

# DO FAMILY CEOS IMPACT FIRM VALUE? AN EMPIRICAL ANALYSIS OF INDIAN FAMILY FIRMS

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## Abstract

We study the association between family CEO and firm value on a sample of 288 family firms during the 6-year period, from 2009 to 2014. The sample is drawn from domestic private companies belonging to non-financial services sector included in the NSE CNX 500 index. We find that family CEO has no significant association with firm value, when the family is not the majority shareholder. Family shareholding has positive relationship with firm value, but does not moderate the relationship of family CEO with firm value. We show that family CEO and firm value are negatively related when the family does not hold majority equity stake in the family firm. While family shareholding has no significant relationship with firm value, it has a negative interaction effect on the relationship between family CEO and firm value. The research findings have important implications for family firms as well as the nonfamily investors in the family firms.

**Keywords:** CEO, Firm Value, Family Firms

**JEL Code:** G34,

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## 1 Introduction

Family firms are rampant all over the world. About 90% of the incorporated businesses in US are owned and controlled by families. (Poza, 2007) Strong presence of families is found in about one-third of S&P 500 corporations (Anderson & Reeb, 2003) and in Fortune 500 companies. (Shleifer & Vishny, 1986) Reins of more than two-thirds of East Asian firms are held by founding families. (Claessens et al., 2002) The family run firms constitute around 44% in Western Europe. (Faccio & Lang, 2002) According to the survey carried out by Credit Suisse (2011), around 67% of the Indian listed companies are controlled by founding families. As a result, India represents largest chunk of family businesses in Asia. Previous works on family firms show that family businesses are more enduring (See for example, Bhattacharya & Ravikumar, 2001), perform better (Anderson & Reeb, 2003) and are more strong (Jones & Rose, 1993) in comparison to non-family businesses. Research is carried out to learn the reasons for the success of these family businesses as they are prevalent all over the world and offer successful business models. There is abundance of research studies on the relationship between family involvement and firm performance. (See for example, Anderson & Reeb, 2003) Research is carried out testing various theoretical viewpoints alternating from agency theory (Schulze, et al., 2003), stewardship theory (Miller et al., 2007), socio-emotional wealth theory (Gomez-Mejia et al., 2001) to resource based angle of firm. (Sirman and Hitt, 2003) However, the question 'Does family CEO enhances the firm value or erodes firm value?' is yet to be answered decisively. (See for example, Chung & Chan, 2012) We answer this question by evaluating the relationship between family CEO and firm value. Our analysis also considers the possible moderating effect of family ownership on the relationship between family CEO and firm value.

Earlier works highlight the need for relating the research findings of family firms' performance to the institutional context of the study before drawing inferences on the principal-agent (PA) and principal-principal (PP) conflicts. (See for example, Bhagat et al., 2010; Liu et al., 2012) According to Bhagat et al., (2010), robust managerial theories should be evaluated in various institutional backgrounds. India's institutional framework which implements the corporate governance regulations is characterised by lack of institutional activism (See for example, Sarkar & Sarkar, 2012), absence of pressure on corporate disclosure, presence of political networks that eases evasion of regulations (Khanna & Palepu, 2000) and less developed capital market and managerial market. We study the relationship between family CEO

and firm performance in India which has the largest number of family firms in Asia. Study of family firms in India that evaluates the impact of family CEO on firm performance is scanty. Hence, we contribute immensely to the study of family firms by filling in the gap in knowledge about the impact of family CEO on firm performance in India, an unexplored context.

We find that family CEO has no association with firm value and family shareholding has a positive relationship with firm value when family is the major shareholder. Family shareholding has no moderating effect on the relationship between family CEO and firm value. When the family is not a major shareholder, family CEO has a negative association with firm value and family shareholding is found to be positively related to firm value. Family shareholding has a negative interactive effect on the relationship between family CEO and firm value.

The rest of the study is organised as follows: Section 2 describes the related theory and reviews the related literature. Section 3 presents the methodology. Section 4 describes the results and the final section interprets the results and discusses the implications.

## **2 Theoretical background and literature review**

We test the relationship between family CEO and firm value from the agency theory perspective. Family firms normally employ a family member in the CEO position. (See for example Peng & Jiang, 2010) According to the PA view of agency theory, conflicts of interests may arise in a family firm between the family shareholders and a non-family professional CEO due the separation of ownership and control issue. (See for example, Jiang & Peng, 2011) A family CEO in a family firm, on the other hand, may help to reduce this problem because of the alignment of interests between the family shareholders and the family CEO. This may result in better firm performance. However, the PP agency theory viewpoint presents a tangentially opposite effect. According to this line of argument, a family CEO in a family firm may give rise to PP conflict. Because of the alignment of interests between the family CEO and family shareholders, there could be a conflict of interest between family shareholders and non-family shareholders. (See for example, Dharwadkar et al., 2000) Family shareholders may pursue their own interests at the cost of the nonfamily shareholders in a family firm. (See for example, Classens et al., 2000) Because a family CEO may place the family shareholders in a family firm in an undue advantageous position, the PP conflict may get more critical. This could pull down firm performance. (See for example, Fama & Jensen, 1983; Lemmon & Lins, 2003) To sum up, PA and PP viewpoints of agency theory suggest two extremely opposite impact of family CEO on a family firm's performance.

Empirical results are mixed. Some works show that family CEO enhances the firm performance. (See for example, Anderson & Reeb, 2003; Villalonga & Amit, 2006) There are also evidences to believe the contrary. (See for example, Peng & Jiang, 2010; Westhead & Howorth, 2006) Various reasons and arguments are put forth by either result. (See for example, Liu et al., 2012; Peng & Jiang, 2010) According to Peng and Jiang (2010), the relationship between family CEO and firm performance is complex. Circumstances in which the falls in the PA costs are compared with the increased costs of PP will have to be studied. This will explain why family CEO enhances firm performance or diminishes firm performance. Some researchers (See for example, Peng & Jiang, 2010; Jiang & Peng, 2011) argue that the rigorousness of PA and PP conflict depends on the institutional and legal framework of the context of study. Level of shareholders protection in a country will decide the value of family CEO. That is why, it is important to study the relationship between family CEO and firm performance in specific contexts and interpret the results in a context specific manner. Previous works cite ownership structure as one of the most important sources of PA and PP conflicts. (See for example, Lemmon & Lins, 2003; Shleifer & Vishny, 1997) Ownership concentration is widespread phenomenon all over the world. (See for example, Faccio & Lang, 2002; Laeven & Levine, 2008) Ownership concentration defines the distribution of ownership and control among large shareholders in a firm. Researchers argue that interests of investors can be protected through two major mechanisms, regulatory framework and concentrated ownership. The two mechanisms can alternate each other. (See for example, La Porta et al., 1999; Young et al., 2008) Varied levels of ownership concentration will have different effects on PA and PP conflicts. Earlier studies have documented evidence to show that value of family CEO to the family firm performance is dominated by the PA and PP conflicts. (See for example, Claessens, et. al., 2002). We study the moderating effect of family shareholding on family CEO and firm performance.

## 2.1 Hypotheses

We test the following hypotheses. As we see from the literature reviewed, level of ownership concentration may result in varying the nature of relationship between family CEO and firm performance. We classify the family firms into two groups; family firms in which the family is the majority shareholder and family firms in which the family is not the majority shareholder. We study the association between family CEO and firm performance in each of these two categories of family firms.

1. Association between family CEO and firm performance will be influenced by the family ownership concentration level.
  - 1.a. Relationship between family CEO and firm performance will be positive in family firms where the family is the majority shareholder. Alignment of interests between family CEO and the majority family shareholders may enhance firm performance.
  - 1.b. Relationship between family CEO and firm performance will be negative in family firms where the family is not the majority shareholder as it may provide an undue advantage to the family shareholders. This could help family shareholders extract private benefits from the firm at the cost of nonfamily shareholders.
2. Family shareholding will interact with family CEO and impact the association with family CEO and firm performance.
  - 2.a. Family shareholding will have a positive interactive effect on family CEO in firms where family holds the majority of equity shares.
  - 2.b. Family shareholding will have a negative moderating effect on family CEO in firms where the family does not hold the majority of equity shares.

## 3 Methodology

### 3.1 Definition of family firm

Research on family firms show that cash flow rights may differ from control rights due to the effect of pyramiding and crossholding by promoters in family firms. Hence, interpreting the results of analysis based on just the cash flow rights of family shareholders could be misleading. Previous works study equity chains encompassing both direct and indirect equity stake. (See for example, Claessens et al., 2002)

Indian data does not suffer from this issue. Disclosure of information on shareholding information by categories of shareholders is governed by Clause 40A of the Listing Agreement in India. Shareholding information is classified as promoters' shareholding and non-promoters shareholding. Promoters' shareholding includes data on shareholding held by both promoters and the persons acting in concert. Hence, information on insiders' shareholding includes the share investments held by other bodies corporate in the promoters group as well. Thus, Indian data on insiders' shareholding relates to control rights and not the cash flow rights.

Existing research on family firms define a firm as belonging to a family firm category along varied factors. Chua et al., (1999) present a review of family business definition adopted by family research studies since 1964. A firm is categorised as a family firm if

- a. family holds majority of shares. (See for example, Barontini & Caprio, 2006)
- b. many members from the founding family serve as directors on the board of the firm. (See for example, Rutherford et al., 2008)
- c. leadership is held by a family member. (See for example, McConaughy et al., 2001)
- d. control is passed on from one generation to the subsequent generations in the family. (See for example, Chrisman et al., 2003)

Most works incorporate more than a single criterion in the categorisation exercise. (Anderson & Reeb, 2003; Arosa et al., 2010, Chu, 2009) We follow this trend and use both family ownership level and family leadership to classify a firm as a family firm. Companies Act, 1956 of India stipulates that just 26% stake in equity is sufficient to stop special resolutions from being passed by the firm. Firms with a family shareholding of 26% or above with family involvement in management should possess the ability to influence the managerial decision making process in the firm and hence may impact firm performance. Corporate governance regulations in India stipulate the requirements on the size of independent directors on the board on the basis of the position of the chairman. If the board has a non-executive non-promoter

chairman, the firm can just include independent directors equal to the one-third of the total board size. In case the chairman is a promoter or an executive, the firm should have independent directors equal to 50% of the board size. Hence, the basis minimum requirement is one-third of the board should comprise of independent directors. We believe that if the board has equal of number of family directors, the family can influence the decisions of the firm. We also include firms that have the family shareholding of less than 26% with a family CEO in the family firms' category. Firms that fulfil any one of the criteria is classified as a family firm and included in our study.

- a. Firms with a median family shareholding of less than 26% and with a family CEO.
- b. Firms with a median family shareholding of 26% to 50.99% with a family CEO.
- c. Firms with a median family shareholding of 26% to 50.99% with one third of the board composed of family directors.
- d. Firms with a median family shareholding of a simple majority of 51% or above which is sufficient to pass any ordinary resolution which is the requirement for most of the businesses of the firm.

**Table 1.** Distribution of firm-year observations across different family ownership ranges

Family ownership range	Total firm-year observations	Firm-year observations with family CEO	Percentage of firm-year observations with family CEO
Less than 26%	59	59	100.00
26% to 50.99%	787	507	64.42
Below 51%	846	566	66.90
Above 51%	815	550	67.48
Total	1661	1116	67.19

Table 1 groups the firm-year observations studied into different family ownership ranges. Firm-year observations with a family shareholding of less than 51% and more than 51% do not drastically vary in the employment of a family CEO. Around 67% of the firm-year observations in both the categories have a family CEO.

### 3.2 Sample and study period

We study 288 firms with valid 1661 firm-year observations over the study period of 6 years spanning from 2009 to 2014. The sample is drawn from domestic private companies included in the NSE CNX 500 index belonging to non-financial services industry with data on study variables available for the study period. The index is a broad based benchmark on Indian capital market. The CNX 500 index represents about 96.42% of the free float market capitalisation of the stocks listed on India's leading stock exchange, National Stock Exchange as of June 30, 2014.

**Table 2.** Industry wise distribution of sample observations

Industry	Total number of firm-year observations	Number of firm-year observations with family CEO	Percentage of total firm-year observations with family CEO
Automobile	137	68	49.64
Cement	48	29	60.42
Chemicals	60	52	86.67
Construction	191	142	74.35
Consumer goods	261	185	70.88
Energy	72	36	50.00
Fertilisers & Pesticides	35	12	34.29
Healthcare services	18	12	66.67
Industrial manufacturing	166	98	59.04
Information technology	141	88	62.41
Media & entertainment	69	52	75.36
Metals	127	94	74.02
Paper	12	4	33.33
Pharmaceuticals	132	110	83.33
Services	77	53	68.83
Telecommunications	34	11	32.35
Textiles	81	70	86.42
Total	1661	1116	67.19

**Table 3.** Descriptive statistics

Variable	Full Sample				Family Shareholding of 51% or more				Family Shareholding less than 51%			
	N	Mean	Standard Deviation	Range	N	Mean	Standard Deviation	Range	N	Mean	Standard Deviation	Range
Market Capitalisation (rupees crores)	1646	80,310.225	249,790.984	3,433,770.220	810	96,347.357	277,668.202	3,433,558.340	836	64,771.854	218,478.372	3,293,350.220
Family Shareholding	1661	0.5112	0.1522	0.8786	815	0.6354	0.0932	0.3896	846	0.3916	0.0889	0.4889
Total Assets (rupees crores)	1661	6,787.689	18,960.009	318,503.150	815	5,979.924	12,294.371	150,041.010	846	7,565.855	23,650.777	318,503.150
Debt (rupees crores)	1661	1,848.365	4,909.804	73,904.480	815	1,581.561	3,745.662	36,479.680	846	2,105.394	5,805.724	73,904.480
Firm Age	1661	35.934	25.286	149.000	815	31.714	24.478	147.000	846	39.999	25.400	131.000
Sales (rupees crores)	1659	44,637.348	165,228.200	3,711,189.300	813	34,849.174	74,693.925	1,392,694.300	846	54,043.713	219,145.602	3,710,949.900
Risk	1606	1.068	0.340	1.92	770	1.025	0.332	1.720	836	1.107	0.344	1.890

**Table 4.** t-test results

Variable	Firm-year Observations with Family CEO			Firm-year Observations with Non-family CEO			Total			t	df	p
	N	Mean	Standard Deviation	N	Mean	Standard Deviation	N	Mean	Standard Deviation			
Market Capitalisation (rupees crores)	1113	70,831.00	222,681.60	533	100,104.60	297,833.50	1646	80,310.22	249,791.00	2.227	1644	0.026
Family Shareholding	1116	0.5102	0.1540	545	0.5134	0.1484	1661	0.5112	0.1522	0.408	1659	0.683
Total Assets (rupees crores)	1116	6,288.43	20,589.48	545	7,810.03	15,049.79	1661	6,787.69	18,960.01	1.536	1659	0.125
Debt (rupees crores)	1116	1,751.99	5,026.79	545	2,045.71	4,659.39	1661	1,848.37	4,909.80	1.145	1659	0.252
Firm Age	1116	32.53	22.14	545	42.90	29.56	1661	35.93	25.29	7.999	1659	0.000
Sales (rupees crores)	1116	45,930.61	194,916.80	543	41,979.36	73,104.51	1659	44,637.35	165,228.20	-0.457	1657	0.648
Risk	1072	1.08	0.35	534	1.05	0.31	1606	1.07	0.34	-1.582	1604	0.114

Table 2 shows the industry wise distribution of the firm-year observations studied. It can be seen from the table that around 67% of the firm-year observations studies have a family CEO. Less than 50% of the firm-year observations from automobile, fertilisers & pesticides, paper and telecommunications have a family CEO. But, more than 50% of the firm-year observations from all other industries have a family CEO. This shows that family CEO is a prevalent phenomenon across all the industries.

Table 3 presents the descriptive statistics for the full sample, firm-year observations with family shareholding exceeding 51% and firm-year observations with family shareholding less than 51%. Mean values of total assets, debt employed, firm age, sales and risk level of firm-year observations with a family shareholding of less than 51% is higher than the corresponding mean levels for firm-year observations with a family shareholding of more than 51%. However, the average market value of the latter group is higher than the former.

Table 4 gives the t-test results. The analysis presented shows that the firm-year observations with a professional non-family CEO have a mean market capitalisation which is significantly higher than the firm-year observations with a family CEO. Mean value of firm age of observations with a non-family professional CEO is higher than the mean firm age of firm-year observations with a family CEO. All other variables like family shareholding, total assets, debt, sales and risk are not found to be statistically significantly different across the two groups.

Table 5 presents the correlation matrix that shows the correlations for the dependent variable, independent variable and the control variables. It can be asserted that the correlation coefficient between any of the study variables is not high enough to cause a concern.

**Table 5.** Correlation between dependent, independent and control variables

Variable	MTB	FCEO	FS	SIZE	DEBT	AGE	GR	RISK
MTB	1							
FCEO	-.028	1						
FS	.253**	-.010	1					
SIZE	-.078**	-.010	-.038	1				
DEBT	-.348**	.067**	-.055*	.223**	1			
AGE	-.117**	-.162**	-.166**	.094**	.003	1		
GR	-.088**	.003	-.004	.062*	.235**	-.178**	1	
RISK	-.414**	.039	-.112**	.172**	.230**	-.037	.078**	1

\*\* Correlation significant at 0.01 level (2-tailed)

\* Correlation significant at 0.05 level (2-tailed)

MTB: Market-to-Book Ratio

FCEO: Dummy variable assigned 1 when the firm has a family CEO, otherwise 0.

FS: Family shareholding as a ratio of total shares.

SIZE: Total assets in logarithmic form

DEBT: Long-term debt divided by total assets

AGE: Years since firm incorporation in logarithmic form

GR: Year on year growth rate of sales

RISK: Systematic risk

### 3.3 Data

Data for the research is extracted from Centre for Monitoring Indian Economy database, 'Prowess'.

### 3.4 Variables definition

This study employs a market based measure as firm performance variable. A market based measure is the result of the consensus of a large number of independent investors in the market. Hence, we prefer it over an accounting measure which is impacted by the accounting policies of the firm. In line with many of the earlier works, we use market-to-book ratio to capture the firm value. (See for example, Claessens et al., 2002)

MTB is the market-to-book ratio which is the ratio of the summation of market value of common stock, book value of debt and preferred stock to book value of assets.

FCEO is a dummy variable, equal to 1 if the firm has a family member as CEO, otherwise 0.

FS is the family ownership variable, which is measured as the proportion of promoters' shareholding to total shares.

SIZE is the log of total assets.

DEBT is the ratio of long-term debt to total assets.

AGE measures the firm's age since its incorporation. It is represented as the log of number of years since the firm's incorporation.

GR measures the growth of the firm and is defined as the annual growth rate in sales.

RISK is the systematic risk of the firm.

### 3.5 Model

We employ hierarchical linear regression model to test if family shareholding moderates the relationship between family CEO and firm value. The hierarchical regression enters control variables, independent variables and moderation variable in blocks. Initial models run are as follows.

$$MTB = a_0 + a_1SIZE + a_2DEBT + a_3AGE + a_4GR + a_5RISK + \varepsilon \dots \quad (1)$$

$$MTB = a_0 + a_1SIZE + a_2DEBT + a_3AGE + a_4GR + a_5RISK + a_6FCEO + a_7FS + \varepsilon \dots \quad (2)$$

$$MTB = a_0 + a_1SIZE + a_2DEBT + a_3AGE + a_4GR + a_5RISK + a_6FCEO + a_7FS + a_8FCO \times FS + \varepsilon \dots \quad (3)$$

The above models are run on three groupings of data namely the full sample which includes all the firm-year observations, firm-year observations with a family shareholding of less than 51% and firm-year observations with a family shareholding of more than 51%. Since, family firms included in the study also have a family as minority shareholders with a stake of less than 51%, we analyse the data to check out if the results for the family firms with family as minority shareholders and family firms with family as majority shareholders differ.

## 4 Results

Results of the basic models are presented in table 6. It can be seen from the analysis run on the full sample shows family CEO has no statistically significant association with firm value. While family shareholding has a positive relationship with firm value, it is not found to have a moderating effect on the relationship between family CEO and firm value. All control variables except growth rate are found to be statistically significant. Firm size is found to be positively associated with firm value. All other control variables which are significant, level of debt employed, firm age and risk are found to have a negative relationship with firm value.

When we segregate the data into two groups, family firms where family is the major shareholder and family firms where family is not the major shareholder, we find the results differ drastically. In case of firms where family is the major shareholder, we find that family CEO has not found to be statistically significant. Family shareholding is found to have a positive association with firm value. However, we find no evidence to show that family shareholding has moderating effect on the relationship between family CEO and firm value. When the family is not the major shareholder, the family CEO has a negative relationship with firm value. While family shareholding is not found to have any statistically significant relationship with firm value, it found to have a negative interactive effect on the relationship with family CEO and firm value. Growth rate is not found to be significant by the analyses carried out on the two groups for family firms. Level of debt employed and risk are found to be negatively associated with firm value in both the cases. Size has a positive relationship with firm value when the family is not the major shareholder, but is insignificant when the family is the major shareholder. Firm age has a negative association with firm value when the family is the major shareholder, but is not significant when the family is not the major shareholder.

**Table 6.** Moderation regression analysis results testing the interactive effect of family ownership on the relationship between family CEO and firm value

Independent variables	Full Sample			Firm-year Observations with Family Shareholding of 51% or more			Firm-year Observations with Family Shareholding less than 51%		
	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3
Constant	4.258** (16.690)	3.998** (15.529)	3.997** (15.520)	5.424** (10.896)	5.558** (10.877)	5.515** (10.730)	2.647** (11.265)	2.762** (11.516)	2.641** (11.090)
SIZE	0.176** (2.999)	0.184** (3.212)	0.185** (3.216)	0.193 (1.707)	0.124 (1.103)	0.137 (1.203)	0.154** (2.759)	0.174** (3.079)	0.182** (3.257)
DEBT	-2.011** (-11.300)	-1.986** (-11.415)	-1.987** (-11.413)	-1.965** (-6.437)	-1.768** (-5.817)	-1.760** (-5.787)	-1.814** (-10.516)	-1.796** (-10.286)	-1.706** (-9.837)
AGE	-0.591** (-5.370)	-0.475** (-4.304)	-0.476** (-4.306)	-0.857** (-4.317)	-0.812** (-4.049)	-0.811** (-4.046)	-0.135 (-1.268)	-0.195 (-1.816)	-0.174 (-1.638)
GR	-0.094 (-0.131)	0.135 (0.194)	0.136 (0.194)	1.620 (1.350)	1.459 (1.230)	1.455 (1.226)	-1.296 (-1.916)	-1.269 (-1.884)	-1.257 (-1.891)
RISK	-1.463** (-16.326)	-1.371** (-15.555)	-1.370** (-15.532)	-2.032** (-12.325)	-2.044** (-12.459)	-2.050** (-12.479)	-0.778** (-9.337)	-0.752** (-9.035)	-0.720** (-8.732)
FCEO		-0.052 (-0.830)	-0.052 (-0.824)		-0.015 (-0.132)	-0.010 (-0.083)		-0.182** (-3.011)	-0.185** (-3.094)
FS		1.724** (8.844)	1.668** (4.743)		2.737** (4.760)	2.120* (2.201)		0.276 (0.876)	0.540 (1.710)
FCEO×FS			0.080 (0.192)			0.952 (0.799)			-3.443** (-4.718)
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R	0.518	0.550	0.550	0.564	0.581	0.582	0.511	0.520	0.538
R <sup>2</sup>	0.268	0.303	0.303	0.318	0.338	0.338	0.261	0.270	0.289
ΔR <sup>2</sup>		0.035	0.000		0.020	0.001		0.009	0.019
Adjusted R <sup>2</sup>	0.261	0.295	0.295	0.301	0.320	0.320	0.249	0.257	0.275
F	38.789**			19.388**			22.337***		
ΔF		39.686**	0.037		11.368**	0.639		5.023***	22.260**

Dependent variable: MTB

\*\* Significant at 0.01 level

\*Significant at 0.05 level

MTB: Market-to-Book Ratio

FCEO: Dummy variable assigned 1 when the firm has a family CEO, otherwise 0.

FS: Family shareholding as a ratio of total shares.

SIZE: Total assets in logarithmic form

DEBT: Long-term debt divided by total assets

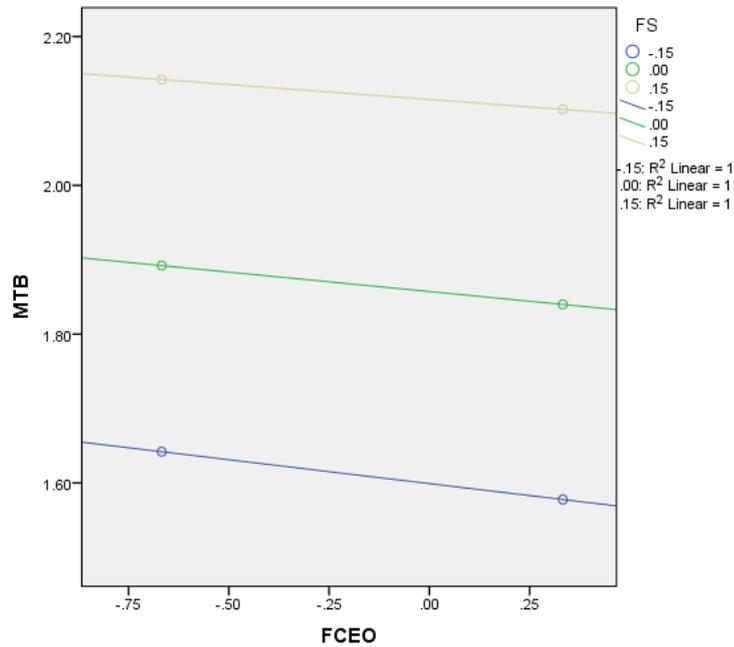
AGE: Years since firm incorporation in logarithmic form

GR: Year on year growth rate of sales

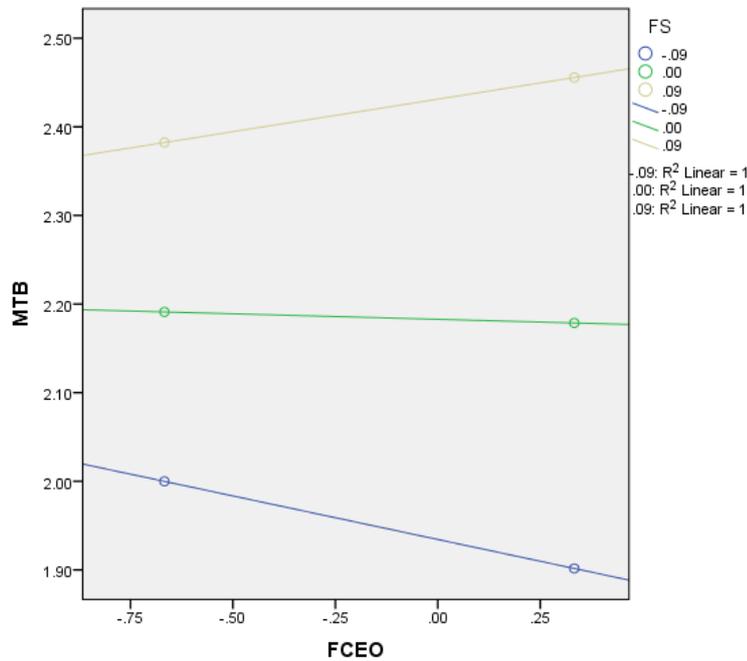
RISK: Systematic risk

Interaction effects are shown in the following figures.

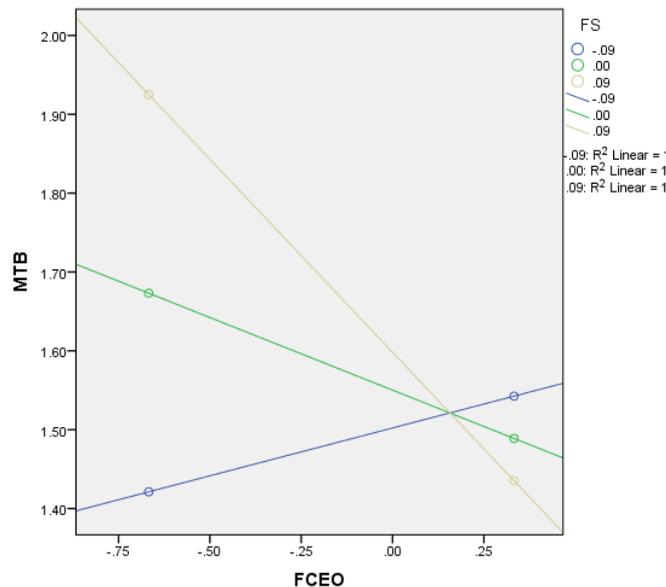
**Figure 1.a.** Full sample: interaction effect of family shareholding on the relationship between family CEO and firm value



**Figure 1.b.** Firm-year observations with family shareholding >51%: interaction effect of family shareholding on the relationship between family CEO and firm value



**Figure 1.c.** Firm-year observations with family shareholding <51%: interaction effect of family shareholding on the relationship between family CEO and firm value



## 5 Discussion of results

We find that family CEO has no association with firm value, when the family is the major shareholder. We show that around 288 of the 500 top Indian firms included in the leading NSE CNX 500 index are family firms that belong to the non-financial services industry. If we include the family firms that belong to the financial services as well, the number will be larger. Around 67% of the family firms employ a family CEO whether the family is the major shareholder or not. Hence, market does not attach any significance to the presence of a family CEO in a family firm, when the family has controlling equity stake. However, family CEO and firm value is found to be negatively related when the family does not hold majority equity shareholding. CEO is the centre of the decision-making process in any firm and can significantly influence its decisions. That CEO can direct business decisions and assumes the most important role among the organizational actors is brought out by many earlier research works. (Minichilli et al., 2010) Appointment of a family CEO gives an undue advantage to the family when it does not have the controlling voting rights. Earlier works show that family shareholders may expropriate non-family shareholders with the help of family CEO. (See for example Villalonga & Amit, 2006) Family may indulge in interested party transactions and accumulate private benefits at the expense of non-family shareholders. Family CEO may widen the information gap between family shareholders and non-family shareholders and use the information asymmetry to their advantage. (See for example, Liu et al., 2012) Hence, family CEO in a family firm has a negative relationship with firm value when the family does not have majority equity stake.

Family shareholding has a positive association with firm value, when the firm is the majority shareholder. Family research shows that strong presence of family improves the earnings quality of family firms. (See for example, Wang, 2006) Lee (2006) argues that family shareholders are keen on the long-run survival of the firms because of their interest in the intergenerational transfer of wealth. They implement strategies focusing on value maximization which benefit the non-family minority shareholders as well. (See for example, McVey & Draho, 2005) Most of the family businesses in India are owned by large business houses of long standing. 230 out of 288 family firms included in this study belong to large Indian business houses which are of good repute. Around 44% of the family firms with an equity stake of above 51% and 50% of the family firms with the family not as the major shareholder have a next generation CEOs leading the firms. This goes to prove that family firms have a strong concern for the reputation and intergenerational transfer of family leadership and wealth. This is positively received by the market.

We find that family shareholding has a negative interactive effect on the relationship between family CEO and firm value, when the family does not have majority shareholding. Family shareholding when considered separately is not found to be significant. Since family shareholding does not have absolute majority voting rights, family may not have significant influence over the firm's decision making process and as a result will not be in a position to gain private benefits. However, even the less than majority shareholding of the family gains the power to impact the firm's decision making process by virtue of its family CEO. This could provide an opportunity for the minority family shareholders to exercise undue influence on the firm through the family CEO and gain private profits. Minority shareholding of family combined with family CEO, as a result has a negative association with firm value.

To conclude, while family CEO has no association with firm value when the family is the major shareholder; family shareholding at less than majority equity stake negatively interacts with family CEO and diminishes firm value. This has an important implication for governance of family firms in India.

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