The Governance Effect of Different CEO Successors' Status in Family Firm

Yili Bian

{a18758155069@163.com}

School of Business Administration, Zhejiang Gongshang University, Hangzhou, Zhejiang, China

Abstract: At present, our country is in a special period of economic transition and social transformation, where many companies are accelerating the transformation into digital organizational forms. Family businesses are becoming increasingly cautious in their selection of successors for the next generation. Due to the clear identity differences between family CEOs and non-family CEOs in family businesses, attitudes towards the two groups may also differ, leading to bifurcation bias. This paper takes Chinese family businesses as samples and analyzes the impact of identity differences between family successor CEOs and non-family CEOs on corporate governance effects from Bifurcation bias and social emotional wealth theory. The study finds that for most Chinese family businesses, sticking to family management will be a better choice, which can greatly reduce the risks of succession. Family businesses also need to consider the issue of corporate succession as early as possible and select suitable successors for training, so that the power transition can occur as soon as possible.

Keywords: Family firm; CEO status; Coexistence of two generations; Bifurcation bias; Enterprise Performance

1 Introduction

Family businesses, which possess both family ties and contractual attributes (Pan et al., 2019)[1], are widely present worldwide and play an irreplaceable role. Currently, Chinese family businesses are in a peak period of leadership transition and power transfer. Existing research indicates that only one-third of family businesses survive to the second generation (Ward, 2016)[2]. And the global economy is currently experiencing a boom in the digital wave, with businesses accelerating their transformation into digital organizational forms (Huang et al., 2018)[3]. In this dynamic and unpredictable background, family businesses are becoming increasingly cautious in their selection of successors for the next generation. Influenced by the traditional "family culture", most of the business founders are unwilling to entrust their businesses to "outsiders", and prefer to entrust their family enterprises to their children. However, some founders also consider the wishes and capabilities of their children, and choose to hire professional managers to manage their businesses. However, due to the obvious identity differences between family CEOs and non-family CEOs in family businesses, attitudes towards the two groups may also differ (Kano et al., 2018)[4]. And this unfair treatment will affect the family members or non-family members of the family enterprise's enterprise performance.

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Academic research on the performance of family-owned and professionally managed companies has long been controversial. Han et al. (2005)[5] argue that an external succession model is more conducive to corporate reform and innovation. Su et al. (2012)[6] argue that family members not only possess relevant professional skills, but also have the opportunity to participate in decision-making, possess unique resources, and can produce a multiplication effect. Gao et al. (2018)[7] found that internal successors are more familiar with the company, are less likely to cause upheaval and chaos, and have a smaller impact on the process of inheritance. Therefore, it is necessary to examine the effectiveness of family governance in China, especially the performance differences caused by different successor CEO identities. In this study, based on a sample of Chinese listed family businesses, we will examine the impact of family successor CEO identity differences on corporate governance effects from bifurcation bias and social emotional wealth theory, answer the impact and differences of family control and professional characteristics, and analyze the mechanisms of the effectiveness of family and professional governance in China, providing empirical testing from the Chinese market for the efficiency debate between family and professional management.

2 Research hypothesis

2.1 The Identity Difference and Corporate Performance

Differing from the principal-agency theory commonly used by scholars in the past, Verbeke and Kano (2012)[8] explained the phenomenon of bifurcation bias in family firms from the perspective of transaction costs. They also provided a new perspective on the performance difference between family CEOs and non-family CEOs. Family firms often treat family members differently from non-family members (Daspit et al., 2018)[9]. Family firms often have stronger emotions towards family members (Gomez-Mejia et al., 2011)[10].At the same time, there is a certain connection between disparity treatment and social emotional wealth. In many cases, the reason for disparity treatment is that the family hopes that family members can stay in the company to maintain family harmony, influence, and intergenerational transmission, among other social emotional wealth (Verbeke & Kano, 2012; Berrone et al., 2012)[8][11]. Therefore, it is further proposed:

H1: The performance of family firms managed by second-generation family CEOs is higher than that of family firms managed by professional CEOs.

When professional managers are insensitive to disparities, unfair perceptions will be relatively weaker. At this time, they will be more willing to acquire higher pay or better resumes to show themselves, in order to actively enhance the image and business level of the company. External professional managers are less sensitive to disparities that exist in family firms than internal professional managers, so they can better exert their own abilities and professional knowledge, Therefore, we further propose:

H2: Family firms managed by external professional managers outperform family firms managed by internal professional managers.

When the first generation and the second generation coexist, family firm founders often have more positive emotions towards family members (Zhu et al., 2018)[12], especially their own children, and tend to give more favorable treatment to second-generation family CEOs (Zheng et al., 2020)[13]. This is the phenomenon of bifurcation bias, and the attitude of the founder also affects the extent of bifurcation bias within the family firm.

H3: When the first generation and the second generation coexist, second-generation family CEO is more conducive to improving corporate performance compared with professional managers.

However, for internal professional managers, due to their long-term work in family firms and the prolonged feeling of the phenomenon of disparity treatment within the enterprise, they are more sensitive to this phenomenon (Jennings et al., 2018)[14]. Therefore, even if they become successor CEOs, as long as the founders are still in office, they will be subject to some supervision and restrictions in terms of recruitment, promotion, salary treatment, supervision, and evaluation. In contrast, external professional managers are less sensitive to the phenomenon of bifurcation bias and can better exert their professional abilities compared with internal professional managers. Therefore, we propose the following hypotheses:

H4: When the first generation and the second generation coexist, family firms managed by external professional managers outperform family firms managed by internal professional managers.

2.2 Theoretical Model

The theoretical model of this article is shown in Figure 1.

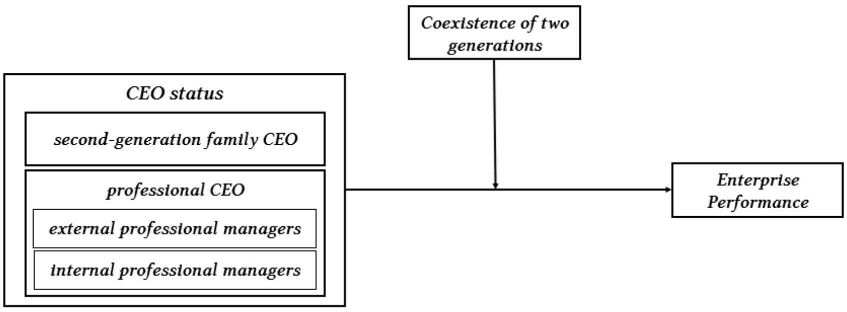

Fig. 1. Theoretical Model

3 Research design

3.1 Research Variable

This article uses 2008-2020 Chinese listed family firms as samples for empirical analysis. The data sources of this article include the Family Enterprise Database of CSMAR and annual reports, and other required data is manually sorted and processed based on the in-depth information of A-shares in the RoyalFlush. Other data is from websites such as Sina Finance and Ping An Securities. After screening and sorting, the total number of samples for statistical analysis in this article is 742, of which 269 are valid panel data.

All variables and their specific representations in this article are as follows:

Dependent variable: Corporate performance (Roa), net income / total assets.

Independent variable: Successor identity (Suc, dummy variables), Suc = 1, indicating that the CEO of a family business is the second generation; if Suc = 0, it indicates that the successor is a professional manager. Professional manager identity (Pro, dummy variables), Pro = 1, indicating internal professional managers; if Pro = 0, it indicates external professional managers.

Moderator variable: Whether the founder was on the board of directors in the year of succession (Gen1, dummy variables). If Gen1 = 1, it indicates that the founder was in office; if Gen1 = 0, it indicates that the founder was not in office.

Control variables: Firm size (lnAsset), natural logarithm of the number of employees in the year of succession. Age of the company (Fage), the total number of years since the establishment of the company to the year of succession. Debt to asset ratio (Lev), total liabilities / total assets. Return on Equity (Roe), net income / average shareholders' equity. Concentration of equity (Ec), the shareholding percentage of the largest shareholder. Board size (lnMsize), natural logarithm of the number of directors in the year of succession. Gender of the successor (Gender, dummy variables), if the CEO's gender is male, it is 1, otherwise it is 0. Age of the successor (Age), total years since birth to the year of succession. Education level of the successor (Edu), 1 if high school, junior college, or below, 2 if junior college, 3 if undergraduate, 4 if master's degree, and 5 if doctorate or above, otherwise 0. Overseas study and work experience of the successor (Ose, dummy variables), if the CEO has overseas study or work experience, it is 1, otherwise it is 0. Industry (Industry, dummy variables), if manufacturing is 1, otherwise it is 0. Region (Area, dummy variables), if the south is 1, otherwise it is 0.

3.2 Research Model

Taking into account previous studies, this paper uses multiple linear regression to test the impact of different successor CEOs on performance and the moderating effect of whether the founder is in office.

First, linear regression is conducted without considering the independent variable and the moderating variable to examine the relationship between enterprise performance and control variables, and construct model 0 as follows:

$$\text{model 0: } ROA = \alpha_0 + \alpha_i \sum CONTROL + \varepsilon \tag{1}$$

Where, represents the control variables, andis a random disturbance term.

Second, in model 0, the dependent variable is added, and the sample is grouped to build models 1 and 2 to test the relationship between different successor CEOs and family firm performance.

$$\text{model 1: } ROA = \alpha_0 + \alpha_1 Suc + \alpha_i \sum CONTROL + \varepsilon \tag{2}$$

$$\text{model 2: } ROA = \alpha_0 + \alpha_1 Pro + \alpha_i \sum CONTROL + \varepsilon \tag{3}$$

Finally, the moderating effect of whether the founder is in office on the relationship between the successor CEO and enterprise performance is tested by adding the moderator variable and its interaction with the independent variable to models 1 and 2, respectively, and building models 3 and 4.

$$\text{model 3: } ROA = \alpha_0 + \alpha_1 Suc + \alpha_2 Gen1 + \alpha_3 (Suc \times Gen1) + \alpha_i \sum CONTROL + \varepsilon \tag{4}$$

model 4: $ROA = \alpha_0 + \alpha_1 Pro + \alpha_2 Gen1 + \alpha_3 (Pro \times Gen1) + \alpha_i \sum CONTROL + \varepsilon$ (5)

4 Empirical Analysis

4.1 Descriptive Statistics

The descriptive statistics for the entire sample are shown in Table 1.

Table 1. Descriptive Statistics for the Entire Sample

Name	Sample	Min	Max	Average	S.D.	Median
Roa	269	-0.370	0.660	0.053	0.103	0.049
Suc_1.0	269	0.000	1.000	0.446	0.498	0.000
Pro_1.0	149	0.000	1.000	0.738	0.441	1.000
Gen1_1.0	269	0.000	1.000	0.691	0.463	1.000
lnAsset	269	2.770	11.600	7.231	1.196	7.250
Fage	269	3.000	38.000	16.338	6.569	16.000
Roe	269	-2.690	0.989	0.051	0.350	0.081
Lev	269	0.042	1.940	0.427	0.223	0.419
Ec	269	0.101	0.900	0.343	0.174	0.303
lnMsize	269	2.300	3.640	2.874	0.240	2.890
Gender_1.0	269	0.000	1.000	0.922	0.269	1.000
Age	269	24.000	69.000	40.937	8.024	41.000
Edu	269	0.000	5.000	3.450	0.899	4.000
Ose_1.0	269	0.000	1.000	0.212	0.409	0.000
Industry_1.0	269	0.000	1.000	0.740	0.440	1.000
Area_1.0	269	0.000	1.000	0.781	0.415	1.000

4.2 Correlation Analysis

The correlation coefficient between Roa and the successor CEO who is the second generation is 0.209 and is significant at the 0.001 level, indicating that there is a significant positive correlation. The correlation coefficient between Roa and the identity of the successor as an internal professional manager is 0.077, close to 0, and the p-value is 0.348>0.05, indicating that there is no correlation. From the magnitude of the correlation coefficient, most of the indicators have absolute values below 0.5, which indicates that the degree of correlation between the variables is low, so it can be prelimin.

4.3 Regression Analysis

This paper uses a multiple linear regression analysis method to examine the relationship between successor CEO identity differences and corporate performance. First, the control variables and corporate performance are regressed using the full sample data, which is model 0. Second, the independent variable is added to model 0 in sequence - the successor CEO as the second generation, and internal professional manager CEO. Two groups of sample data are used for regression, respectively, which are models 1 and 2. The specific regression results are shown in Table 2. Model 1 uses the sample of the successor CEO as the second generation, and according to the regression results, the coefficient of the independent variable Suc_1.0 is 0.024 and is significant at the 5% level, meaning that the successor identity as the second generation will have a significant positive impact on Roa, thus hypothesis H1 is verified. Model 2 uses the sample of the internal professional manager CEO, and the regression results show that the coefficient of the independent variable Pro_1.0 is 0.015, but it does not pass the significance test, so hypothesis H2 is not supported.

To test the moderating effect of the coexistence of two generations, we used models 1 and 2 as the basis and regressed the interaction term between the successor CEO and the founder in the year of succession. From the regression results, the coefficient of the interaction term between the successor CEO as the second generation and the founder in the year of succession in model 3 is 0.036 and is significant at the 5% level, indicating that the coexistence of two generations has a positive moderating effect on the relationship between the successor CEO as the second generation and corporate performance, which also verifies hypothesis H3. The coefficient of the interaction term between the internal professional manager CEO and the founder in the year of succession in model 4 is -0.046, but it is not significant, indicating that hypothesis H4 is not supported.

Tabel 2. Regression Result

Name	Model 0	Model 1	Model 2	Model 3	Model 4
lnAsset	-0.012**(-3.245)	-0.013***(-3.524)	-0.010* (-2.094)	-0.012***(-3.382)	-0.011*(-2.209)
Fage	-0.001*(-2.059)	-0.002* (-2.496)	-0.002(-1.958)	-0.002*(-2.523)	-0.002(-1.799)
Roe	0.214***(16.709)	0.212***(16.630)	0.206***(12.731)	0.213***(16.739)	0.206***(12.739)
Lev	0.032(1.601)	0.029(1.453)	0.076**(2.877)	0.030(1.496)	0.082**(3.054)
Ec	0.073**(2.898)	0.059*(2.247)	-0.014(-0.289)	0.053*(2.051)	-0.010(-0.203)
lnMsize	-0.027(-1.463)	-0.022(-1.193)	-0.034(-1.240)	-0.023(-1.241)	-0.038(-1.396)
Gender_1.0	0.004(0.285)	0.006(0.377)	-0.010(-0.389)	0.003(0.179)	-0.006(-0.235)
Age	0.000(0.672)	0.001(1.770)	0.001(1.160)	0.001*(2.008)	0.001(1.327)
Edu	0.005(0.980)	0.005(1.075)	0.005(0.682)	0.005(1.108)	0.004(0.585)
Ose_1.0	-0.004(-0.353)	-0.006(-0.539)	0.002(0.128)	-0.005(-0.512)	-0.001(-0.036)
Industry_1.0	-0.007(-0.773)	-0.010(-1.045)	-0.018(-1.369)	-0.012(-1.252)	-0.019(-1.422)
Area_1.0	-0.001(-0.116)	-0.002(-0.222)	-0.015(-1.057)	-0.002(-0.209)	-0.019(-1.302)
Suc_1.0		0.024*(2.179)		0.001(0.045)	
Pro_1.0			0.015(1.127)		0.047*(1.984)
Gen1_1.0				-0.006(-0.449)	0.043(1.632)
Suc_1.0*Gen1_1.0				0.036*(1.986)	
Pro_1.0*Gen1_1.0					-0.046(-1.596)
Sample	269	269	149	269	149
R^2	0.613	0.62	0.591	0.628	0.6
Adjusted R^2	0.595	0.601	0.552	0.606	0.555
F	F(12,256)=33.840 ***	F(13,255)=32.060 ***	F(13,135)=15.017 ***	F(15,253)=28.486 ***	F(15,133)=13.288 ***

4.4 Robustness Check

To test the reliability of the empirical results, this paper uses the Variance Inflation Factor (VIF) method to test the multicollinearity of the independent variables, as shown in Table 3. All the VIF values in the model are less than 5, indicating that there is no multicollinearity problem, and thus ensuring the reliability of the regression results.

Table 3. VIF Result

	VIF	VIF
Suc_1.0(1)	1.897	-
Pro_1.0(2)	-	1.058
Gen1_1.0(3)	1.251	1.439
lnAsset(4)	1.194	1.285
Fage(5)	1.206	1.368
Roe(6)	1.261	1.385
Lev(7)	1.249	1.408
Ec(8)	1.306	1.364
lnMsize(9)	1.243	1.292
Gender_1.0(10)	1.023	1.170
Age(11)	1.750	1.169
Edu(12)	1.084	1.239
Ose_1.0(13)	1.149	1.179
Industry_1.0(14)	1.156	1.215
Area_1.0(15)	1.081	1.205

5 Conclusion and discussions

This paper selects the data of A-share listed family enterprises in China from 2008 to 2020 as the research object. Through empirical analysis, this paper draws the following conclusions:

(1) In the transition economy with China as the background, the performance of family enterprises managed by the second generation of family CEOs is better. "Family culture" thinking has long existed, and Chinese family fathers have a stronger "other-oriented behavior" tendency than Westerners, making it easier to occur in family enterprises.

(2) There is no significant relationship between the performance of family enterprises and professional managers. The average lifespan of Chinese family enterprises is still short, and the sense of unfairness felt by internal professional managers and the sense of unfairness felt by external professional managers are not very different.

(3) The phenomenon of two generations coexisting will have a significant positive moderating effect on the governance effect of second-generation family CEOs. The gradual power transfer of the founder allows the company and the second generation to have more time, reduces the management mistakes of the successors, and thus forms an effective internal pacification mechanism.

Through the above analysis, this article provides insights on how to select and cultivate a successor CEO more conducive to corporate governance effects in family businesses: Firstly, due to continuous technological and market developments, for most Chinese family businesses, maintaining family ownership would be a better choice. It can minimize succession risks and contribute to enhancing business performance. Secondly, family businesses need to consider enterprise inheritance issues at an early stage and select suitable candidates for training. Allowing for an early transition of power enables the family business to smoothly pass through the inheritance phase and adapt more effectively to the constantly changing environment.

However, the identity and form of successor CEOs are diverse, such as other family members taking over the business, among others. These scenarios were not discussed in detail in this article, which may lead to different conclusions.

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