



## Family Business: Why Firms Do Well When Founders Are at the Helm

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Despite the lack of independent directors on their boards and voting power for minority shareholders, family-run companies are still the better bet for all stakeholders as long as the founder of the firm is involved as chief executive officer or chairman. If the descendent of a founder runs the company, value is lost.

Those are some of the conclusions of a paper by Wharton professor [Raphael Raphael \(Raffi\) Amit](#) and Harvard Business School professor Belen Villalonga. The paper - "How Do Family Ownership, Control and Management Affect Firm Value?" - suggests that family ownership of corporations performs better than non-family firms when the founder serves as the CEO of a family firm or as its chairman with a hired CEO. When a descendent serves as the CEO of a family-run company - even if the founder remains chairman - the firm's market value declines.



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Amit and Villalonga analyzed proxy data on all Fortune 500 firms from 1994 to 2000. For the purposes of the study, a family firm was defined as a company where the founder or member of the family by either blood or marriage was an officer, a director or the owner of at least 5% of the firm's equity either individually or in a group. Some of the most successful U.S. companies, including Wal-Mart, Home Depot, Heinz, Rubbermaid and Black & Decker, are family-run. The hallmark of each of these companies is a founder who had vision and the managerial skills to rally employees around a business.

But performance slips when the founder's vision is diluted by descendants, as shown by such firms as Ford Motor and Motorola. William Ford Jr., a fourth generation descendent of Henry Ford, now runs the giant auto manufacturer, which recently reported that September sales fell 7% from a year ago - in part a reflection of stiff competition from Japanese rivals. William Ford Jr. had been brought in three years ago to revive the company. Wireless phone maker Motorola, facing tough competition from Nokia and Samsung, saw CEO Christopher Galvin, whose great-grandfather founded the company, officially hand over the reins to former Sun Microsystems executive Edward Zander in January.

By the numbers, family firms in Amit and Villalonga's sample are younger (62.68 mean years vs. 72.19 for non-family firms), deliver better sales growth (19.6% for family firms vs. 13.8%) and have higher return on assets (11.6% vs. 10.9%). Amit points to some of the negatives of family businesses - notably different levels of voting rights among shareholders, cross-holdings and voting blocks, all of which are designed to keep company control in family hands.

But even with those control issues, family-run companies still do better for shareholders if the founder remains involved. The ideal family company for minority shareholders is one where the founder is CEO or chairman of a firm that does not have any control-enhancing mechanisms such as Class A and Class B super voting and nontradable shares.

### Why Founders Matter

The goal of Amit and Villalonga's project was to ask whether they perform better for shareholders. That said, family firms seem to outperform their non-family counterparts for two reasons. Many non-family

companies suffer from the standard conflict between management and shareholders over such issues as returns, management pay and governance. "This conflict between owner and manager is standard in widely-held firms" says Amit. "In a family-run company, the manager and owner are the same and so the conflict doesn't exist."

Family firms do carry the baggage of tensions between majority and minority shareholders; however, stockholders are still better off because there is a higher cost to the shareholder-owner conflict compared to squabbles between minority and majority shareholders. Although those conflicts may help or harm results, the real reason family companies seem to work is their link to founders. "We don't go into the effects of founders specifically, but there is an effect," says Amit. "Founders instill commitment into the entire employee base. That makes the company better. Non-family companies don't have that."

Such reasoning is why struggling companies often bring back their founders to right the ship. Apple Computer co-founder Steve Jobs returned to the company in 1997 as interim and later permanent CEO, and turned the company around with new products such as the iMac and iPod. PeopleSoft ousted CEO Craig Conway Oct. 1 and brought back founder David Duff. Charles Schwab's founder and chairman stepped back in as CEO in July after the company announced a 10% drop in earnings for the quarter.

Amit's and Villalonga's findings illustrate the founder effect. According to this research, firms with a founder-CEO at the helm have the best mean ratio of market value to assets, also known as Tobin's q. Firms with a founder-CEO and chairman had a mean Tobin's q of 3.12. Firms with a founder as chairman and an outside CEO scored almost as high (2.81). The founder-performance link, however, seems to break when descendants enter the picture. When the founder is succeeded by a descendent as chairman, Tobin's q drops by a full point to 1.81. The ratio of market value to assets drops further when the CEO is also a descendent.

The lesson: Family run companies need to have the founders involved to succeed. "Our results confirm that founders bring valuable skills to their firms," write Amit and Villalonga. "However, when we look at the chairman's position as well as the CEO's, we find that founders' skills are almost as valuable when they bring them to the firm through their position as chairman but have a hired CEO in place. One likely explanation for this is the nature of the skills that founders bring to their firms: Founders may be inspiring leaders, great visionaries, or exceptionally talented scientists. But they may not-and need not-be good managers as well."

## The Corporate Family Tree

Despite the definition of 'family firm' offered earlier, it isn't always clear what constitutes a family-run company. There are companies such as Hewlett-Packard, founded by Bill Hewlett and David Packard, whose families now control large blocks of shares in H-P. The Packard family owns twice as many shares as the Hewlett family and is deemed the controlling family by Amit and Villalonga. Cereal maker Kellogg Company is controlled by the W.G. Kellogg foundation. Fashion retailer Nordstrom is another family-run firm.

But other situations aren't as obvious. Time Warner became a family firm in 1996 as the result of the acquisition of Turner Broadcasting System, whose founder, Ted Turner, became the largest shareholder in the merged entity. The Ochs-Sulzberger and Graham families took over the New York Times Co. and Washington Post Co., respectively, by acquiring bankrupt companies. Amit aggregated family ownership across all family members and representatives as well as share held in trusts.

Once family ownership is established, firms fall into the following broad categories:

Family firms with controlling mechanisms and a family CEO. In these companies, families control the company through mechanisms such as super-voting shares, which may not trade publicly and give the family a certain number of shares of voting power for every share

they own.

Family firms with controlling mechanisms but no family CEO. These firms have a structure that keeps family voting power, but hire outsiders to run the company. Ford hired Jacques Nasser as CEO in the 1990s, for example, before handing the reins back to a Ford descendent.

Family firms with a family CEO but no control-enhancing mechanisms.

In all those cases, whether the founder is involved in the company seems to be the biggest differentiator behind its success.

## Good Governance

Although family companies often lack independent directors and give insiders more voting power, they still managed to score higher on corporate governance than non-family companies. To Amit, this finding is one of the more surprising conclusions.

On the corporate governance index, family-run companies had a mean score of 9.05 compared to a non-family firm score of 10.02. A lower score is better. "The family firm is often cleaner," says Amit, who adds that family firms have fewer "golden parachutes" for executives and don't have change-of-control provisions to line executive pockets in the event of an acquisition.

Nevertheless, that's not to say there are no governance issues, Amit adds. Family companies are more likely to employ measures to keep control of the company by issuing shares differentiated by voting power. Families own 16% of the equity of the Fortune 500 firms they represent, but 50% of them use control-enhancement mechanisms. In contrast, 13% of the non-family firms use control-enhancing techniques. These methods allow family shareholders to have more voting power than their ownership stake would suggest.

According to Amit and Villalonga, family firms also maintain control in another way: They keep the percentage of non-family shareholders low. In addition, family firms have a significantly lower proportion of independent directors compared to non-family companies, says Amit. But even when all the potential governance issues are weighed, he adds, family firms still come out ahead.

Being a shareholder of a company that lacks independent directors and keeps voting power with one family may seem counterintuitive given today's focus on corporate governance. But the bottom line is family-run companies are valuable - especially when the founder serves as chairman and CEO and creates a positive corporate culture for the firm's employees.

"Altogether, our findings suggest that in order to understand whether and when family firms are more or less valuable than non-family firms, one must distinguish among three fundamental elements in the definition of family firms: ownership, control, and management," write Amit and Villalonga. "Despite the costs associated with the family's excess control," they add, "the benefits of family ownership make minority shareholders of founder CEO family firms better off than they would have been in a non-family firm."

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