir	3%	5%	-2%	-0.02
Exstrdir	2%	1%	1%	-0.45
Otstrdir	1%	1%	0	-0.61
<b>AT</b>	<b>603.878</b>	<b>3.158.193</b>	<b>-2.554.315</b>	<b>-3.31***</b>

FF is a dummy variable that adopts one if the firm is considered a family firm either by criteria one (FF1) or criteria two (FF2) and zero otherwise.; NFF is a dummy variable that adopts one when the firm is not a family firm and zero otherwise, DIFFFNFF is a dummy variable that adopts value 1 if the firm is a FF firm and zero if the firm is a non-family firm. For dichotomous variables a pearson chi-squared test was run.

\*\*\*p<0.001; \*\*p<0.05; \*p<0.10

Table 4 relates duality with the family generations: 16 family firms are first generation firms, while 50 firms are run by second or subsequent generations. Duality is found in 39 of the family firms, but the chi-squared test reveals no association between duality and family generations, thus the results do not confirm Hypothesis 3b.

Regarding Chairman tenure in family firms, they amount on average to 16.25 years, a figure substantially higher than that found for non-family firms (9.8 years); significant at  $p < 0.01$ <sup>vii</sup>. This result supports Hypothesis 4.

Regarding board committee existence (H5a), we find no statistical differences between family and non-family firms for auditing committees (a mandatory committee in Spain). Looking at the non-compulsory committees, family firms tend to establish to a lesser extent nominating and remuneration committees (significant at  $p < 0.05$ ) as well as executive committees (significant at  $p < 0.10$ ) than non FF. These results, although we must say that they may be partly related to firm size, seem to support H5a, and point to the lesser use that family firms may make of internal mechanisms of corporate governance.

Regarding the composition of the board committees (H5b), the results show differences in the composition of the executive and auditing committees between family and non-family firms, but no differences are found for the nominating and remuneration committee or for the strategy committee. For the executive committee, differences between family and non-family firms are found regarding the proportion of nominee directors.

Non-family firms have more directors representing large shareholders (30%) than family firms (15%), (significant at  $p < 0.05$ ), but family firms have fewer independent directors (9%) on the executive committee than non-family firms (16%) (significant at  $p < 0.10$  level).

Auditing committees are comprised almost equally of directors representing large shareholders and independent directors. Nevertheless, it is worth noting that inside directors, contrary to what is recommended by most Codes of Best Practice, are still represented on this committee. Moreover, family firm auditing committees have more executive directors (13%) than non-family firms (6%); significant at  $p < 0.05$ .

Within the nominating and remuneration committee, nominee directors (32%) and independent directors (34%) account for almost the same proportion, followed by executive directors (8%) and grey directors (4%). No statistical differences are found in the composition of the nominating and remuneration committees between family and non-family firms.

Finally, regarding the strategy committee, a residual committee that is only present in 15 firms, the composition does not differ between family and non-family firms.

Summing up, family firm executive committees are comprised of less nominee directors than those of non-family firms (nearly double the proportion), and present a lower proportion of independent directors. Also, family firm auditing committee composition is biased towards insiders (executive directors). These results support H5b

TABLE 4: RELATIONSHIP BETWEEN DUALITY AND GENERATION FOR FAMILY FIRMS

Duality	First generation	Two or more generations	n	Chi-squared test
No	8	19	27	
Yes	8	31	39	
<i>n</i>	16	50	66	0.722

vii We have deleted the firm which has the maximum value (64 years) and repeated all the empirical analysis and the results remain similar. Mean tenure of family firms is then 15.51 years and for NFF firms about 9.86. The differences are still significant at 0.01 levels.

only where it refers to the auditing committee. Similarly to what was observed for the whole board, family firm auditing committees seem to be over-represented by insiders.

#### 4.3. Family firm ownership structures and corporate governance

In order to test H6, we analyse whether there are differences in corporate governance structures between the two types of family firms (FF1 and FF2) (see Table 5).

The sample contains 31 family firms under the FF1 definition, and 35 family firms under the FF2 definition. Although FF2 firm size, as a mean, is almost double FF1 firm size (significant at  $p < 0.10$ ), we do not find significant differences in their corporate governance structures. Family firms, despite their size, seem to establish similar corporate governance structures. Statistical differences between the two types of family firms – in terms of their corporate governance structures – are only found in: firm board size,

**TABLE 5: DIFFERENCES BETWEEN FF1 AND FF2 CORPORATE GOVERNANCE VARIABLES (MEAN VALUES)**

	FF1 mean/Percentage	FF2 mean/Percentage (for dichot. Vrbles.)	DIFF1FF2U Mann Whitney (Z)/ (for dichot. Vrbles.)	Chi-squared (for dichot. Vrbles.)
<b>Ownership Structure</b>				
Owncon	50%	53%	0.109	
Dirows	36%	31%	-0.77	
Free Float	50%	47%	-0.11	
<b>Board of Directors Composition</b>				
Bexdir	28%	27%	-0.21	
Bmaindir	37%	39%	-0.37	
Bindpdir	32%	29%	-0.55	
Bodir	0	5%	-0.67	
Binsmaindir	65%	66%	-0.04	
Boutdir	72%	73%	-0.129	
<b>Other Corporate Governance Variables</b>				
Bsize	8.48	9.97	-1.75*	
Dual	64%	54%	0.837	
Tenure	17.8	14.86	-0.91	
Family Chairman	65%	54%	1.462	
Family CEO	61%	54%	0.33	
<b>Board Committee Existence</b>				
Excom	30%	37%	3.85	
Auditcom	100%	100%	2	
Nomcom	47%	66%	7.835**	
Strategycom	17%	9%	1.138	
<b>Board Committee Composition</b>				
Mainexdir	11%	17%	-0.35	
Indpexdir	10%	8%	-0.36	
Exexdir	32%	20%	-1.12	
Otexdir	3%	0%	-1.86*	
Mainauditdir	37%	42%	-1.15	(Continued)

**TABLE 5: DIFFERENCES BETWEEN FF1 AND FF2 CORPORATE GOVERNANCE VARIABLES (MEAN VALUES) (Continued)**

	<b>FF1 mean/Percentage</b>	<b>FF2 mean/Percentage (for dichot. Vrbles.)</b>	<b>DIFF1FF2U Mann Whitney (Z)/ (for dichot. Vrbles.)</b>
			<b>Chi-squared (for dichot. Vrbles.)</b>
Indpauditdir	43%	41%	- 0.05
Exauditdir	16%	10%	- 1.38
Otauditdir	3%	6%	- 0.62
Mainnomdir	27%	34%	- 0.78
Indpnomdir	31%	36%	- 0.26
Exnomdir	15%	5%	- 2.20**
Otnomdir	5%	4%	- 1.01
Mainstrtdir	6.6%	3%	- 1.09
Indpstrtdir	4%	2%	- 0.67
Exstrtdir	3.5%	1%	- 1.23
Otstrtdir	1.4%	0%	1.58
<b>Family Firm Variables</b>			
Famex	44%	42%	- 0.23
Fammaint	31%	34%	- 0.66
Famindp	3.8%	1%	- 1.18
Famot	0%	3%	- 1.65*
Famacom	18%	23%	- 0.83
Famexcom	17%	17%	- 0.38
Famnomcom	25%	18%	- 1.11
Famstratgcom	2%	2%	- 0.178
Generation	71%	80%	0.730
<b>Others</b>			
SIZE	316.869	858.086	- 1.88*
Number of firms	31	35	

FF1 is a dummy variable that adopts value 1 if a firm is owned directly or indirectly by an individual or a family who has more shares than the rest of the significant shareholders together (over the 10% threshold), and zero otherwise. FF2 is a dummy variable that adopts value 1 if there is a pyramidal structure and the ultimate owner (when following chains of control) is a family or an individual who has more shares than the rest of all the significant shareholders together, and zero otherwise. DIFF1FF2 is a qualitative variable that adopts value 1 if the family firm is a FF1 firm and two if the family firm is a family firm under the FF2. For dichotomous variables a pearson chi-squared test was run.

\*\*\* $p < 0.01$ ; \*\* $p < 0.05$ ; \* $p < 0.10$ .

board committee existence, board committee composition and the type of family directors.

Regarding board characteristics, FF2 firms have slightly larger boards (significant at  $p < 0.10$ ) than FF1. This result supports partially H6, but we find that other board characteristics – such as duality, CEO tenure, family chairperson, family CEO or family members among firm top executives – are similar for FF1 and FF2 family firms.

Regarding board committees, FF1 firms seem to use less internal control devices than FF2

firms. FF1 firms establish less nominating and remuneration committees than FF2 (47% of the cases versus 66% of the cases; significant at  $p < 0.05$ ), but other differences do not turn out to be statistically significant.

Regarding board committees' composition, again we do not find many differences between FF2 and FF1, although FF1 executive committees have a larger proportion of other type of directors (3%) (significant at  $p < 0.10$ ) than FF2 (0%).

For the nominating and remuneration committee, we again find no statistical differences between both types of firms except in the proportion of executive directors. FF1 firms have more executives on this committee than FF2 firms (15% versus 5%; significant at  $p < 0.05$ ), but no differences are found in the composition of auditing and strategy committee. These results contradict H6.

There are also no other differences between FF1 and FF2 regarding the number of firms that have a family Chairman, a family CEO, in the proportion of family directors, or in the proportion of different types of family directors within firm committees.

Summing up, these results do not confirm H6 as we do not find significant differences between FF1 and FF2 corporate governance structures. We only find differences in board size. As a consequence, we cannot affirm that differences in the way the family shareholders hold their shares determine family firm corporate governance structures.

Although not shown, when we analyze possible differences between FF1 and NFF1 and between FF2 and NFF2, the results confirm that differences are really driven by the idiosyncrasy of being a family firm, more than by the use of control devices. In FF1 firm directors hold larger fractions of firm shares and the proportion of executive directors is larger. The number of outside directors is larger for NFF1 firms than for FF1 firms. FF1 firm board size is smaller than NFF1 firms and Chairman tenures are longer for FF1 firms. FF1 firms use the nominating and remuneration committees less than NFF1 firms, and have more insiders in the auditing committee and nominating and remuneration committee. More types of directors within the strategy committee are present in FF1 firms than for NFF1 firms. When comparing FF2 with NFF2, the results are similar.

These results reinforce the idea that differences in firm corporate governance structures are mainly in the family origin of the firms, and not in the control devices used by families.

## 5. DISCUSSION AND CONCLUSION

This paper describes the main differences in firm corporate governance structures between family firms and non-family firms, and analyses whether different family ownership configurations affect corporate governance structures. It aims only to describe family firm board characteristics in the Spanish context and not to prescribe family board best practices.

The results suggest that board characteristics are not linked to different family ownership configurations. Pyramidal structures do not seem to alter family firm board composition but family firm corporate governance structures do exhibit characteristics of Continental models of corporate governance – which involve companies with a concentrated shareholder base and family members active in management and the board. As a result, Spanish family firm boards tend to be dominated by insiders (who are mostly family members). Moreover, for family firms, Chairman tenure is longer than for non-family firms. Whether using pyramidal structures or not, families, when present, seem to hold the majority of the shares and control of the firms in which they invest. Directors hold more shares in family firms than in non-family firms. Also, family firm use of committees is lower compared to non-family firms. The higher percentage of executive directors within family firms is also reflected in the composition of the auditing and the executive committees.

Summing up, these results suggest an insider control of corporate governance structures for family firms, owing to a higher presence of family executive directors on family firm boards. The fact that family firm boards show a lower percentage of nominee directors points to the higher involvement of families in firm management.

From an agency point of view, these characteristics of family firms could lead to the entrenchment of families and opportunistic behaviours. Furthermore, these characteristics contradict the recommendations of most Codes of Best Practice, since they may contribute to the possibility of extraction of private benefits from control by

families. Nevertheless, one has to remember that these Codes have frequently been written from an agency theory perspective and may not have taken into account the specificities of family firms. Distinctive family corporate governance practices may not necessarily be negative as the effect of family control could be better than professional control.

This research suggests the importance of corporate governance for family firms and the need to continue studying this topic. Academics need to adapt corporate governance prescriptions to family firm characteristics. We have studied the implications of different family ownership configurations in a descriptive way, but further implications, particularly the impact of such differences on firm value, should also be analyzed.

The managerial implications of the paper suggest that family firms should be proud of being different. To have small, active but internal boards could be fine. Only strategy dysfunctions could motivate organizational changes and board composition changes. Family firm associations may promote corporate governance codes to maintain these differential characteristics and advance family firm corporate governance practices.

Further implications of the paper are related to policy makers. Laws and Codes should respect family firm differences. Laws should not enforce a uniform behaviour. Codes of Best Practices, soft-laws, are mainly based on the corporate governance practices of non-family firms, and may not be adequate for family firms.

Future studies could relate family firm corporate governance differences to firm value and adopt a longitudinal perspective. Future studies could also analyse the reason for employing pyramidal structures in the presence of sufficient control power by families.

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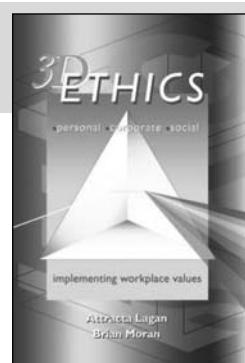
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