TOP EXECUTIVE COMPENSATION IN PORTUGUESE FAMILY FIRMS

Ivo Nuno Pereira*, José Paulo Esperança*

Abstract

Performance based compensation is considered a decisive tool in the co-alignment of interest between owners and managers. The solution to agency problems in public corporations hinges critically on the use of variable compensation mechanisms. Empirical analysis of this phenomenon is exiguous and the background theory has been suffering developments, like the introduction of family firm agency problems. This study confirms the larger use of variable compensation by public firms but shows that the potential for using variable compensation in second or third generation family firms is particularly high due to higher potential form conflict emergence between the different stakeholders. The framework used in this paper has the potential to encompass a wide range of phenomena where conflict can emerge and incentives can be used to co-align interests between the different transacting parties.

Keywords: Corporate governance; compensation models

*Both: ISCTE Business School – Lisbon, Portugal
Note: Correspondence concerning this paper should be addressed to José Paulo Esperança, ISCTE Business School, Av. das Forças Armadas, 1649-026 Lisbon, Portugal. Email: jose.esperanca@iscte.pt . Phone: +(351) 967056666.

1. Introduction

Family firms are predominant, not only in less developed capital markets like Continental Europe or Japan, but also in the Anglo-Saxon countries. However, in this region, easier access to capital markets led the largest firms to build up an effective separation between ownership and management. By contrast, in Continental Europe many of the larger firms remain under family control (La Porta et al., 1999, Faccio and Lang, 2002), often with an active management role by the founding family.

This paper draws on theory formulation that compares governance problems, namely the case of compensation as an interest alignment tool, in family and non-family firms. We give special emphasis to the recent argument that the agency problems is not exclusive to public firms, and may be complicated by factors like altruism and emergency of motivations that are not strictly economic. We present literature based hypotheses and the conclusions of a non-parametric analysis of the practice of variable compensation in 102 Portuguese firms in which we compare executive compensation policies of family owned and non-family owned firms. Finally, we summarize the main conclusions and give a set of recommendations for governance and executive compensation in family firms

The main objective of this study is to identify the specificity of family firms, use of variable compensation, a relatively neglected topic in empirical studies on performance related pay.

Another relevant issue in this study is the dynamic nature of agency problems faced by family firms. As they become older, family firms deal with succession problems. We find that benefits of variable pay are related to the age of family firms.

This study confirms the larger use of variable compensation by public firms but shows its benefits for second or third generation family firms, due to higher potential conflicts among different stakeholders.

2. Interest Alignment between Managers and Owners

Are public firms more efficient and prone to survival than family firms? Do these firms have better conditions to generate efficient corporate models, value creating strategies, overcoming succession crisis and attracting better managers? Many experts, academics and government officials offer a positive reply to these questions. This leads to the continuous effort to develop capital markets, use privatizations to promote larger levels of free float and foment initial public offerings (IPOs). The resulting separation between ownership and management is believed to bring about a more dynamic, competitive and prosperous economic environment.

Financial theory suggests that public firms have some limitations and may be managed in sub-optimal ways due to the propension of managers (agents) to pursue specific objectives that defraud the stockholders' (principals) expectations. The agency costs include the drawing effort, control (monitoring) and implementation of contracts between managers and stockholders that guarantee that the agents manage the firms according to the stockholders'

interest (Jensen and Meckling, 1976, Eisenhardt, 1989).

In later years Jensen (1989) expressed his concern with the decline and eclipse of public firms, which seems unable of competing with family and private firms in general. Public firms' poor financial performance revealed their low attention to costs and excessive focus on growth sacrificing profit, maximizing managers' utility rather than the stockholders'. As a corollary of this pessimistic view of public firms, he defends that a conjugation of property and management is an efficient instrument for minimizing agency costs.

Performance based compensation, including variable pay, has been regarded as an efficient mode of co-aligning interest between managers and stock holders. Naturally, this problem is smaller in family firms because management activities are often carried out by owners, reducing the need to enforce compensation mechanisms that turn out expensive. Variable compensation has led to a significant rise of the total amount paid to top executives.

Executive compensation includes a large number of different tools: fixed compensation, bonuses, fringe benefits (car, house, etc.), stock options, company stock, golden parachutes or non-reimbursable loans. The level of total compensation has expanded significantly, in absolute and relative weight. The Economist (October, 2003) shows that the relation between top executive and the workers' average compensation in the US went up from 40 in 1980 to 400 in 2003. A similar trend has been found in other countries, although the growth rate has been smaller. Brennan (1996) observes that between 1980 and 1990 the difference between CEO compensation and average workers' compensation in the UK grew from 10.6 to 22.2. This growth of executive compensation was systematically above the expansion of their firms' profits. The expansion of total compensation was caused mainly by the spread of different types of performance based pay as an attempt to align interests between managers and shareholders.

Recent contributions (Schulze et al., 2002) show the existence of agency problems in the context of family firms which may cause the misalignment of incentives and the creation of distributive injustice. This suggests the need of corporate models that ensure bigger transparency. The problem of compensation in family firms is more complex and relevant than may be inferred from a straight application of agency theory.

Chrisman et al., 2007 find that family business owners tend both monitor and provide incentives to family managers and that performance is improved by doing so. That is, owners in privately held family firms, appropriately, treat family managers as agents in terms of the compensation packages and monitoring mechanisms used. In this study, they link governance efficiency mechanisms of monitoring and incentives to perceived firm performance.

Within public corporations, the separation between ownership and management generates a delegation of the responsibility of management for managers, creating a threat of opportunism or after-contractual moral hazard (Alchian and Woodward 1988). The main problem consists on the possibility of not making decisions as if proprietors. The agency problems (Jensen and Meckling, 1976; Jensen et al., 2004) become particularly acute when they include decisions of high personal cost for the agents such as the firing of workers or the alienation of part of the company; or of straight benefit for the agent, such as the refurbishing of the headquarters or the acquisition of an expensive service vehicle.

Agency problems can be minimized by the adoption of appropriate control mechanisms, either external or internal (Jensen and Meckling, 1976, Schulze et al., 2002). External control can be achieved through the intervention of different markets. Capital markets achieve an efficient allocation of risk among shareholders. There is relevant price information conveyed by share quotation and market discipline is brought in through the hostile take-over threat if management decisions are judged sub-optimal. One example would be the undertaking of expansion or other investment decisions with negative expected positive net present value, for the sake of maximizing the managers' utility function. Product markets convey additional information on customers' evaluation of products or services delivered by the firm. The market for production factors, especially human and management resources must be competitive to enable efficient hiring; and curbing the threat of adverse selection or pre- contractual opportunism by candidates who hide information about their (lack of) relevant skills for the future exercise of the new position (Fama, 1980, Schulze et al., 2002). These external mechanisms can be complemented by the existence of internal control mechanisms such as a board of directors or performance related pay for the managers. Therefore, Jensen and Meckling's model assumes that a lower efficiency of external control mechanisms, in a context of relatively low competitiveness coupled with the absence of internal control structures tend to exacerbate the agency problems. One example is the hiring of top executives, assisted by *head-hunting* specialists, which lowers the effective competitiveness of the job market for executives raising the bargaining power of the few candidates under scrutiny. Further, the board of directors usually displays lack of independence towards the CEO as well as lack of skills or time for the effective monitoring of the strategic decisions made by the CEO. A natural corollary of Jensen and Meckling's model is that private corporations, in which ownership and management converge, are an efficient alternative to public corporations, at least in the context of high agency problems. Jensen's (1989) popular HBR article on "the eclipse of the public corporation" regarded the takeover wave of the 80's as a corporate

governance improvement due to the capital concentration it entailed.

Family firms, as a particular case of privately held corporations, should permit agency cost reduction due to lower level of conflict that is so common in the public corporation. Indeed Jensen et al., 2004, observe that if a manager held one hundred percent of shares, ignoring risk aversion issues, the decisions made by this manager would maximize firm value without requiring an incentive package. Family control lowers the agency problem between owners and managers, but gives rise to conflicts between the family and minority shareholders when shareholders protection is low and control is high (Maury, 2006)

However, a different view has been expressed in a number of studies. The concentration of ownership and control may generate agency problems due to the inefficiency of external control mechanisms that affect these firms (Schulze et al., 2002). As an example, the close control exerted by the owning family seriously bounds the firm's capacity to compete in the factor market where managers and other employees can be hired. For external candidates' equity ownership and career development are limited by the eventual preference that family members may enjoy (Lew and Kolodzeij, 1993; Schulze et al., 2002). Kellemanns and Eddleton´s (2007) investigate how dispersion of ownership among generations of family and extent to which family managers exchange information with one another moderate the relationship between conflict and performance and they show that when conflict and family members exchanges are high, performance improves.

Moreover, being precluded from accessing the capital markets, the family firm faces two additional problems: a "holdup" risk as the owner of a core competence or asset may exert some kind of threat over his co-owners (Rajan and Zingales, 1998); by not being listed shares of family firms do not benefit from the capital markets' disciplinary effect, as the ownership concentration prevents hostile take-over, deferring or preventing the needed replacement of inefficient management practices (Jensen, 1993).

Schulze et al (2002, p. 252) refute the statement that family businesses may do without internal control mechanisms due to the "special relations among deciding agents" as postulated by the standard formulation of agency theory. By contrast, they consider that family relations may generate even more complex agency problems. One such factor is "altruism", or moral values that lead influential family members to benefit their relatives without expecting any kind of retribution. While altruism can be very positive in the context of the family as it strengthens family bonds (Simon, 1993), its repercussions within the family firm may lead to "spoiling" of children or grand-children". This problem is more significant the more asymmetric the altruism level (Schulze et al., 2002). This originates two types of agency problems: horizontal (among brothers) and vertical (between parents and sons). Lubtkin et al. (2007) identify this paternalistic altruism as form of altruism that flows from attempts to provide merit goods (that parents judge to be essential for their childrens´ future success and happiness). These problems are not the exclusive outcome of selfish behavior: information problems make adequate decisions difficult even when there is a common goal of a positive outcome. Schulze et al quote a son's statement: "I loved your gift", which may distort information creating an obstacle for a generous and fair resource distribution by a caring parent. Envy risks, *holdup* and moral hazard are all higher due to these problems.

Schulze et al. (2002) regards altruism as an efficient governance model during the uncertain start-up period, compensating the imperfect capital and labor markets that affect younger firms. At a later stage, the internal constraints of capital and management may lead to strategic inertia" and incentives' missalignment, in which the founder's altruism may generate lack of effort by younger family members and a perception of injustice by managers external to the family. One consequence of altruism may be the uniform compensation of family members working at the firm penalizing the most active and entrepreneurial. These problems affect the governance model suggesting the need to hire independent managers, external to the family, precisely as is generally recommended with regard to public corporations. In fact one study discuss the agency effect of altruism on firm governance and present a contingency influence, based on how the effects of altruism change as firm ownership passes over generations (Lubatkin et al., 2005)

Altruism thus renders the succession problem more difficult within family firms, as confirmed by numerous studies. Two-thirds of family firms fail to transfer to a second generation of family ownership (Handler, 1990). This failure of family firms to transition to second and third generations has prompted researchers to examine the succession process, including demographic and behavioral variables (Marshal et al., 2006)

3. Compensation within Family Firms

Compensation is a key element of the typical conflict of interests between shareholders and other stakeholders. Although these interests can be made compatible and contribute to the long term efficiency of the firm (Carrillo, 2007), efficient management and control mechanisms are required to achieve that goal.

In addition to the general challenges that an efficient compensation policy raises, family firms must deal with the constraints emerging from family bonds. Although many managers posit that their pay policies reflect the standard procedures typical of their industries, regardless of family considerations, this factor may influence both the pay and career policies.

In order to analyze the complexity and extension of determinants for family firms' compensation, it is

useful to take in consideration the "three circle framework" (Figure 1) based on capital, family and firm proposed by Gersick et al. (1997)

.

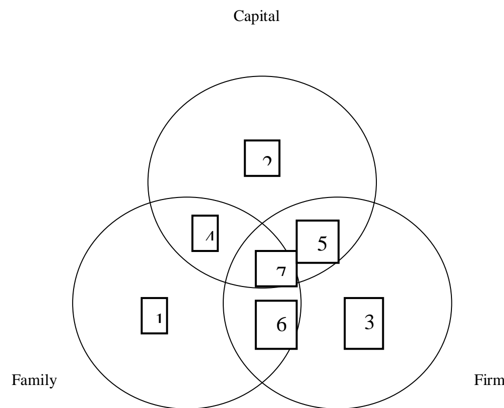

Figure 1. Family Firms' Three Circle Framework

Source: Gersick et al (1997)

The upper circle contains the group of shareholders, while the left circle includes the family members and the right circle represents the firm's employees. It is easy to infer that the interaction levels may vary wildly. Subset 7 represents the family members who are simultaneously shareholders and work for the firm. Group 4 includes family members who own shares but who do not work in the firm. Subset 5 represents non family members who are shareholders and work for the firm. Group 6 represents family members who work for the firm but do not own shares in the firm.

These seven groups have different interests and objectives: a member of group 4 gives higher value to the dividend policy while members of group 6 are more concerned with their professional career and profits plow in for the firm's development. One may add that this group also favors higher salaries and fringe benefits, like public corporations' executives. Information disclosure and transparency goals may also differ significantly across the above groups. Shareholders, especially members of group 2, support a high level of disclosure for the company accounts, while groups who include family members or employees may favor higher levels of opacity. Compensation policy defined by family firms reflects power relations, objectives and level of integration for the above mentioned seven groups. Internal conflicts tend to be smaller at an early stage of the family firm in which group 7 is still highly predominant.

When the three circles overlap, agency problems tend to be small reducing the need for the use of variable compensation as an interest alignment tool. Compensation levels also tend to be modest because the owners / family members / employees are also residual claimants to the wealth to be generated in the future. Current personal savings by the firm's founders can facilitate the financing of the firm, in exchange for the appropriation of future revenues. However, as time goes by and the company expands, the firm needs to recruit new employees and to raise capital from new sources. Moreover, the family also expands enlarging the pool of residual claimants. Successive successions may become critical events, as the centrifugal forces tend to place the circles further apart, aggravating the potential for conflict.

Family firms in which there is some level of separation between management and ownership are prone to agency problems, similar to public corporations, due to interest misalignment between owners and managers. Performance based compensation may also be required to generate an incentive for value creation by managers who do not share ownership. However, one additional problem arises because family firms' performance is harder to measure, especially if they are not listed. Neves (2001) proposes a set of three tools for an appropriate measurement of family business performance. S*tock-options* are a possible interest co-alignment instrument, but only for listed firms. However a number of problems associated with top executives' buy back efforts to preserve declining quotations have highlight a number of shortcomings for this instrument (Esperança, 2000). A second solution can be provided by *companion stock redemption* - the process of buy back of preferential shares. Finally, for listed firms, *phantom stocks,* whose price can be based on accounting or some other estimate of firm value. Some enthusiasts of performance related pay assume that these mechanisms are efficient even in the absence of agency problems. Other authors, however, are more skeptical. Pfeffer (1998) fears that poorly designed compensation schemes may induce forms of opportunism that render this instrument a

source of value destruction rather than enhancement. He provides substantial anecdotal evidence of the dangers associated to performance based pay. Sears discontinued this practice after widespread cheating was found among involved employees. In the software industry he contrasts the high turnover and employee dissatisfaction related to individual performance measurement with the high profitability and employee retention of SAS, a firm that chose a policy of prizes based just on the overall performance of the firm. Jensen et al. (2004) are particularly concerned with the "non-linear pay performance relations once the targets are set". The complex and time consuming budgeting process teaches managers that "those who tell the truth about what they can do get punished by getting more demanding targets". Jensen et al are not as skeptical about the performance related pay at the sub-unit level as Pfeffer, because they believe that a purely linear compensation formula provides no incentive to lie, or to distort information. One may conclude that variable pay is not a costless solution and that it must be implemented only if its benefits outweigh its costs. Schulze et al (2002) observe that most American family firms practice some type of performance based pay, with a shorter or longer range. They reason that this finding is a proof that these firms face some level of agency problems.

4. Sample and Procedure

Given the predominance of family firms, even among those listed on the stock market, Portugal provides an interesting setting for the study of the determinants of top executive compensation in family firms. The link between family firm conflicts and executive compensation that may be found within this context helps in shedding light on compensation policies on a wide range of firms from countries where capital markets and ownership separation are not predominant. Researchers' bias for public corporations can be essentially explained by the availability of large data bases. Some studies also present theoretical predictions that this kind of firms may favor meritocracy better than family, therefore becoming a more efficient type of institution.

Family control is common in publicly traded firms around the world (Burkart et al., 2003). Family firms have now started to receive attention even in mainstream financial economics. A recent study on family firms (Anderson and Reeb, 2003, p. 1301) that looked at the S&P 500 finds that about one-third of those firms are still family owned and that, contrary to the authors' conjecture, these perform better than non-family firms. They also find that better performance can be found when family members serve as CEOs and draw a major conclusion that "our results are inconsistent with the hypothesis that minority shareholders are adversely affected by family ownership, suggesting that family ownership is an effective organizational structure". Another study (Maury, 2006) finds that active family control firms have higher profitability than non family firms. In fact, active family control continues to outperform non-family control, in terms of profitability, in different legal regimes. Although international evidence suggests that families may be unhelpful to firm performance, recent analyses of U.S. public companies indicate that family firms outperform. One study (Miller et al., 2007) investigate measures of family business in U.S., making distinction between lone founder business and family business that include multiple family members as managers, and conclude that only business with lone founder outperform. We tried to go beyond publicly listed firms and built a data set based on a survey. The data set is based on the 500 largest non financial firms, operating in Portugal, identified by the 'Exame' magazine, which provided some accounting and demographic information about those firms. To obtain compensation specific information, we designed a very short questionnaire that was pre-tested with six firms. It was emailed, in the first quarter of 2002, to the human resources director of each firm. Later, we made a follow-up telephone call to speed up the answering process. We obtained 104 answers, of which 102 were complete and included in the study. The response rate was slightly above 20%. In Table 1 we present the distribution of firms within different sectors. Overall it can be observed that family firms are significantly represented in the sample. These firms control key sectors, such as building and construction, hotels, industrial machinery and textiles, that contribute significantly to the domestic product.

We classify our variables in two groups: executive and corporation. Executive variables include level of education (q) (measures whether the executive is a college graduate - this variable takes value 1 if she (he) is a graduate and 0 otherwise) and variable compensation (percentage of the variable compensation in total compensation). Corporation variables include firm age, number of employees, volume of sales, service (if the firm is in the services sector or not - this variable takes value 1 if the firm is in a service sector and 0 otherwise) and location (if the firm is located in Lisbon or not - this variable takes value 1 if the firm is located in Lisbon and 0 otherwise).

5. Analysis and Results

The main objective of this study is to identify the specificity of family firms in contrast to public firms where ownership and management are separated. Following the reasoning presented in the previous sections, we assume that family firms have less agency problems than public corporations. Therefore, we formulate the first hypothesis as:

Hypothesis 1: Family firms use less performance related compensation

Table 1. Number and percent of family and non family firms by industry

Industry Description	Family firms	Public firms	%Family Firms
Buildings and construction	9	2	81,8
Chemical	3	7	30,0
Communications	0	3	0,0
Electric, gas and sanitary services	2	4	33,3
Electronic and electrical equipment	2	5	28,6
Food products	9	5	64,3
Heavy equipment	1	1	50,0
Hotels	2	0	100,0
Industrial machinery	1	0	100,0
Paper products	1	3	25,0
Petroleum and coal products	0	2	0,0
Printing and publishing	2	1	66,7
Retail services	2	3	40,0
Rubber products	0	1	0,0
Services	2	5	28,6
Textile products	2	0	100,0
Transportation by air	1	2	33,3
Transportation equipment	3	9	25,0
Transportation services	3	3	50,0
Wood products	1		100,0
Total	46	56	45,1

Table 2 shows that family firms are not significantly different from public corporations, on variables such as executive education. This finding may seem peculiar for those who expect family firms to favor the hiring of family members for executive positions, in neglect of their skills and training. "Professional" managers from public corporations should, therefore, have better education. Several studies show a different attitude by family firms, at least for the larger ones. Lima (2003, p. 287) analyzed a set of large Portuguese economic groups. One respondent mentioned that "We can no longer keep waiting for family members to fill the firm's positions … The promotion criteria has to be competence, rather than being a family member."

Table 2. Variables, mean difference between family firms and public firms and significance

Variable	Family firms (n = 46)	Public firms (n = 56)	T test Significance
Firm age	38	33,6	
Employees (number)	785	1683	*
Volume of Sales (€ million)	136.9	392.5	**
Services	0,5	0,64	
Location	0,59	0,64	
College degree (%)	87%	88%	
Variable Compensation (%)	9,2%	17,1%	***

Significance: *** 1%; ** 5%; * 10%

We did find a significant difference size – publicly-owned firms tend to be larger than family-owned firms, with larger volume of sales and number of employees. A similar in observation was made by Anderson and Reeb (2003) for the S&P 500 - the average assets of family controlled firms were about 64% of those present in non-family firms. Although in the framework of much larger firms the differences were larger (average assets of $9.6 billion for family firms and $15 billion for non family firms). These observations are consistent with the literature on family businesses that regard family ownership as raising a financial and administrative barrier to further expansion (Chandler, 1990). This is probably a more serious issue for Portuguese family firms than for S&P 500 family firms, therefore explaining the sharper difference found in our sample – the average turnover for family firms was only 35% of the mean for non-family firms. However, even in publicly-owned firms, resistance to surrendering control by the leading family may limit the firm's growth potential.

The most significant difference was found for variable compensation, confirming our hypothesis. The separation of ownership and control calls for more intensive use of interest co-alignment through the use of variable pay. Another relevant issue is the dynamic nature of agency problems faced by family firms. As they become older, family firms must deal with significant succession problems. Schulze et al (2002) considers the role of the altruism effect - the moral value that motivates people to take actions without direct reward. Altruism is positive at the initial stage, in which entrepreneurs face a high level of uncertainty. However, as the firm grows, altruism may cease acting as a cohesion factor. The owner may give "gifts" to family members to compensate them for his absence (Kets De Vries, 1996). On the other hand, the employees that do not belong to the family

(group 3 of Figure 1) may feel negatively discriminated, with a negative impact on performance.

Agency problems that emerge due to the separation of ownership and management tend to be aggravated by the family expansion, with more people claiming residual rights. This problem only intensifies with the transfer of power to a new generation. Therefore, as they face more serious agency problems, older family firms should require a more intensive use of incentives for interest co-alignment, especially between pure shareholders (group 2 in Figure 1) and pure managers (group 3 in Figure 1). This issue is neglected in studies on family firm governance and incentives. One way to address this issue is to relate performance with the utilization of variable compensation, using age as a discriminant factor. The second hypothesis is:

Hypothesis 2: Variable compensation leads to better performance in the older family firms

For testing this hypothesis we obtained the median age and then, for each group, we measured the variable compensation median. Table 4 shows the return on equity for each group. One of the problems of this procedure is the reduced number of observations in each quadrant. The second problem is associated to the measurement of profits, as reported to the 'Exame Magazine', that we use in this study. Although these data are more reliable for larger firms who are usually audited, there is a risk that some firms may understate their revenues, for tax reasons, while others, more concerned with their credit ratings, may present a more rosy picture of their performance.

Table 3. Average return on equity for different age and variable compensation groups

Firm Age	Variable Compensation	
	Low < 8.5%	High >= 8.5%
Young: < 32 years	11.3	4.8
Old: >= 32 years	9.9	9.5

Even after taking into account these issues, we find some interesting results. The group of younger firms – less than 32 years old – is more likely to be managed by the first family generation, therefore facing less agency problems. The efficiency of variable compensation should be lower for this group as it faces less separation between management and ownership. By contrast, the group of firms older than 32 is more likely to be managed by the second or above generation. For this group, variable compensation was expected to bring in the benefits of interest alignment as the separation caused by the drift apart of the circles represented in Figure 1.

Table 3 shows that the performance of older family firms is not affected by the use of variable pay, suggesting that its inherent costs are equivalent to the potential benefits. This observation is consistent with several empirical studies who find no significant relation between the use of variable pay and performance. The more interesting reading of this table is that younger firms who make low use of variable pay enjoy the highest return (11.3%). By contrast, the group of younger family firms with high usage of variable compensation enjoys the lowest return (4.8%) of all four groups, suggesting that this is a costly mechanism that needs to generate compensating benefits to become neutral or beneficial. Younger firms, with low agency problems, do not benefit from variable pay.

6. Conclusion

In this study of 102 Portuguese firms we find evidence that non-family firms make a significantly more extensive use of variable pay than the more closely held family firms, in possible response to higher agency problems and the corresponding need to align interests of managers and owners. This result is consistent with similar studies, carried out in Anglo-Saxon settings and elsewhere.

However, we were also concerned with the specific agency problems of family firms as may be inferred from the traditional "three circles framework" and the inherent aggravation of conflict of interests as one generation leaves place for the next managers and the specific altruistic problems become more important. Variable costs were regarded as a costly interest alignment tool that could be compensated by the benefits of circumventing serious agency conflicts. Although based on a small sample, the results were quite important as they showed that relatively agency problems free first generation family firms display a clearly lower performance as they can not get a return for the significant costs associated with variable pay.

This issue is certainly worth studying with a more representative sample, preferably including firms from different national environments. If confirmed, the results obtained here are paramount in defining appropriate governance structures and conflict avoidance mechanisms within family firms.

Although exploratory, this study raises important issues for management compensation within service firms. While performance related pay seems to be costly and ineffective for young family firms, it seems to become more beneficial within older family firms, as they are prove to higher agency problems. Indeed, the concentration of ownership and management typical of younger family firms, leads this group the appropriate the residual wealth generated by the firm, permitting a more frugal and simple compensation. Younger firms, especially if they enjoy high growth potential, usually face negative or low free cash flows. High cash payments, performance related or not, may become a significant burden that young firms should avoid. The core issue of management compensation in family firms must be researched within a broaden sample, with higher potential for generalization. Although age is a good proxy for management

generalization and agency problems, more detailed information about governance of specific family firms should provide a better link measurement of the benefits of variable pay in family firms. An international comparison is also important to take into consideration the impact of common versus civil law countries (La Porta et al., 1999). This is an exploratory study on a very important theme of corporate governance. The traditional view that family firms are efficient tools for avoiding agency costs has been partially challenged by the more detailed focus on the ownership and management structure of family firms. Altruism has also been regarded as a potential source of agency costs specific to this type of hierarchy. However, the empirical study of this issue is still at its infancy and our results are quite promising. The limited size of the sample precludes a confident generalization off the main findings, calling for a larger and more detailed database in ulterior work. Nevertheless, the methodology used in this study can be replicated to shed more light on the efficiency of governance mechanisms, given the specificity of family firms.

References

1. Alchian, A.A., and Woodward, S. (1988), "The firm is dead: long live the firm: a review of Oliver E. Williamson´s, The economic institutions of capitalism", *Journal of Economic Literature,* vol. 26, pp.65-79.
2. Anderson, R.C. and Reeb, D.M. (2003), "Founding–family ownership and firm performance: evidence from the S&P 500", *The Journal of Finance*, vol. 58 nº 3, pp. 1301-1327
3. Brennan, M.J. (1996), "Executive compensation in the U.K", *Journal of Applied Corporate Finance*, vol.9 No 1, pp. 88-92.
4. Burkart, M., Panunzi, F. and Shleifer, A. (2003), "Family firms", *Journal of Finance*, Vol. 58, pp.2167-2210.
5. Carrillo, E. (2007), "Corporate governance: shareholders´ interests and other stakeholders´ Interests", *Corporate Ownership & Control*, Vol. 4 No 4, pp.96-102.
6. Chandler, A.D. Jr (1990), *Scale and Scope: the Dynamics of Industrial Capitalism,* Belkan Press, Cambridge.
7. Chrisman, J., Chua, J., Kellermanns, F., Chang, E. (2007), "Are family managers agents or stewards? An exploratory study in privately held firms", *Journal ob Business Research*, Vol. 60 Nº 10, pp. 1030-1038.
8. Eisenhardt, K. (1989), "Agency theory: An assessment and review", *Academy of Management Review*, Vol. 14, No 1, pp. 57-74.
9. Esperança, J. (2000), "Modelos de remuneração dos gestores: a perspectiva financeira", *Revista Portuguesa de Gestão*, III série, year 15, No1, pp. 48-54.
10. Facio, M. and Lang, L. (2002), "The ultimate ownership of Western European corporations", *Journal of Financial Economics,* Vol.65, pp. 365-395.
11. Fama, E.F. (1980), "Agency problems and the theory of the firm", *Journal of Political Economy*, Vol .88 No 2, pp. 288-307.
12. Gersick, K.E., Davis, J.A., Hampton, N.N. and Lansberg, I. (1997), *Generation to Generation: Life Cycles of the Family Business. Harvard Business School Press*, Cambridge, MA
13. Handler, W.C. (1990), "Succession in owner-managed and family firms. A mutual role adjustment between the entrepreneur and the next generation", *Entrepreneurship Theory and Practice*,Vol.15 No 19, pp.37-51
14. Jensen, M. and Meckeling, W. (1976), "Theory of the firm: managerial behavior, agency cost and ownership structure", *Journal of Financial Economics*, Vol. 3 No 4, pp.305-360.
15. Jensen, M. (1989), "Eclipse of the public corporation", *Harvard Business Review*, September-October, pp. 61-74.
16. Jensen, M. (1993), "The modern industrial revolutions, exit, and the failure of internal control systems", *The Journal of Finance, Vol.* 48 No 3, pp. 831-880.
17. Jensen, M., Murphy, K.J. and Wruck, E.G. (2004), "Remuneration: where we´ve been, how we got there, what are the problems and how to fix them", *Harvard Business School NOM Research Paper No. 04-28.*
18. Kellermanns, F., Eddleston, K. (2007), "A family perspective on when conflict beneficts family firm performance", *Journal of Business Research*, Vol 60 No 10, pp. 1048-1057.
19. Kets De Vries, M. (1996), *Family Business: Human Dilemmas in the Family Firm,* Thomson Business Press, London.
20. La Porta, R., Lopez-de-Silanes, F. and Shleifer, A. (1999),"Corporate ownership around the world", *Journal of Finance*, Vol.54 No 2, pp. 471-517.
21. Lew, M.I. and Kolodzeij, E.A. (1983), "Compensation in a family owned business", *Human Resources Professional,* Vol. 5 No3, pp. 55-57.
22. Lima, M.A. (2003), *Grandes famílias grandes empresas*, Publicações D. Quixote, Lisboa**.**
23. Lubkatin, M., Schulze,W., Ling, Y. and Dino, R. (2005), "The effects of parental altruism on the governance of family-managed firms", *Journal of Organizational Behavior*,Vol.26 No3, pp.313-330.
24. Lubtakin, M., Durand, R., Ling, Y. (2007), "The missing lens in family firm governance theory: a self-other typology of parental altruism", Journal of Business Research, Vol.60 No 10, pp. 1022-1029.
25. Marshall, J., Sorenson, R., Brigham, K. Wieling, E. Reifman, A. and Wampler, R. (2006), "The paradox to sucession-related processes and plans", *Journal of Business Venturing*,Vol. 21 No 3, pp.348-368.
26. Maury, B. (2006), "Family ownership and firm performance: Empirical evidence from Western European corporations", *Journal of Corporate Finance,* Vol.12 No 2, pp.321-341.
27. Miller, D., Breton-Miller, I., Lester, R., Cannello Jr, A (2007), "Are family firms really superior performers? ", *Journal of Corporate Finance*, In Press, Corrected Proof.
28. Neves, J.C. (2001), "A sucessão na empresa Familiar: A estrutura de governo e o controlo do capital", *Conferência de Finanças*, Universidade dos Açores.
29. Pfeffer, J. (1998), "Six dangerous myths about pay", *Harvard Business Review*, May-June, pp. 109-119.
30. Rajan, R.G., and Zingales, L. (1998), "Power in a theory of the firm", *Social Science Research Network*
31. Schulze, W., Lubatkin, M., and Dino, R. (2002), "Toward a theory of agency and altruism in family firms", *Journal of Business Venturing*, Vol 18, No 4, pp. 473-90.
32. Simon, H.A. (1993), "Altruism and economics", *American Economic Review*, Vol.83 No 2, pp.156-161.