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CEO Succession: Choosing Between Family Member or Outsider?

Noor Afza Amran, PhD

School of Accountancy Universiti Utara Malaysia

06010 Sintok Kedah Malaysia

E-mail: afza@uum.edu.my

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Abstract

Studies discussing on having a family chief executive officer (CEO) or outsider to manage family companies are widely discussed in overseas but little research that actually taking place in Malaysia. Thus, this study examines the relationship between the choices of family or outside CEO with company performance. The sample size of this study was 888 family companies listed on Bursa Malaysia from 2003 to 2007. Interestingly, the findings indicate as expected that family CEO enhanced company performance greater than outside CEO. Within the family company, CEO-successor enhanced the firm value greater than the CEO-founder. More importantly, family companies prefer to have family CEO to manage the company because of strong family cultures, high sense of family unity and belongings within the companies.

Keywords: Succession, CEO, Family Member, Outsider, Malaysia

1. Introduction

Family companies do play an important role in the business activities. However, research documents that family companies have a low survival rate (Ket de Vries, 1993; Morris, Williams & Nel, 1996). One of the factors that lead to low survival rate is the issue of family succession. The family succession will affect whether the succession will help enhance firm performance or not. There are many studies that discuss on the choice between insider or outsider to manage the family companies (Burkart, Panunzi & Shleifer, 2002; Lee, Lim & Lim, 2003), but to my knowledge, limited study that explore this issue in Malaysia. Therefore, this study wants to examine the choice whether better to have family CEO or outsider in enhancing the company performance.

Experts claim that family-owned and managed companies achieve higher performance than those that are professionally managed (Monsen, Chiu, & Cooley, 1968; Daily & Dollinger, 1992; Ang, Cole & Lin, 2000). Villalonga and Amit (2006) found that family ownership only creates value when the founder serves as the CEO or as Chairman with a hired CEO. Anderson and Reeb (2003) result indicate that family companies perform better when the founder is the CEO of the company, but not under the descendant's management. However, study in India by Johl, Jackling and Joshi (2010) also show the significant result when the CEO is from the descendant's family rather than from the founder.

In contrast, empirical studies elsewhere evidence that firms managed by professionals perform better than the founders (Lauterbach & Vaninsky, 1999). The non-family employees or professionals play an important role in the family companies (Chrisman, Chua, & Sharma, 1998; Gallo, 1995; Ibrahim, Soufani, & Lam, 2001). Companies run by a professional manager have a positive impact on the performance (Chittoor & Das, 2007). Professionals possess particular knowledge that is valuable in mentoring of future-generation leaders or in filling the leadership role (Lee et al., 2003). In larger companies, non-family executives also participate in strategic decision-making (Chua, Chrisman & Sharma, 2003). A study in Taiwan by Lin and Hu (2007) shows that family companies require high managerial skills and by using a professional CEO it helps to boost the firm performance.

In Malaysian scenario, it is challenging to get a potential successor who is calibre in managing the family company. Some family companies train their sons or grandsons to be the successors. However, failure occurs when the successors are incapable of handling the tasks. Therefore, sometimes family companies need to include professional management (non-family managers) based merit rather than on criteria such as blood or regional ties (Ping, 2001). This is to ensure the family companies survival. For example, Public Bank Bhd. is controlled by Tan Sri Teh Hong Piow and it is professionally managed by Teh and his managers. Although Public Bank was founded by Teh, but none of his children hold significant positions within the group. Thus, based on the succession issue discussed above, this study aims to find out the answer whether family CEO or outside-CEO is better-off in enhancing the firm value. In term of the contribution of the study, these findings are likely to provide information on the level of succession planning especially in the emerging countries like Malaysia. By carrying out this study, the findings may explain the family succession planning and the corporate governance practices witin the family companies.

In terms of the organization of this paper, it is structured as follows. In the introduction section, an overview on family CEO and outsider with firm performance are discussed. This is followed by the discussion on the motivation, objective and contribution of the study. The second section elaborates on literature reviews. Research methodology is then explained in the next section. Next, this paper highlights a section on results and discussion. The last section covers on the conclusion, limitation and future research.

2. Literature Review

2.1 Succession Planning in Malaysia

In Malaysia, the majority of family companies evolved from traditional family-owned companies. These firms do not embrace openness in the firms' practices and continue to be managed as if they are still owned by their founders (Ow-Yong & Cheah, 2000). A survey conducted by Shamsir Jasani (2002) found that majority of Malaysian family companies are small-scale; founders manage the company with the help from children and relatives; and founders do not force the children to join the firms, unless the children themselves are willing to work with families. For example, the Genting Group is a well-planned succession. The late Tan Sri Lim Goh Tong has appointed a successor to ensure his huge business empire will continue. Lim has passed the baton to his second son, Tan Sri Lim Kok Thay, in December 2003. The Genting Group is involved in gaming, power generation, plantations, and oil and gas. Better known as KT Lim, the 55-year-old tycoon seems to have inherited his father's ability to seize and exploit fleeting opportunities based on the group's swift expansion abroad in recent years. Assisting KT Lim in the global push is his nephew, Justin Leong 28 who is the head of strategic investments (2007, October 24). Other Chinese companies tend to have similar stories.

For Bumiputera companies, some of the notable Malay families in today's market are the Melewar Group founded by Tunku Abdullah Tuanku Abdul Rahman and Sapura Holdings Bhd started by Tan Sri Shamsuddin Abdul Kadir. Both families are now in their second-generation (Ngui, 2002). For a smaller business, Habib Jewel Bhd. is one of the relatively unknown success stories. This company was founded by Habib Mohammad in 1953 in Penang. In 1988, the father (founder) passed the business to the son, Meer Sadik, who has been leading it ever since. Besides, there are also several successful northern Indian textile enterprises operating in Malaysia such as KAJ Chortimall, Globe Silk Store and P Lal Store. These companies are in their third-generation. Unlike the Chinese and Bumiputera companies, the Indian companies have remained basically one-store operations, with little expansion or diversification. The Indian entrepreneurs remained conservative and largely cautious of firm expansion due to the highly competitive industry (Gomez, 2001). Thus, in ensuring the family companies to remain competitive with other non-family companies, strong corporate governance will ensure family companies to last longer. A family company needs to share company vision and must hire professionals to help incorporate the right systems and procedures into the company (Say, 2009).

2.2 Family CEO or Outside-CEO

Proponents of internal successions (family CEOs) stress that the family CEOs have greater knowledge of the firm, and their established social networks (Chung, Lubatkin, Rogers & Owers, 1987). Internal candidates provide a smooth transition and stability because they are well acquainted and have anticipated in developing the existing corporate strategy (Carlson, 1961). Internal successions also promote loyalty and reputation, thus, the family CEO has a strong incentive to ensure a firm's profitability (Davis, Schoorman & Donaldson, 1997).

Experts claim that family-owned and managed firms achieve higher performance than professionally managed (Monsen et al., 1968; Daily & Dollinger, 1992, Ang et al., 2000). Family members often hold key positions in family companies. Owner-managed companies achieve 75% higher profit (ROE) than outside-CEO that managed the companies (Monsen et al., 1968). A study in the US by Anderson and Reeb (2003) evidenced that family companies have higher Tobin's Q and ROA when family members serve as the CEO than outside CEOs.

Villalonga and Amit (2006) conducted a study on the performance of family companies and non-family companies in the US. The findings show that family ownership only creates value when the founder serves as the CEO or as Chairman with a hired CEO. Experts found that family companies that intend to keep the business for future generations perform better than non-family companies. The study found that the family CEO plays an important role in governing family companies, and family members serve as managers (Miller & Breton-Miller, 2006). Based on accounting performance measures, Anderson and Reeb (2003) results indicate that family companies perform better when the founder is the CEO, but not under the descendant's management. Daily and Dollinger (1992) reveal that outside-CEO managed companies are larger, older and follow more aggressive strategies. In contrast, family-owned companies are smaller and use less aggressive strategies, but achieve higher performance than outside-CEO who managed the companies.

Adams, Almeida and Ferreira (2009) found that the good and bad past accounting performance increases the likelihood that founder-CEOs will step out. Founder-CEOs value control over their succession more than non-founders and founder-CEOs want to leave their companies "in good shape". On the other hand, Jayaraman, Khorana & Nelling (2000) found that there is no main effect on stock return over a three-year holding period, but firm size and firm age moderate the CEO founder status-company performance relationship. A study in India by Johl et al. (2010) show that companies led by family CEOs do not add value to firm performance. However, when the CEO is from the descendant's family, the company value is enhanced. This may be because founder CEOs are not good managers and or perhaps the founder CEOs are managing their income to minimise taxes.

In contrast, empirical studies evidence that companies managed by outside-CEOs perform better than the founders. Lauterbach and Vaninsky (1999) distinguish between companies that were managed by a representative of the owners and companies being led by outside-CEO. Their analyses demonstrate that companies managed by their owners perform worse than those run by outside-CEO. Therefore, family businesses need to professionalise and delegate authority because of growth, lack of management skills within the family, preparation for succession, or to change the norms and values of the business (Sharma, Chrisman & Chua, 1997). The outside-CEO possess particular knowledge that is valuable in mentoring of future-generation leaders or in filling the leadership role (Lee et al., 2003). A study in Taiwan by Lin and Hu (2007) shows that family companies require high managerial skills and that using an outside-CEO can help increases the firm performance, especially if the family has a low cash-flow rights and weak control. However, when there is a great opportunity for expropriation in a family company, the company's performance will be better-off if the CEO is a family member and the family has a high cash-flow right.

Outside-CEOs are generally prescribed as a remedy for company difficulties (Helmich & Brown, 1972). When drastic changes are required, external managers appear to be more promising because he/she is not bound by old policies and implicit contracts of the firm. Kosnik (1987) emphasizes that an external succession is the most effective cure for internal inefficiency because a new manager brought from outside is more likely to conceive and implement fresh initiatives. In the same spirit, Hambrick and Mason (1984) argue that when an organization performs poorly and needs a "change agent", an external succession becomes more likely. Based on the above literatures, there are mixed findings on the importance role of family CEO and outside-CEO. However in Malaysian context, this study presumes that family CEOs play a significant impact in enhancing companies' performance than outside-CEOs. Family CEOs have the power, control and better understand about the company. Therefore, based on the arguments above, this study hypothesized that:

H_1: There is a significant relationship between family CEO and company performance.

3. Research Method

3.1 Sample Selection

This study used data from 2003 to 2007 with 888 family companies as a sample. Companies which were classified under finance, unit trusts and REITS are excluded from this study because of their differences in compliance and regulatory requirements. The data for this study was hand-collected from the secondary sources, such as company annual reports, Thomson Financial Datastream Advance[1], business magazines, newspapers, and books.

3.2 Research Model and Measurement

The research model is discussed below.

$$PERF = b_0 + b_1CEO_{it} + b_2DEBT_{it} + b_3FAGE_{it} + b_4FSIZE_{it} + b_5CP_{it} + b_6IP_{it} + b_7TS_{it} + b_8PROP_{it} + b_9OTHERS_{it}$$

Where:

PERF = Tobin's Q and EPS (tests one at a time)

[1] The Datastream database is available in Sultanah Bahiyah Library, Universiti Utara Malaysia. Financial data was downloaded using the Thomson Financial Datastream Advance.

CEO	= Type of CEO
DEBT	= Business debt
FAGE	= Firm age
FSIZE	= Firm size
CP	= Consumer products
IP	= Industrial products
TS	= Trading services
PROP	= Properties
OTHERS	= Hotels, plantations, infrastructure projects, technologies and constructions

This study has tests for the outliers, multicollinearity and heteroscedasticity, and found no serious violations on the data tested.

3.3 Control Variables

3.3.1 Debt

In family companies, the first generation companies had the highest use of the equity versus debt financing (Sonfield & Lussier, 2004). Chen, Chen & Cheng (2008) found that family companies are less likely to acquire external capital from the debt or equity market. Debt may reduce agency costs by reducing the cash flows available for expropriation of negative net present value projects (Harris & Raviv, 1991; Jensen, 1986). However, managerial insiders are reluctant to use the optimal amount of debt financing for the organization because of the additional bankruptcy risk associated with the higher level of debt engendered (Fosberg, 2004). Therefore, managers will not issue the optimal amount of debt without pressure from a disciplining force (Jensen, 1986).

3.3.2 Firm Age

Firm age is an important determinant of firm growth, the variability of firm growth and the probability of firm dissolution (Evans, 1987a). As firm age increases, the managers learn more about their abilities over time (Evans, 1987b). Studies have shown that young firms, for a given size, grow faster than old firms (Dunne & Hughes, 1994). Smaller firms are vulnerable and firm age is expected to survive "only 5-10 years" (Ward & Mendoza, 1996). Study claims that older firms are more likely than younger firms to achieve a lower performance on average (Dunne & Hughes, 1994). Older firms suffer from ossification of their routines, non-learning processes, blindness, and conservatism, which cause poor performance and decline (Boeker, 1997).

3.3.3 Firm Size

Study claims that family companies "only grow at a pace consistent with meeting the advancement needs of organizational members in the family system" (Daily & Dollinger, 1992). Firm size cannot expand if a family management team is reluctant to raise external funds because they fear losing family control (Church, 1993). Family companies have greater opportunity to train and develop top management and more complex succession plans (Helmich, 1972), more training programmes and complex succession plans (Trow, 1961), and larger resources to engage external consultants for advice on facilitating the succession planning process. Thus, larger family businesses may have more qualified and experienced candidates in place for possible succession (Harveston, Davis & Lyden, 1997).

3.3.4 Industry

Industry do influences the performance outcomes. However, the relationships are significantly mediated by the levels of debt that are sensitive to the sectors (Tam & Tan, 2007). A study in Taiwan found that high-tech firms have significantly higher firm values than other industries no matter what types of large-block ownership they have (Chen, 2006). Haniffa and Hudaib (2006) found that some industries are better than others. Plantation/mining sectors under-perform, but the trading sector performs relatively better than their counterparts in the industrial sector).

3.4 Model Specification

The variable CEO is measured using dummy (0, 1). If the CEO is a family member, then it is coded as 1, otherwise 0. There were four control variables in this study. Firm age is defined as the number of years since incorporation. Firm size is measured as natural log of book value over total assets. Debt is the book value of long-term debt by total assets. Industry such as consumer products, industrial products, plantation, trading services, construction, infrastructure projects, technology, hotels, and properties were coded as 1, otherwise 0.

Two dependent variables (Tobin's Q and Earnings Per Share) are used in this study and tested one at a time. Tobin's Q is the market value of common equity plus book value of preferred shares and debt divided by book value of total assets. EPS is the published earnings for ordinary shares divided by average number of shares issued during the period.

4. Results and Discussion

4.1 Descriptive Statistics

Table 1. Distribution of family companies (by board)

	Frequency	Percent
Main board	650	73.2
Second board	238	26.8
Total	888	100.0

Table 1 explains that family companies were split into main board and second board. The distribution of family companies on the main board was 650 (73.2%), and 238 companies (26.8%) on the second board companies.

Table 2. Distribution of family succession

Panel A: Level of family succession		
	Frequency	**Percent**
Founder (1st generation)	575	64.8
Successor (2nd generation)	313	35.2
Total	888	100.0
Panel B: Type of CEO		
	Frequency	Percent
Family CEO	883	99.4
Outside-CEO	5	.6
Total	888	100.0

Table 2 (Panel A) explains that 64.8% (575 family companies) were in the first/founder generation, and these groups contribute significantly to the Malaysian economy. Meanwhile, second/successor family generations were smaller in number with 35.2% (313 family companies). From the analysis, majority of Malaysian family companies were in the 1st generation, and there was a trend of family succession among the Malaysian companies. Some family companies have passed the power and control to the second generation. This shows that family companies plan for succession in ensuring the family empires remain in the next generation.

Table 2 (Panel B) shows that majority of family businesses in Malaysia are still being managed by family CEO. This contributes to 99.4% (883 companies). Meanwhile, family companies managed by outside-CEO represent 0.6% (5 companies) only. The reasons why family CEO is preferred are because family directors mostly spend their working lives in the firm they govern, therefore they understand the firms better than outside directors and they are able to make superior decisions.

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4.2 Correlation Matrix

Table 3. Pearson's Correlation (Transformed data)

	Q	EPS	CEO	DEBT	FSIZE	FAGE	CP	IP	TS	PROP	OTHERS
Q	1										
EPS	.13***	1									
CEO	.22***	.08**	1								
DEBT	-.07**	.04	-.02	1							
FSIZE	-.16***	.36***	-.07**	.47***	1						
FAGE	-.08**	.06	-.05	.11***	.17***	1					
CP	-.04	-.03	.10***	-.07**	-.21***	-.05	1				
IP	.08**	-.05	.03	-.08**	-.17***	.02	-.35***	1			
TS	-.13***	-.05	-.07**	.06	.01	.05	-.19***	-.26***	1		
PROP	.06	-.01	-.11***	.12***	.28***	.02	-.20***	-.28***	-.15***	1	
OTH	.24***	.16***	-.02	.02	.17***	.10***	-.17***	-.24***	-.13***	-.14***	1

Note: Q=Tobin's Q; EPS=Earnings Per Share; CEO=Chief Executive Officer; DEBT=Debt value; FSIZE=Firm Size; FAGE=Firm Age; CP=Consumer Products; IP=Industrial Products; TS=Trading Services; PROP=Properties; OTH=Other industries.

* p< .01, ** p< .05, *** p< .001

Table 3 explains the correlation signs for family companies. CEO was positively correlated with Tobin's Q (significant at 1 percent level) and EPS (significant at 5 percent level). This shows that family CEOs do influence the company performance. While a negative relationship exists between Tobin's Q and firm size, firm age, trading services and others. A positive relationship exists between EPS and CEO, firm size and others.

4.4 Multivariate Analyses

Table 4. Multivariate analyses for CEO and company performance

	Expected sign	Tobin's Q		EPS	
		coef.	p-value	coef.	p-value
FamCEO (H_1)	+	.1108854	0.000	.1460748	0.000
DEBT	-	.0053001	0.919	-.0059658	0.951
FSIZE	+	-.0191292	0.000	.0768891	0.000
FAGE	+	-.0017053	0.001	-.0049109	0.000
CP	+	.040372	0.003	.0241345	0.340
IP	+	.0832931	0.000	.0327309	0.160
TS	+	.0510101	0.001	.0401071	0.165
PROP	+	.1063905	0.000	-.0600479	0.028
OTHERS	+	.1312887	0.000	.0160802	0.620
_CONS		.8796963	0.000	-.9946571	0.000
R^2:		24.21		18.00	
Adj. R^2		23.00		16.69	

Note: Q=Tobin's Q; EPS=Earnings Per Share; CEO=Chief Executive Officer; DEBT=Debt value; FSIZE=Firm Size; FAGE=Firm Age; CP=Consumer Products; IP=Industrial Products; TS=Trading Services; PROP=Properties; OTH=Other industries; CONS=Constant.

* p< .01, ** p< .05, *** p< .001

With reference to Table 4, family CEO shows a significant relationship with firm performance (when measured using Q and EPS). Family CEOs mostly spend their working lives in the family companies, therefore, they understand the companies better than outside CEOs. They are able to make superior decisions and usually the CEO has planned to pass the company to the family successor. Therefore, this finding supports the previous works (Monsen et al., 1968; Anderson and Reeb, 2003) that family companies' value is better-off. Hence, hypothesis H_1 is supported in this study.

Firm size was positively related with Tobin's Q and EPS. This explains that larger companies are able to generate more profit than smaller companies. When firm size is large, family businesses have greater opportunity to train and develop top management and more complex succession plans, more training programmes, complex succession plans, and larger resources to engage external consultants' advice to facilitate the succession planning process (Trow, 1961). Firm age was found to be negatively related with Tobin's Q and EPS. These findings indicate that as the family companies are more matured in the market, the firm value decreases. Older firms are more likely than younger firms to achieve a lower performance on average (Dunne & Hughes, 1994). Older firms suffer from ossification of their routines, non-learning processes, blindness, and conservatism, which cause poor performance and decline (Boeker, 1997). Most of the industries were positively related to Tobin's Q and EPS.

Thus, it indicates that majority of the industries do greatly contribute to higher company profits.

Table 5. Sensitivity test between CEO-founder, CEO-successor and company performance

	Tobin's Q		EPS	
	coef.	p-value	coef.	p-value
GEN	-.0692617	0.000	-.1195755	0.000
DEBT	.2055711	0.043	-.0056453	0.972
FSIZE	-.0335895	0.000	.0476533	0.000
FAGE	-.0029203	0.000	-.0032264	0.009
CP	.0319317	0.047	.0267197	0.295
IP	(dropped)		(dropped)	
TS	.0064968	0.744	.0053184	0.866
PROP	.0346998	0.081	-.0741367	0.019
OTHERS	.0603965	0.074	-.0415262	0.438
_CONS	1.261349	0.000	-.3956809	0.010
R^2:	21.30		16.99	
Adj. R^2	18.89		14.45	

Note: Q=Tobin's Q; EPS=Earnings Per Share; CEO=Chief Executive Officer; DEBT=Debt value; FSIZE=Firm Size; FAGE=Firm Age; CP=Consumer Products; IP=Industrial Products; TS=Trading Services; PROP=Properties; OTH=Other industries; CONS=Constant.

* p< .01, ** p< .05, *** p< .001

Further test examines whether the CEO-founder or CEO-successor that affects the firm value. It was found that CEO-successor influences the company performance for Tobin's Q and EPS. This explains that CEO-founder makes a small increase for company performance. On the other hand, when the CEO-successor manages the company, the company performance is better-off. It shows that the CEO-successor is able to generate more profits and the vast experience in managing the business was gained from the CEO-founder. Moreover, the young CEOs are risk takers, aggressive, innovative and energetic in implementing new decisions.

5. Conclusion

In sum, this study confirms that family CEOs enhance company performance greater than outside-CEO. The CEO-successor was evidenced to increase the company performance greater than the CEO-founder. With exposure to business environment, education, experience, and sufficient business capital may give added values to the young CEOs to better manage the family companies than the founders.

In terms of the limitation, this study only focuses on the family companies. In future, the sample may be expanded to include the non-family companies, so that more concrete conclusion can be made. Qualitative study can also be considered in future study in order to have more robust findings.

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