**Succession and family firm performance: evidence from Chinese listed family firms.**

**Abstract:** This thesis investigates how succession affects family firm performance, using a dataset from the Chinese stock market. I contrast family succession when the successor is a family member with unrelated succession, where the firm is managed by a professional manager after succession. Results show that family firm’s performance is negatively affected after succession in case of family succession as well as unrelated succession. Focusing on family succession, the successor who has not worked in the firm before succession outperform the successor who has already worked in the firm before succession, suggesting that the natural of family tie compensate the lacking of being in the firm before succession. However, no evidence is found that whether change a chairman of the board or a general manager will cause different effects on firm performance.

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**Introduction**

As a widespread form of organization, the family firm plays a very important role in the economy all over the world. Anderson and Reeb (2003) state that one third of S&P 500 firms in US are classified as family firms. In Germany, two-thirds of GDP is generated by family firms; in the UK, about half of total jobs are created by family firms (Ralph, 2001). In China, although family firm status was not legal until the late 1980s, they now account for more than one third of China’s GDP (Cai et al 2010). Previous research further shows that compared to non-family firms, family firms perform relatively better in terms of profitability (Anderson and Reeb2003; David and David, 2007).

On the other hand, family firms face one problem that non-family firm may not necessarily have. Ronald and David (2003) point to a distinct feature of family firms which is to sustain the family presence in the firm, making the issue of succession extremely important.It isso important that Ward (1987) define a family firm as “a family business …. that will be passed on for the family's next generation to manage and control" (p.252) However, Birley (1986) and Ward (1987) show that in US, about one third of family businesses survive into the second generation and the percentage decreased to only 10% to 15% on that of the third generation.

Does this mean that succession will harm family firm’s performance? And that passing the firm to family successors will have a negative effect on firm performance? Evidence from western companies is mixed. Daniel et al (1999) and Denis and Denis (1995) suggest that mostly, family firms outperform non-family firms when experiencing succession, whereas Brian and Ben (1999) and Perez-Gonzalez (2006) find that successions are not only followed by large declines in profitability but also by a drop in stock price. Daniel et al (1999) show that profitability is increased when transferred managerial position to family members, but Marco et al (2008) study a sample of Italian family firms, find that family successor has a negative effect on the firm's post-succession performance.

Furthermore, several factors will impact on the decision of succession, thereby affecting firm performance. For example, Ye and Wang (2012) and Gong Yuchi (2001) suggest that theinternal successor who works in the firm before succession has lower assessment cost and better understanding of the firm, is a better source of successor for the firm. Correspondingly, positive relation between internal successor and firm’s performance is observed in previous study (Cannella and Lubatkin, 1993; Lauterbach et al, 1999).Such consideration should apply to all kinds of firms including family firms, even if the successor has family tie.

With this premise, this thesis studies the effect of succession on family firms’ performance. For this purpose, a dataset from Chinese listed family firms within the period over 2003 to 2010 is used. The subsample used in the analysis contains successions which have valid data for one year before and one year after the succession. That is, I create a cross-sectional data-set of successions, which includes firms’ performance in the year before and the year after the succession. In the analysis, I distinguish between several types of succession, as explained below.

Before focusing on effects of succession, I first compared family firm and non-family firms in Chinese stock market. This is mainly because Chinese economic environment is quite different from western economy, and family firms only have short development history in China. The results show that Chinese listed family firms outperform non-family firms in profitability, which is consistent with most evidence from western firms.

Following Marco and Giacinto (2008), several classifications of succession are used to distinguish effect on firm performance. The main two groups are that I contrast family succession, where the successor is a family member, with an unrelated succession, where the management of the family firm is passed to a professional manager. I find that both the family succession and the unrelated succession have a negative effect on post-succession performance; moreover, when the succession occurred in a firm that performs relative poor before succession, the family successor performs worse than the unrelated successor. Focusing on family successions, in case of poor pre-succession performance, family management even underperform in case of good pre-succession performance.

One extension of this thesis is that I further examined the effect of family successions in terms of successor source and managerial positions. Compared with the successor who has already worked in the firm, the external successor who has not worked in the firm before succession positively affects firm’s performance. Indicating that lacking working experience in the firm is not necessarily cause negative effect on firm performance. However, no evidence can be found that whether change a chairman of the board or a general manager in the firm will induce different effect on firm performance.

The most important contribution of this thesis is that it studies Chinese family firms. The study of family firm and succession obtain increasingly attention, but most evidence stems from western companies. Few papers study about Chinese family firms, mainly because of unavailable data and its inaccuracy (Yuan et al, 2008). However, since the first family firm listed in Chinese stock market in 1992, after nearly 20 years development, more and more founder-controlled family firms are facing the succession problem, which makes such study quite necessary.

The remainder of this thesis is structured as follows: section 2 reviews related literature and derives main hypotheses; section 3 describes the data selection and statistic summary; section 4 presents the empirical results and analysis; section 5 offers some conclusions.

**Section2. Literature Review and Hypotheses Development**

Do family firms outperform non-family firms? Based on agency theory, it is expected that the family control reduce the cost of principal-agent conflict between owners and managers (Fama and Jensen, 1983). So the active family controls increase the profitability compared with non-family firms (Benjamin, 2006).

Recent studies support above arguments. Evidences from western firms show that family firms outperform non-family firms in both profitability (ROA and ROE) and market measurement of performance (Tobin’s q) (Anderson and Reeb2003; David and David, 2007). Vincent et al (2010) even find that the third-generation family firms still perform better than non-family firms.

Another explain is that long-term development concern induce the family sustained presence in the firm (Ronald and David, 2003), and Anderson et al (2002) show that the family's sustained presence in the firm incentives family managers to improve the firm performance.

Studies on Chinese firms also show positive evidence to family firms. Wang et al (2010) indicate that the founder-led family firm significantly proves firm’s performance compared with non-family firms. Yuan et al (2008) study a sample of listed family firms, find that family firms outperform state-owned firms in respect of profitability and market performance. Therefore, the first hypothesis is conducted as followed:

Hypothesis 1: Family firms perform better than comparable non-family firms.

Do family firm perform better after succession? Vincent et, al (2010) state that no evidence is found for negative influence to a family firm’s profitability after succession occurred.

However, if a succession is related to the purpose of improvement, positive changes in performance should ensue from succession. Daniel et al (1999) study a sample of US family firms; find that after succession firms are more profitable. When restrict the study sample to listed family firm, Yuan et al (2008) find that after succession, the firm’s financial performance with reference to five measures: revenue per employee, revenue per unit of cost, net profit per employee, return on assets, and market-to-book ratio are significantly improved.

Although Denis and Denis (1995) believe that mostly, an increase of operating performance should be observed after the turnover in a firm, it may not always the case in family firms.Brian and Ben (1999) examine 124 Canadian family firms’ top managerial successions and find that successions have negatively affect firms’ performance. Perez-Gonzalez (2006) shows that family successions cause decrease of firm performance in the US. Perez-Gonzalez (2002) also found that the succession is often followed by a large decline in profitability and stock price. Following above arguments, the second hypothesis is developed as:

Hypothesis 2: Succession has a negative effect on family firms’ performance.

For the family firm, it is a difficult decision whether choosing a family member or a professional manager as the successor. Ronald and David (2003) state that a common feature of family firms is that family members always are the first choice to top management positions. Do family successors perform better than those successors that are not family members?

Davis et al (1997) believe that family members relate themselves closely to the firm and view firm performance as an extension of their own well-being. For this reason, they have incentives to perform better than others. This is consistent with the argument that when transferred managerial position to family members, firms are more profitable (Daniel et al, 1999).

However, focusing on family relationship, considering that as the founder of a family firm, the first generation family managers have sufficient technical or business skills necessary for the creation of the business, but the descendants of the founder may not have the same talent of those special abilities. Alternatively, the professional managers who meet those criteria are better performed (Vincent et al, 2010; McConaughy and Phillips, 1999; Villalonga and Amit, 2004).

Similar evidence is observed cross countries. Morten et al (2007) investigate a sample of 5,334 successions from 1994 to 2002 in Denmark, find that family successions have a negative effect on firm performance. Marco et al (2008) study a sample of Italian family firms, suggesting that remain the management in the family has a negative effect on the firm's performance. Brian and Ben (1999) show that Canadian firms that experienced family successions are correlated with negative abnormal returns at the time of announcement. Evidence from Chinese researcher Yu Ghee Wee (2012) also shows a negative relation between family succession and firm performance.

From the perspective of relation between ownership and management in a family firm,Mike et al (2003) present a theoretical model, showing that although there is cost for the family to monitor the professional manager, the benefit still higher for the family to surrender the managerial position to a professional manager.

Moreover, many researchers point to neporism playing important but negative role in succession planning, that is, the founders’ bias to family members may leads them to appoint the family member regardless of their capability(Singell, 1997). Consistently, Perez-Gonzalez (2002) found that nepotism in family succession significantly causes decrease of profitability. Therefore, the third hypothesis is developed as follows:

Hypothesis 3: The family succession underperforms the unrelated succession in a family firm.

Is there any different effect on firm performance whether a successor has worked in the firm before succession or not? In some family firms, heirs often worked in the firm before appointed to the position (Wendy, 1994). As such internal successors, they are familiar with the firm and being trained to fit the position. But for some successors, they are appointed at an untimely moment without any experience with the firm, for example, after a sudden death of the founder. Such outsiders always face intense pressure and particular difficulties in the family firms (Herz Brown, 1993).

More generally, for both family firms and non-family firms, knowing that the firm’s current situation is an important consideration of having a succession, those well performed firms will prefer to choose inside successor because they can better smoothly continue the previous strategies to keep the firm in good direction than external successors (Cannella and Lubatkin, 1993; Lauterbach et al, 1999; Salancik and Pfeffer, 1980).In contrast, firms that expect reform to change firms’ current poor performance, the outsiders are more appropriate because they are easier to operate innovation, thereby improving firm’s performance (Hambrick and Mason, 1984; Kang and Anil, 1995).

Some researches show that internal or external has no significant effect on firms’ performance after succession (Chung et al, 1987; Rokiah et al, 2013). However, Parrino et al (1997) study a sample of 8033 CEO-years between 1969 and 1989 in US, found that outside successors are more likely to positively affect firm’s performance. Similarly, Lauterbach et al (1999) and Mark et al (2004) also indicate that inside selection worse the performance after successions.

Overall, succession is not simply a step to handover the rubber stamp, it is a process that lasting over time**.** On one hand, the firm takes time and cost to assess whether the successor is suit for the position, on the other hand, the new manager has to spend time on adapting the firm. Hence, internal successors are considered as first choice, as they are convenient to be assess before appointed and knowing the firm better than external successors (Ye and Wang, 2012; Gong Yuchi, 2012).

For family successors, they may benefit from family relationship before succession, but it is still a disadvantage of lacking working experience in the firm before succession. Therefore, I draw this hypothesis as follows:

Hypothesis 4: The internal succession outperforms the external succession in a family firm.

**Section 3 Summary of data**

**3-1. Data resource**

In order to have sufficient data to analyze how succession affects family firm’s performance, three sources are used to fulfill dataset. First, CSMAR database (China Stock Market and Accounting Research) the leading of Chinese financial and economic data provider offers all Chinese listed firms’ financial information and company profiles. The original data comprises firm profile and annual reports are downloaded from this database. Second, the two main Chinese stock exchanges’ websites, namely, Shanghai stock exchange websites and Shenzhen stock exchange websites provide all listed firms’ announcements, covering the most important information of succession, such as date, position, relationship between successor and predecessor, reasons of leaving position, etc. Third, I manually collected those missed information of family management from various sources, including firm’s websites, professional financial websites, newspaper, etc.

**3-2.Selection of sample**

The whole sample is restricted to non-state-owned and non-financial firms in Chinese stock market from 2003 to 2010, with the number of 753 firms in total. I choose 2003 as the starting year because from this year being listed in stock market to solve financial problem becomes a prevailing trend among Chinese family firms (Zhoujiancheng 2008).

The family firm in the sample is defined as: when the founder or the founder’s family still hold shares of the firm (Sraer2007). As a result, 443 firms are selected that satisfied this definition; in contrast, 310 firms are classified as non-family firms.

The most important subsample that is used to analyze how succession affects family firm’s performance is the 172 family firms which experienced succession during the data period.

The process of selecting the subsample follows two steps. First, among the 443 family firms, 194 family firms are selected as family firms without any succession over 2003 to 2010[[1]](#footnote-2). However, successions that the other 249 family firms experienced cannot all be used to analyze their effect on firm’s performances. Therefore, the second step is to select valid successions that have feasible data. The feasible data for each succession include a one-year window, that is, one year before the succession and one year after the succession, hence, three criteria are required as follows. First, successions occurred on 2003 and 2010 are deleted. Because there is no data on 2002 and 2011, so it is unfeasible to compare the effect of succession before and after it happened, in other words, the time interval for capturing valid successions is from 2004 to 2009. Second, consecutive successions are deleted. The reason can be explained by an example, such as if the firm had successions on 2004 and 2005, then it is difficult to investigate whether changes of firm’s performance is induced by succession occurred in 2004 or in 2005. Third, I remove the observations where more than one succession occurred in one year. Because the effect of succession is mixed if there are more than one succession occurred within one year.

Finally, 208 successions (within 172 family firms) satisfy all above criteria are included in the subsample. The final data-set is cross-sectional in nature, containing information on performance in the years before and after the succession. As a result, it is not possible to control for year-fixed effects in the analysis. Whether it can be observed or not, time variant might affect firms’ performance, however it cannot be controlled in such cross-sectional setting.

**3-3. Definitions and classifications**

I am interested in examining the effect of succession to family firms’ performance, especially, when the successor is a family member relative to the successor is unrelated to the family. As such, I define a family succession where any of the following criteria are met: (1) the firm directly states the family relationship between the successor and predecessor in the announcement, including marital relationship and blood ties; (2) the legal family ties, for example the relation between father and son-in-law; or there is no explicit description but (3) the successor and the predecessor share the same family name. Where a succession meets any of the above criteria it is coded as family succession and equals to one, unrelated successions otherwise and equals to zero.

Considering that firms’ ability is varying across industries, higher ability with relative good performance should be observed before succession. To distinguish such feature, I divide the family successions into good performer and poor performer. Following Marco and Giacinto (2008), I take the firms’ pre-succession performance ROA and ROE, which is the year before succession, as grouped profitability and rank them in each industry. Good performer is a succession with pre-succession performance above the median score in its industry. Poor performer is a succession with pre-succession performance below the median score in its industry. The variable good performer is equals to one and zero otherwise.

Second, previous evidence suggest that whether a successor is internal or external to the firm, matters for the effect of succession on firm’s performance. Ye and Wang (2012) indicate that internal successors have lower assessment cost and can be trained to fit the position early before the succession**,** so they are expected to have positive effect on the firm performance. Such preference should be applied for afamily successor as well; therefore, I take the successor source into account. The external successor is defined as when they did not work in the firm before being appointed to the new positions, and the internal successors otherwise[[2]](#footnote-3). The variable External reflects this feature and equals to one when the successors are external successors, and zero otherwise.

Third, to investigate whether different positions will cause different effects on family firms’ performance, I divide the managerial positions into chairman of the board and the general manager. When the family succession is related to the change of chairman of the board, the dummy variable position equals to one and zero otherwise.

The firms’ performance is measured by accounting profitability ROA and ROE which are often used in previous studies. ROA is defined as the net profit divided by the last year’s total assets. ROE is defined as the net profit divided by the last year’s equity.

Several variables are used in this thesis to reflect the firm characteristics. The firm size is reflected by the total assets (in million RMB) and the number of employee; the control of the firm is measured by the fraction of shares hold by chairman of the board and the general manager; the firm age also is considered.

Table1 indicates how sample firms and successions are distributed across industries[[3]](#footnote-4). Three types of firm are considered, namely, family firms, non-family firms and family firms with succession. For family firms which experienced succession, a succession rate is added to state the weight of family firms with succession in total family firms. For all successions, in column 4 to 8, the table describes the distribution of family successions and unrelated successions across industries; similarly, family succession rate is added to reflect the fraction of family successions to all successions.

**3-4. Description of sample**

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| **Table 1 Description of the sample: industry** | | | | | | | | |
|  | Family firms | Non-family firms | Family firms with succession | | Successions | | | |
| Industry | Number(a) | Number(b) | Number(c) | Succession rate(c/a) | All succession(d) | Family succession(e) | Unrelated succession(f) | Family succession rate (e/d) |
| A | 11 | 8 | 3 | 27% | 3 | 2 | 1 | 66.67% |
| B | 2 | 2 | 2 | 100% | 2 | 2 | 0 | 100.00% |
| C | 303 | 176 | 116 | 38% | 141 | 88 | 53 | 62.41% |
| D | 8 | 6 | 1 | 13% | 2 | 1 | 1 | 50.00% |
| E | 4 | 7 | 2 | 50% | 2 | 2 | 0 | 100.00% |
| F | 37 | 4 | 2 | 5% | 2 | 1 | 1 | 50.00% |
| G | 20 | 24 | 16 | 80% | 19 | 9 | 10 | 47.37% |
| H | 12 | 23 | 5 | 42% | 6 | 4 | 2 | 66.67% |
| J | 18 | 17 | 16 | 89% | 20 | 9 | 11 | 45.00% |
| K | 2 | 7 | 2 | 100% | 2 | 1 | 1 | 50.00% |
| M | 26 | 36 | 7 | 27% | 9 | 7 | 2 | 77.78% |
| Total | 443 | 310 | 172 | 39% | 208 | 126 | 82 | 60.58% |

A=Agriculture; B=Coal Mining and Quarrying; C= Manufacturing; D=Production and Supply ofElectricity, Steam& Hot Water; E=Civil Engineering Construction; F= Transportation; G= Communication Service; H=Whole sale and Retail Trade; J= Real Estate Development and Management; K= Public Facilities Services; M=Conglomerates;

Obviously, family firms and non-family firms have a very similar distribution of industry in this sample. Most firms exist in manufacturing sector, the number is 68.4% for family firms and 56.77% for non-family firms. Very few firms belong in sector of coal mining and quarrying, mainly because this sample is restrict into non-state owned firms, and in china, this sector is historically in the hands of the states.

Within family firms, successions are not evenly happened among all industry. Two sectors have 100% succession rate, but such high rate can be explained by that there are very few firms in the two sectors (2 firms in each).

Table 1 shows that family firms are prefer to inherit family members related to those successors who are not family members, that is, the family successions rate is more than 60%. Interestingly, the family successions relatively uniform distribute across industries except two extreme values. The lowest family succession rate is in communication service sector (G). This can be explained that, although for a family firm, the family member has priority to non-family member (Ronald and David, 2003), as the special technical skill is required in the communication service, a professional manager is preferred.

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| **Table2 Summary statistics: comparison between family and non-family firms** | | | | |
| Variable | All Firms(a) | Family Firms(b) | Non-Family Firms(c) | Differenceof means(b-c)  (p-value) |
| Number of firms | 753 | 443 | 310 |  |
| Firm age | 19 | 17 | 22 | -5(0.00)\* |
| Number of employee | 2267.00 | 2665.00 | 1863.00 | 802(0.00)\* |
| CH in shares% | 3.87 | 7.77 | 0.07 | 7.7 (0.00)\* |
| GM in shares% | 2.31 | 4.59 | 0.08 | 4.51(0.00)\* |
| Assets | 2355.64 | 3656.58 | 1929.93 | 1726.65(0.00)\* |
| ROA(%) | 4.25 | 5.45 | 2.54 | 2.91 (0.00)\* |
| ROE(%) | 8.43 | 9.60 | 7.91 | 1.69 (0.00)\* |
| CH: the chairman of the board. | | | | |
| GM: the general manager.  Assets: in million RMB. | | | | |

\*Significant at 5%.

Previous researches mostly compare state-owned firms and family firms, since they are two most important types of firm in Asia (Zhao et al, 2007). But given that the sample is restricted to non-state-owned firms, a natural question is: do family firms still better performed than non-family firms in this category? Table 2 shows how family firms operate compared with non-family firms in Chinese stock market[[4]](#footnote-5).

Obviously, family firms are younger than non-family firms, and with relative larger firm size in both number of employee and firm assets. This is in contrast to evidence from UK listed firms and US S&P 500 which suggests that non-family firms are larger than family firms (David and Patrick 2009; Ronald and David, 2003) but this is consistent with family firm status in Chinese economy where that family firms gained legal status in the late 1980s and then have flourished (Cai et al 2010).

In family firms, top managers hold higher percentage of shares than that of non-family firms. Precisely, in average, chairman of the board hold the fraction of 7.77% shares and the general manager hold 4.59% of shares in family firms, whereas in non-family firms, the percentages are only 0.07% for chairman of the board and 0.08% for the general manger. Such remarkable difference shows that the ownership and management are highly combined in Chinese family firms.

In terms of firm performance, the difference between family firms and non-family firms is still significant, precisely, in average, ROA and ROE in the family firms are 5.45% and 9.6% respectively, while in non-family firms, the number decrease to 2.54% and 7.91% respectively. In other words, even restrict the sample in non-state-owned firms; still, family firms are outperforming non-family firms averagely.

Overall, family firms are relative young, large and profitable than non-family firms, while managerial have higher percentage of shares. As an essential characteristic of family firm, it is accepted that family control reduce the agency cost between owner and manager, hence an active family control could improve family firms’ performance (Fama and Jensen, 1983; Benjamin Maury, 2006).

**Section 4 Analysis in managerial successions in family firms**

**4-1. Pre-succession and post-succession performance: the whole subsample**

The data discussed above suggests that family firms perform better than non-family firms, but how such better performed firms be after a succession? Do successions harm or improve the family firms’ performance? Table3 presents the mean comparison and show the differences between the pre-succession and post-succession performance in family firms.

The pre-succession performance measures the ROA and ROE in one year before succession occurred, accordingly, the post-succession performance measures the values one year after the succession, that is, every succession has two observations.

Intuitively, there is significant decrease after successions in both ROA and ROE, which means successions have negative effect on firms’ performance. But when examining

unrelated successions and family successions separately, the result is different. Both unrelated successions and family successions induce significant decrease in ROA to the family firms, and the degree is larger in family firms related to non-family firms, that is, the average reduce in family firms is 3 times to that of non-family firms. However, when measured by ROE, although there are still decreases in profitability, they are not statistic significant.

Focusing on family successions, I further compared firms’ performance within different categories. In terms of ROA, all categories of successions have significant reduce after the

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| **Table3 Pre-succession and post-succession firm performance: ROA and ROE** | | | | | | | |
| Variable | Observations | ROA(%) | | | ROE(%) | | |
|  | Observations  (successions) | Pre-succession | Post-succession | Difference  (p-value) | Pre-succession | Post-succession | Difference  (p-value) |
| A.Total subsample | 416  (213) | 5.71 | 4.91 | -0.8 (0.000)\* | 9.94 | 9.20 | -0.74 (0.005)\* |
| Unrelated successions | 164 (82) | 5.74 | 5.38 | -0.36 (0.018)\* | 10.30 | 9.95 | -0.35 (0.113) |
| Family successions | 252 (126) | 5.68 | 4.60 | -1.08 (0.000)\* | 9.71 | 8.72 | -0.99 (0.116) |
| B.Family successions |  |  |  |  |  |  |  |
| 1-1.Good performer | 128  (64) | 6.45 | 5.29 | -1.16 (0.000)\* | 11.17 | 10.00 | -1.17  (0.000)\* |
| 1-2.Poor performer | 124 (62) | 4.86 | 3.88 | -0.98 (0.043)\* | 8.21 | 7.40 | -0.82  (0.315) |
| 2-1.External | 78  (39) | 5.32 | 4.57 | -0.75 (0.007)\* | 9.30 | 8.73 | -0.57  (0.171) |
| 2-2.Internal | 174  (87) | 5.83 | 4.60 | -1.23 (0.000)\* | 9.89 | 8.71 | -1.18  (0.037)\* |
| 3-1.GM  successions | 104 (52) | 5.26 | 4.13 | -1.13 (0.043)\* | 9.38 | 7.89 | -1.49  (0.106) |
| 3-2.CH  successions | 148  (74) | 5.94 | 4.92 | -1.02 (0.044)\* | 9.92 | 9.29 | -0.65  (0.024)\* |

\*Significant at 5%.

succession, to be precisely, those good performers[[5]](#footnote-6) which the group profitability above median rank in specific industries have larger decrease compared with those poor performer; external successions also cause higher decrease than internal successions; and the decrease caused by chairman successions is slightly higher than that of general manager successions. Also, negative effects are observed in all categories when measured in ROE, but those decreases are not significant in the terms of poor performer, external successions and the change of chairman. Moreover, some performance difference is quite large around succession, for instance, the change of chairman of the board induce more than two times of reduction related to the general manager successions.

**4-2. Post-succession performance: the whole subsample**

Although obvious decreases are observed in above comparisons, to what extent the firms are influenced still unknown. To further investigate the impact of successions includes both family successions and unrelated successions on the family firms’ performance, I estimate the regression equation (1). Having a fixed-effect within firms can control the time-invariant firm characteristics, but the Hausman test result[[6]](#footnote-7) shows that the model is not fit for the fixed-effect; therefore, the random effect are included in the model.

(1)

The dependent variables are ROA and ROE respectively. If successions affect firm’s performance, either positive or negative relations should be observed. Above comparisons show obvious reduces after successions, so it is expected that there is negative influence of successions. After is a dummy variable which equals to one when the succession already occurred (the year after successions) and zero otherwise; Family is a dummy variable equals to one if the successor is a member of the family and zero otherwise; the interaction term After\*Family captures the effect of family successions compared to unrelated successions when succession occurred. The firms’ characteristics include firm age, assets and number of employees is also considered.

Colum 1 and 2 in Table 4 shows the estimated results for all successions. Obviously, there is significant reduce in profitability after successions occurred, and the degree is almost the same in ROA and ROE. The firms that will have a family successor perform worse than firms that will have unrelated successors in the year before succession; however, it is not statistically significant. Moreover, the result shows that when family successors managed the family firms, the firms clearly underperform the family firms that managed by unrelated successors, such negative difference is larger in terms of ROA. This finding is consistent with evidences documented by Marco and Giacinto (2008) that there is negative relation between family firms’ performance and successions. They further argue that such distinct around managerial changes might because of the different status of the firms and the reform which is often observed after successions occurred. Specifically, if the poor

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| **Table 4 Family management and firm's performance** | | | |
|  | ROA (p-value) | | |
| Variable | All successions | All successions | Poor performer |
| Constant | 6.7 (0.00)\* | 6.48 (0.00)\* | 5.80(0.00)\* |
| After | -0.72 (0.00)\* | -0.28(0.29) | -0.42(0.38) |
| Family | -0.45 (0.16) | -0.08(0.82) | -0.28(0.06) |
| After\*Family | / | -0.73(0.03)\* | -0.38(0.05)\* |
| Firm age | -0.05 (0.08) | -0.05(0.07) | -0.56(0.24) |
| Assets | 1.53E-05(0.79) | 1.90E-05(0.74) | 3.57E-05(0.90) |
| Number of employees | 1.34E-05(0.63) | 1.27E-05(0.65) | 2.07E-05(0.64) |
| Firm random-effects | Yes | Yes | Yes |
| Number of firms | 172 | 172 | 86 |
| Number of observations | 416 | 416 | 206 |
| R-square | 0.08 | 0.08 | 0.05 |
|  | ROE(p-value) | | |
| Variable | All successions | All successions | Poor performer |
| Constant | 10.82(0.00)\* | 10.62(0.00)\* | 9.25(0.00)\* |
| After | -0.73(0.01)\* | -0.32(0.44) | -0.78(0.36) |
| Family | -0.96(0.05)\* | -0.62(0.27) | -0.67(0.45) |
| After\*Family | / | -0.67(0.04)\* | -0.61(0.55) |
| Firm age | -0.03(0.55) | -0.03 (0.52) | -0.05 (0.52) |
| Asset | 5.88E-05(0.50) | 7.01E-05(0.45) | 2.37E-04(0.23) |
| Number of employee | 6.90E-06(0.88) | 7.11E-06(0.88) | 1.59E-05(0.82) |
| Firm random-effects | Yes | Yes | Yes |
| Number of firms | 172 | 172 | 86 |
| Number of observations | 416 | 416 | 206 |
| R-square | 0.03 | 0.03 | 0.02 |

\*Significant at 5%

performed firms are more likely to appoint unrelated successors, the new managers are always expected to reorganize firms more extensively than family successors, accordingly improve firms’ performance. Thus, such potential preference to unrelated successors when the firms are in poor situation might induce different effect between family successions and unrelated successions.

Considering the above argument, equation (1) is again estimated separately for poor performers. The poor performer is the successions that pre-succession profitability (group ROA and ROE) is above median score within the industries. Notably, in this section, the comparison is in the whole subsample, that is, the poor-perform successions include both unrelated successions and family successions. So the observations for poor performer here is 206 in total[[7]](#footnote-8).

Column 3 in Table 4 shows the estimated results. Although the coefficient of After indicates that the negative effect of succession is not statistic significant in both ROA and ROE, the entire effect is captured by interaction After\*family and is still significant in ROA, suggesting that the firms’ performance is negatively affected by family succession compared to unrelated successions. In other words, in terms of ROA, family successor might not have enough talent to change firm’s poor situation which is already exist before succession, but performing even worse than unrelated successors. So it is more likely for unrelated successors to transfer the poor situation, where they are considered as easier to restructure the firm, thus improving firm performance.

Previous studies show that firm asset, number of employees and firm age has positive effects on firms’ performance (Singell, 1997; Marco and Giacinto, 2008), however, the negative sign of coefficient on firm age shows that firm age have a negative impact on firms’ performance, but it is not statistically significant. Moreover, the firm size which is reflected by asset and number of employees also have no effect on firm performance.

**4-3. Family successions**

Many factors will affect the process of succession, such as firm-specific, time-specific and even the founder’s personality might produce different strategies or plans around the succession, thereby affecting the post-succession performance. Some factors are applied to all kinds of firms but some are unique in family firms. For instance, if the family firm is very poorly performed so that the founder determines to sell the firm to outside investor who is unrelated successor, then the comparison between the family and unrelated successions is quite incomparable Marco and Giacinto (2008).

Besides, the main feature of a family firm is to maintain the family in the firm, such potential preference to family successor might have unpredictable effect on firms’ performance under different situations. Therefore, it is worthy to investigate family successions separately in a more detailed way.

**4-3-1. Family successions: post-succession performance**

Above analysis show that in case of the whole subsample, family successors underperform unrelated successors when family firms’ pre-succession performance is relative poor. Focusing on family successors, will they still perform poor after a relative good situation?

Becker and Tomes (1986) suggest that all performance tends to regress to average level. If so, the expectation of post-succession should be decreased related to good pre-succession performance, even for the family succession.

The equation (2) is used for evaluating the effect of family succession under such situation. Where Good\_performer is a dummy variable equals to one when the succession with a pre-succession profitability above median rank in specific industries, and zero otherwise.

Table 5 shows estimated results when restricted the sample to family successions under good-perform situation. Still, after family successions, firms’ profitability decrease in both ROA and ROE. Obviously, the coefficient on good performer is positive and statistically significant, as a good performer is a succession that with relative good pre-succession performance. Most importantly, the negative coefficient of interaction After\*Good\_performer suggests that family successors caused inefficient management after a relative good pre-succession performance, that is, in case of a relative good situation, family successors even underperform relative to the case of poor pre-succession performance.

However, such consideration about firms’ pre-succession performance contains a drawback in this thesis, which is the timing of succession in family firms. This endogeneity problem mainly related firm’s characteristics to resent performance, so that the succession decision includes both whether and when to select a manager within the family firm (Demetz and Villalonga, 2001). As a result, firm’s performance after succession may affected by different factors at the time of the succession.

Focusing on timing of successions, the optimal transfer time varies within firms and affected by both firm features and the family characteristics. Especially, in a founder controlled family firms, the founder may delay to pass the firm to a family successor until the firm get a high level of performance so that the heir have more chance to achieve a

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| --- | --- | --- | --- | --- |
| **Table 5 Family management and firm's performance: Good performer** | | | | |
| Variable | ROA(p-value) | | ROE(p-value) | |
| Constant | 5.57(0.00)\* | 5.52(0.00)\* | 8.52(0.00)\* | 8.42(0.00)\* |
| After | -0.99(0.00)\* | -0.88(0.02)\* | -0.95(0.02)\* | -0.72(0.23) |
| Good\_performer | 1.53(0.00)\* | 1.64(0.00)\* | 1.82(0.00)\* | 2.06(0.00)\* |
| After\*Good\_performer |  | -0.22(0.73) |  | -0.47(0.05)\* |
| Firm age | -0.05(0.17) | -0.05(0.17) | -0.02(0.73) | -0.02(0.68) |
| Asset | -5.58.E-04(0.42) | -5.63E-04(0.42) | -1.1E-04(0.34) | -1.1E-04(0.32) |
| Number of employee | 4.695E-05(0.26) | 4.8E-05(0.22) | 8.28E-05(0.18) | 8.48E-05(0.17) |
| Firm random-effects | Yes | Yes | Yes | Yes |
| Number of firms | 109 | 109 | 109 | 109 |
| Number of observations | 252 | 252 | 252 | 252 |
| R-square | 0.13 | 0.13 | 0.10 | 0.11 |

\*Significant at 5%.

better future; or when the firm is poorly performed, it is less likely for the founder still to pass the firm to family member (Kimhi, 1994; Adams et al, 2005).

Whether such endogeneity issue is observable or unobservable, it is difficult to deal with. For this reason, the results might be potentially biased.

**4-3-2. Family management and successions characteristics**

As an overall better form of firm, family firms outperform non-family firms; however, above analysis show that the family succession induces negative effect on family firms’ performance. Particularly, when management maintains in family members, they underperform unrelated successors. Moreover, in case of poor pre-succession performance, they even underperform in case of good pre-succession performance.

Is there any factors related to succession that affect family successors, thereby affecting firms’ performance? In this section, succession features including the source of successor and the change of different managerial positions are considered.

The equation (3) is used to test effects of such features. The source of successors means whether the successor is internal of the firm or external of the firm. Where External is a dummy variable equals to one when family successors are outsider of firms, and zero otherwise. Position is a dummy variable equals to one when the successor is appointed as chairman of the board, and equals to zero otherwise as appoint to general manager.

The estimated results are reported in Table 6. The column 1 and 2 are results for the source, the column 3 and 4 are results for the positions. Still, after successions there is negative effect on firm performance both in ROA and ROE. In terms of source, the firms that will have an external successor perform worse in the year before succession than firms that will have an internal successor. After successions, those family successors who do not have working experience in the firm before appoint to new position, positively affect firms’ performance. The improvement is observed both in ROA and ROE, and statistic significant in ROA. Such unexpected result indicate that as a family member, lacking of experience in the firm do not necessarily cause inefficient management after succession, in contrast, as “fresh blood” they perform well, leading the firm develop into a good future.

Many previous researches suggest that internal successors have more advantages than external successors such as lower assessment cost, familiar with firm and easier to keep the turnover process smoothly operate, as those strategies are applied to all kinds of firms, they should be suited to family firm as well. So this distinct outcome might be responsible to the feature of family members as they naturally close to the family, that is, there are relative more ways for family members to familiar the firm, firm’s future business plan and even the founder. Similarly, the family (or the founder) also has more chance to assess family successors, and even training them in early stage before they entered to the firm (Wendy, 1993).

In column 4, the sign of coefficient on interaction After\*Position suggest that compared to the change of general manager, changing the chairman of the board have negative impact on firm performance. But it is not statistically significant, that is, whether change a chairman of the board or a general manager will differently impact family firms’ performance, in other words, there is no evidence that change a chairman of the board will cause more harm than change a general manger in family firm.

As state in Table2, in this sample, chairman of the board averagely hold higher shares in family firm, before or after succession, such relative higher level of control right should incentives the chairman perform well, thereby improving firm performance. For this reason, a future research can be extended by examining whether the different range of share holdings by top managers have effect on firm performance.

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| --- | --- | --- | --- | --- |
| **Table 6 Family management and firm's performance:succession characteristics** | | | | |
| Variable | ROA(p-value) | | | |
| Constant | 6.47(0.00)\* | 6.56(0.00)\* | 6.51(0.00)\* | 6.49(0.00)\* |
| After | -0.84(0.00)\* | -1.16(0.00)\* | -1.02(0.00)\* | -0.98(0.00)\* |
| External | -0.30(0.05)\* | -0.55(0.14) | / | / |
| Position | / | / | -0.67(0.11) | -0.63(0.21) |
| After\*External | / | 0.52 (0.04)\* | / | / |
| After\*Position | / | / | / | -0.09(0.86) |
| Firm age | -0.05(0.15) | -0.05(0.14) | -0.04(0.26) | -0.04(0.25) |
| Asset | -1.78E-05(0.81) | -1.8E-05(0.81) | -2.89E-05(0.69) | -2.98E-05(0.69) |
| Number of employee | 3.56E-05(0.37) | 3.72E-05(0.36) | 3.58E-05(0.37) | 3.56E-05(0.37) |
| Firm random-effects | Yes | Yes | Yes | Yes |
| Number of firms | 109 | 109 | 109 | 109 |
| Numberof observations | 252 | 252 | 252 | 252 |
| R-square | 0.08 | 0.08 | 0.09 | 0.09 |
| Variable | ROE(p-value) | | | |
| Constant | 10.07(0.00)\* | 10.19(0.00)\* | 10.19(0.00)\* | 10.03(0.00)\* |
| After | -0.97(0.02)\* | -1.2(0.02)\* | -0.98(0.02)\* | -0.67(0.22) |
| External | -0.25(0.07) | -0.62(0.05)\* | / | / |
| Position | / | / | -0.92(0.17) | -0.54(0.49) |
| After\*External | / | 0.75 (0.06) | / | / |
| After\*Position | / | / | / | -0.77(0.36) |
| Firm age | -0.03(0.64) | -0.03(0.62) | -0.01(0.83) | -0.01(0.85) |
| Asset | -2.91E-05(0.80) | -2.93E-05(0.80) | -4.7E-05(0.68) | -4.74E-05(0.68) |
| Number of employee | 5.86E-05(0.36) | 6.9E-05(0.35) | 5.69E-05(0.17) | 5.78E-05(0.37) |
| Firm random-effects | Yes | Yes | Yes | Yes |
| Number of firms | 109 | 109 | 109 | 109 |
| Numberof observations | 252 | 252 | 252 | 252 |
| R-square | 0.03 | 0.03 | 0.04 | 0.04 |

\*Significant at 5%.

Finally, a further question is concerned to whether the internal or external successors differently affect firms’ performance if the firm is in relative good situation before succession. The equation (4) is used to exam such impact.

(4)

The interaction item After\*Good\_performer\*External captures the effect of how external family members manage the family firm, in case of firms were perform relative well before

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| **Table 7 Family management and firm's performance: source effect** | | |
| Variable | ROA(p-value) | |
| Constant | 5.57(0.00)\* | 5.61(0.00)\* |
| After | -0.99 (0.00)\* | -1.18 (0.01)\* |
| Good\_performer | 1.53(0.02)\* | 1.63(0.01)\* |
| External | 0.01 (0.03)\* | -0.20 (0.70) |
| After\*Good\_performer | / | 0.05 (0.91) |
| After\*External | / | 0.76(0.30) |
| Good\_performer\*External | / | -0.09(0.93) |
| After\*Good\_performer\*External | / | 0.66(0.56) |
| Firm age | -0.05(0.17) | -0.05(0.16) |
| Asset | -5.57E-05(0.42) | 5.90E-05(0.41) |
| Number of employee | 4.68E-05(0.23) | 4.93E-05(0.21) |
| Firm random-effects | Yes | Yes |
| Number of firms | 109 | 109 |
| Number of observations | 252 | 252 |
| R-square | 0.13 | 0.09 |
| Variable | ROE(p-value) | |
| Constant | 8.38(0.00)\* | 8.45(0.00)\* |
| After | -0.96(0.02)\* | -1.26(0.09)\* |
| Good\_performer | 1.87(0.01)\* | 2.05(0.01)\* |
| External | 0.31(0.64) | -0.11(0.91) |
| After\*Good\_performer | / | 0.14(0.88) |
| After\*External | / | 1.38(0.25) |
| Good\_performer\*External | / | 0.19(0.91) |
| After\*Good\_performer\*External | / | 1.68(0.31) |
| Firm age | -0.02(0.75) | -0.02(0.73) |
| Asset | 1.03E-04(0.35) | 1.11E-05(0.33) |
| Number of employee | 8.16E-05(0.18) | 8.54E-05(0.17) |
| Firm random-effects | Yes | Yes |
| Number of firms | 109 | 109 |
| Number of observations | 252 | 252 |
| R-square | 0.13 | 0.11 |

\*Significant at 5%.

succession occurred. Improve or reduce, the effect of such changes should be observed.

Considering that family successors perform even worse after good pre-succession, external successors who lacking knowledge of the firm are expected cause negative impact on the family firms’ performance.

Table7 shows the estimated results. Obviously, successions have negative effect on firm performance both in ROA and ROE. Although the difference is very small, firms that will engage in external successors perform relative good in year the before succession than firms will have internal successors.

The coefficient on interaction shows that the external successors who have no working experience in the firm before succession, still have positive relation with firm performance after succession occurred in the good performing firms. However, such results are not statistically significant; suggesting that the advantage of family tie might not necessarily still play a positive role when pre-succession performance is relatively well. The effect of external in good performing firms (0.76-0.99+0.66) is not significant, since the Wald test on the null that the effect is equals to zero has a p-value of 0.41.

Again, this approach contains the endogeneity problem of timing of succession. As family member, it is nature to take advantage of family tie, that is, the disadvantage of lacking actual experience of working in the firm or other merit that belongs to internal successors can be compensated by being appointed when firm is in “good shape”. In this case, it is not necessarily conclude that external successors still outperform internal successors when pre-succession perform is relative well. Correspondingly, the insignificant coefficient of interaction term After\*Good\_performer\*External confirms above argument.

Another reason of such results might because of insufficient observations, since external family successors only have 78 observations (39 successions), and a small sample size also cause potential biases as well.

**Section 5 Conclusions**

Mike et al (2003) point that family firms which are controlled by the founders or the founders’ families are the most extensive form of organization in the world. In the US some of the largest firms, such as Wal-Mart Stores and Ford Motor, are still controlled by the family. In Europe, significant ownership also maintains in the family after the founder retires. His children can either hire a professional manager to manage the firm, as in BMW or Fiat, or to manage the firm by themselves, as in Peugeot.

Whether the family firms can smoothly transfer management to family members or to professional managers, while sustains the family in the firm, becoming one of the most critical issue in this field, and with important practical implications (Wendy, 1994).

However, most recent researches are focusing on western companies; there is little evidence from Chinese papers. On one hand, as the fastest developing country in the world, family firms remarkably contribute to China’s GDP growth (Yuan et.al, 2008)**.** On the other hand, they are facing succession problem as well.

By using a Chinese listed family firms’ dataset, this thesis mainly studies the relationship between successions and family firms’ performance; moreover, how family firm’s performance is affected by family successions under different situations.

The results indicate that successions including family successions as well as unrelated successions negatively influence family firms’ performance. When the successions are following a relative poor performance of the firm, the family management underperforms the unrelated succession.

For those family successions, family management still cause negative effect on firms’ performance even after a relative good situation before succession occur. However, in terms of external family members, positive effect on firm performance are observed, which is in contrast to most of previous evidence. Such result suggests that the natural of family member such as closer to the firm or to the founder might compensate the disadvantage of lacking working experience before successions. However, no evidence is found that change different managerial positions will cause statistic different effect on firm performance. This study extends the earlier work by Marco and Giacinto (2008) into successor’s source and managerial positions.

Some Further research can be investigated in this area. In particular, the factors related to the succession determinations for the family firms. One example is the gender effect. Such as the first child’s gender of the family dynamically affect the choice of the founder; or since more women are becoming founders of the firm, their characteristics may differ from those male founders, thereby affecting the decision of succession and firm performance.

Some potential drawbacks of this thesis must be addressed. First, the analysis consists of the endogeneity problem of succession. That is the timing of succession, which is mainly related firm’s current performance. For example, in a family firm, the founder tends to pass the management to family member when the firm is in a relative good status, thereby causing the post family firm performance differ from other firms. Second, as a cross-sectional data, the analysis does not control for the year effect, for instance, after a succession in 2007, poor firm performance in 2008 may not purely due to the succession but the year effect of economic crisis.

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1. The CSMAR database also provides the option to choose the firm that experienced managerial changes, accordingly the changed position, which can be confirmed by the announcement. [↑](#footnote-ref-2)
2. There is option in CSAMR database to select internal or external successions. [↑](#footnote-ref-3)
3. Industry classification is based on the “The industry classification of listed companies (2001) “which is issued by China securities regulatory commission. [↑](#footnote-ref-4)
4. Notably, in this comparison, all years of data for each firm are included. Each mean of variable followed two steps: first step is to take each firm’s average of variable, secondly, taking average of firms that in each category. [↑](#footnote-ref-5)
5. Since there is only one family firm in industry D,F and K, these three successions are compared with the industry mean of the whole family firms, as a result, the succession in D and F industries are good performer, the succession in K industry is classified as poor performer. [↑](#footnote-ref-6)
6. P- value is 0.85 which is insignificant and cannot reject the null hypothesis which is random-effect model. [↑](#footnote-ref-7)
7. The poor performer observations in table 4 is 124, that is only for the family successions. [↑](#footnote-ref-8)