Family Ownership and Investment Performance

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It is now ten years since I started my university studies at Jönköping International Business School (JIBS). Coming from Skåne I was not sure if I wanted to live in Småland but quite soon, I fell in love with economics so I stayed. Now, ten years later, I am about to defend my doctoral dissertation. It has been an instructive, fun, interesting, and exiting journey. I would like to thank many people who have made it possible for me to complete this work.

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Johanna Palmberg

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Abstract

This dissertation provides an economic analysis of families as owners of large listed firms. The essential research question is whether family ownership provides an efficient form of governance. Family ownership and control is evaluated from different angles; how ownership, control, management, and board structure affects firm performance, and executive compensation.

Chapter two “A Contractual Perspective of the Firm with an Application to the Maritime Industry” is a conceptual paper analyzing the contractual structure of a firm. The chapter conceptualizes the relations between firms, and markets, and gives a transaction cost perspective of why firms are organized the way they are.

The third chapter “The Impact of Vote Differentiation on Investment Performance in Listed Family Firms” investigates ownership and control in Swedish family-controlled firms. The analysis shows that family control is beneficial, but only if voting rights and cash-flow rights are aligned.

The fourth chapter “Family Control and Executive Compensation” analyses whether families use remuneration as a way to expropriate minority shareholders. The study shows that managers in family-controlled firms have a lower share of variable compensation than managers in non-family controlled firms. The analysis shows further that family control has a reducing effect on the total level of CEO-compensation.

The last chapter “Board of Directors, Dependency, and Returns on Investment” investigates if there is a relationship between ownership structure, board of directors, and firm performance. The marginal q analysis indicate that firm-dependent directors have a negative impact on firms’ investment performance. Owner-dependent and employee elected directors do not affect firm investment performance.

To sum up, the empirical results show that family ownership and control affects remuneration in listed firms, and the firm investment performance. The analysis further shows that there are clear differences in the ownership and governance structure between family and non-family controlled firms.
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Chapter 1

Introduction and Summary of the Thesis

By
Johanna Palmberg

1. Introduction

Family ownership is a common feature in many countries (Astrachan & Shanker, 2003; Barca & Becht, 2001; Claessens & Fan, 2002; La Porta, López-de-Silanes, & Shleifer, 1999). The corporate governance model, described by Berle and Means (1932), with free-standing firms characterized by diffused ownership and strong separation of ownership and control, is dominant, more or less, only in the USA and the UK. In almost all other countries, a great deal of the firms is part of greater networks or business groups. In many cases, a family controls the group via control-enhancing mechanisms such as pyramidal ownership structures and shares with multiple voting rights.

The general view is that family firms are important and give rise to vital dynamism during the early phases of industrial development. As the economy matures and its institutional settings become more sophisticated, the family firm as business form is dismantled to give room for managerial corporations (Colli, 2003; James, 2006). History shows, however, that family firms as business form have outlived both the first, and the second European industrial revolution and are still a dominant form of business organization in many countries. Many family firms are small-scale firms with none or only a few employees, but families are also in control of large, often international, public firms (Jones & Rose, 1993).

Family ownership and control have implications on both a macro- and a micro-economic level (James, 2006). One important research question is to find out how firm performance relates to economic growth, i.e., how does firm level performance relate to economic growth on the macro level? That is, what type of capitalism generates the highest standard of living in a longer time perspective? Is the relationship type of capitalism, as prevalent in continental
Europe and Japan the most efficient or is it the Anglo-Saxon type of capitalism that best contributes to long-term economic growth? The continental European relationship capitalism is strongly characterized by family relations. This type of relationship capitalism has created, in the past, high-growth economies. The continental European financial markets have until the 1980s-1990s been characterized by a bank-based system and strong national capital markets with limited international mobility of capital. Therefore, it is an important research question to assess how these economies will develop following the financial globalization in recent decades.

This dissertation is related to the above discussion by providing an economic analysis of families as owners of large listed firms. The essential research question is whether family ownership is an efficient form of governance. The aim is to improve the understanding of family ownership and control for investment performance. Family ownership and control is evaluated from different angles; how ownership, control, management, and board structure affects firm performance, and executive compensation. Family firms are in this dissertation defined in terms of control rights, i.e., if the largest owner control the firm. See Section 2.4. in this chapter for further discussion. Further, each study contains a discussion of the variables used.

The dissertation consists of four chapters in addition to this introductory chapter. This chapter aims to present the overall theoretical framework applied and to contextualize the dissertation. The different chapters can be read independently but when taken together they provide a comprehensive analysis of the firm and family ownership and control of firms. The theoretical framework of the dissertation rests on principal agent theory and transaction cost analysis. The second chapter “A Contractual Perspective of the Firm with an Application to the Maritime Industry” differs somewhat from the other three, in the sense that it is a conceptual paper analyzing the contractual structure of a firm. It clarifies how the nature of shareholders’ contract differs from those of other stakeholders. The chapter contributes to the dissertation since it conceptualizes the relations between firms, and markets, and gives a transaction cost perspective of why firms are organized the way they are.

1.1. Summary - Research Focus and Outline of Dissertation

Family business research is, within economics and business administration, a relatively young research area (Casillas & Acedo, 2007). For example, in the late 1980s a number of research institutes1 were established, and in 1988, the Family

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1 In 1986, Academics and family business executives founded the Family Firm Institute (FFI) in the USA. The European Family Business Network (FBN) was established in 1994. See Colli (2003), pages 22-26, for an interesting discussion of the “Changing Perspectives on Family Firms”. This section discusses how the field has developed over the last decades since the 1960s.
Firm Institute (FFI) launched the scientific (quarterly) journal *Family Business Review*. It is interesting to note that the field combines many different disciplines such as management, economics, finance, law, economic history, sociology, psychology, econometrics, and statistics. Alongside, the scientific discussion there has also been a, sometimes lively, political debate regarding family capitalism.²

This dissertation adds to the knowledge on family business in a number of ways. First, the research on corporate governance issues is context-based (Morck & Steier, 2005; Randøy, Thomsen, & Oxelheim, 2006). This dissertation adds to the general knowledge of corporate governance issues, family ownership and control, and firm performance by using Sweden as an object of study. The excellent availability of corporate governance variables makes it possible to perform detailed study of these issues. The Swedish corporate governance model is a variant of the continental European model with a strong presence of family firms, concentrated ownership, and historical dependence on a bank-based financial system.³ However, the Swedish financial markets, over time, have become more and more like the Anglo-Saxon system with a highly developed market-based system. Section 4 provides a discussion on the development of the Swedish political and economic system.

Second, a relatively new methodology for measuring firm performance has been applied. Marginal $q$, which in essence is a marginal version of Tobin’s $q$, is used in two of the studies (chapter 3 and 5 in this dissertation). The marginal $q$ methodology helps to circumvent some of the problems that are usually associated with average performance measures. Section 3 in this introduction discusses methodological issues related to performance measures.

### 1.2. Outline of the Introductory Chapter

The rest of this chapter is outlined as follows: Section 2 discusses theories of the firm, corporate governance, and family ownership and control. Section 3 provides an overview of methodological issues such as endogeneity and reverse causation related to how firm performance is measured. Section 4 presents an overview of the Swedish corporate governance model. The introductory chapter ends with a concluding discussion of the dissertation, its contributions, and implications for further research.

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² Hermansson (1971) is one important example of the Swedish debate in the 1960s and 1970s.
³ See for example Henrikson and Jakobsson (2005) for an overview of the development of the Swedish corporate model.
2. Theories of the Firm and Corporate Governance

Section 2 provides a theoretical framework for the dissertation. The focus is set on the rationale behind the structure of a firm, the agency problem, and a discussion of what constitutes a family firm. The central theme in this dissertation is how separation of ownership and control affects the performance of the firm. Families are considered as owners with special characteristics that affect a firm’s contractual structure and performance. Following Jensen and Meckling (1976), the firm is seen as a “nexus of contracts” where the owners constitute one contracting partner and the management of the firm another. In the following, the firm is analysed from a contractual perspective.

2.1. Theories of the Firm - From a Transaction Cost Perspective

Before going further into the subject of families as owners’ we should take a step back and consider the rationale behind firms. In essence, economic theory is about explaining the actions of humans in the market system. If firms are given and do not have to be explained, production and allocation of resources in a pure capitalist society takes place via the market, through interaction between households and firms. This interaction takes place within an institutional framework partly determined by the public sector. Specialization, competition, and cooperation among economic actors generate increased profitability, productivity, economic growth, and higher standards of living. Hence, there is an increasing demand for economic organizations, which facilitates such firms.

By asking why firms exist, Coase (1937) inspired a new field of research and the school of transaction cost analysis (TCA) which has been further developed by, among others, Williamson (1985). Prior to the TCA, scholars within mainstream economic theory only concluded that production takes place within firms and then went on to analyse the functioning of markets. The TCA assumes that it is costly to use the price mechanism, so production takes place within a firm, if it is less expensive to organize the production into one legal entity that is separated from its owners. One important implication of this is that the corporation is legally responsible for its actions, i.e., the owners have limited liabilities.

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4 Here the focus is on a special form of the firm, i.e., the corporation. The corporation is a legal entity that is separated from its owners. One important implication of this is that the corporation is legally responsible for its actions, i.e., the owners have limited liabilities.

5 See North (1990) for a further discussion regarding institutions. North separates informal and formal institutions; this division also is valid here.
entity. Accordingly, transaction costs determine the size, the scope, and the structure of a firm.

Fama and Jensen (1983a; 1983b) use the Coasian approach and define the firm as a "nexus of contracts"\(^6\) between owners of production factors, suppliers, and customers, where the manager-entrepreneur gather different stages of the production in one entity (a firm) to lower production transaction costs. An efficient production requires a steady flow of goods, this, sometimes, makes the different production factors interdependent of each other and they become vulnerable to post-contractual issues such as delays, hold-up problems, moral hazard, bounded rationality, and opportunism. Williamson (1985) refers to this type of dependence as *asset specificity*. According to Mueller (2003) a firm differs from other organizations and co-operations’ on the market with respect to the nature of the contract; "The salient characteristics of a firm as an organization for cooperation is the informal and implicit nature of its contract" (Mueller, 2003, p. 23).

Common to all these theories of the firm is that the ultimate goal of a firm, from the owners’ perspective, is to maximize shareholder value, i.e., to maximize firm profit. Due to various incentive structures, the managers might tend to have other goals, such as maximizing sales instead of profit (Baumol, 1967) or to withdraw private benefits of control from the firm (Williamson, 1964; 1963)\(^7\). Further, Marris (1963, 1964) argues that managers might cater to other objects and maximizes their own utility rather than shareholder values.\(^8\) When owners and managers have conflicting interests, the classical principal-agent problem occurs (Berle & Means, 1932). In firms with concentrated ownership a second type of principal-agent problem arises, namely between majority and minority shareholders. This second type of principal-agent conflict is assumed to be especially pronounced in family firms (Villalonga & Amit, 2006, 2009).

### 2.2. Agency Problems

Following Jensen and Meckling (1976), most studies in corporate governance rest on the principal agent theory. An agency relationship can be defined as:

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*Jensen and Meckling (1976) coined this expression in the article “Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure”. Chapter 2 in this dissertation presents an overview of the different types of contractual relations a firm has.*

*See Mueller (2003) chapter 5, for an extensive discussion on managers’ goals.*

*This school of thought is often referred to as the “Managerial Theory of the Firm”. Pentrose (1995) (originally published in 1959) also belongs to this school of thought. Her book “The Theory of the Growth of the Firm” has laid the floor for the resource-based theory of the firm. Cyert and March (1963) takes a behavioral approach when explaining the rationale behind firms. Alchian and Demsetz (1972) give a different analysis and focus on administrative costs and monitoring issues related to team production within a firm.*
“a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent”.

(Jensen & Meckling, 1976, p. 308)

In a corporate setting, the agency relationship means that, the equity and bond holder(s) is the principals that hire a CEO/management (agent) to lead the firm. Principal-agent problems arise since it is costly to formulate complete contracts; therefore, contracts are bound to be more or less incomplete with loopholes inviting opportunistic behavior. Agency costs then are:

“the sum of 1. the monitoring expenditures by the principal, 2. the bonding expenditures by the agent, 3. the residual loss”

(Jensen & Meckling, 1976, p. 308)

As a nexus of contracts, the firm can therefore be seen as a coordinating entity with contractual relationships with investors, bondholders, suppliers, customers, and labor. A firm’s two most important contracts are, however, i) the contract that stipulates how the residual claims are organized and ii) the contractual relationship that defines the decision process within the firm to safeguard these claims. As owners of the firm, the shareholders have the residual claim on the cash flows when all other contractual obligations have been met. This implies that the residual claimants bear the risk of the firm and for this; they receive the profit, i.e., the net cash flows. The residual claimants are directly dependent on how well the firm is managed and should therefore influence the governance of the firm. In larger corporations, the shareholders influence the firm via the board of directors.

The decision process, at the chief executive level, that affects the size of the residual claim, can be divided into four steps: initiation, ratification, implementation, and monitoring (Figure 1). Decision management includes initiation of new investment projects, resource allocation, contracts, and implementation of ratified projects to one decision body. Decision control includes ratification of investment projects and monitoring (Fama & Michael Jensen, 1983a; 1983b). In large firms, the residual claimants delegate the decision control to the board of directors. The board of directors then delegates the decision management of the firm to the Chief Executive Officer (CEO).

In family firms, for example, the family is in control of the voting and cash flow rights of the firm. If it is a small private firm, the family also controls the board of directors and the management of the firm (often these are the same persons). In large listed firms, the family does not have 100 percent of the voting and cash flow rights; rather, other investors have residual claims and

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9 See Knight (1921) for a discussion on risk, uncertainty, and profits. See Fama and Jensen (1983a; 1983b) for a thorough discussion of residual claimants.
therefore interest in how the firm is governed. The question becomes more complex when firms use control-enhancing mechanisms since they give the (controlling) owner excess control over cash flow rights. The ownership structure is, hence, of crucial importance in this discussion.

Following this division Fama and Jensen (1983a, 1983b) examine when it is efficient to combine the decision management, decision control, and residual claims into one agent and when it is more efficient to allocate these functions to several agents. They derive two complementary hypotheses regarding the governance of the firm:

"Separation of residual risk bearing from decision management leads to decision systems that separate decision management from decision control.

Combination of decision management and decision control in a few agents leads to residual claims that are largely restricted to these agents."

(Fama & Michael Jensen, 1983a, p. 304)

In small non-complex family firms the whole decision process both management and control, and the residual claimants, is in the hands of the owners. Agency problems can be circumvented by allocating everything to the agent or the group of agents who have the firm specific information. In this sense, the restricted residual claims substitute for expensive control.

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10 Fama and Jensen (1983a) define noncomplex firms as firms where a few agents are in control of the firm specific information, where specific information is "detailed information that is costly to transfer among agents" (Fama and Jensen, 1983a, p. 305). See Fama and Jensen (1983a) footnote seven for further discussion. Complex firms, on the other hand, can be defined as firms where "specific knowledge relevant to different decisions-knowledge which is costly to transfer across agents- is diffused among agents at all levels of the organization" (Fama & Jensen, 1983a, p. 308).
mechanisms. This organizational form is commonly used. For example, the residual claimants and the decision process in closed corporations, sole proprietorship, and partnership are all concentrated to one or a few agents.

In complex organizations, on the other hand, the decision process and the residual claimants are not the same agents. Agents that are in control of the decision process do not bear the full wealth consequence of their actions, which makes it important to deal with the agency problem. A separation\textsuperscript{11} of the decision process, i.e., what scholars usually refer to as "separation of ownership and control," is important to keep it effective and to limit the possibilities of opportunistic behavior both by the management and by the controlling owners (Fama & Jensen, 1983a).

To overcome the agency problem, decision management and decision control are separated into different units. Different checks and counter-checks balance the decision process and no single agent has the power to control the whole process. By separating decision management from decision control incentives to extract private benefits from the firm as well as opportunistic behavior can be reduced. This means that at the same time as the decisions process is allocated to agents that have the specific information, the separation of management and control in the decision process reduces the associated agency problem.

Family-controlled firms are especially interesting in this sense, since in these firms it is possible to identify one or a close group of agents, who are in control of the firm. Through the board of directors and subsequently via the management, the family has the potential to influence the firm on a number of levels. As discussed in the next section, families often apply different control mechanisms, which accentuate the disproportional ownership structure.

2.3. Disproportional Ownership and Family Firms

There are a number of mechanisms available to increase the separation of ownership and control. Family business groups often use pyramidal ownership structures, cross-holdings, and voting agreements to gain or to keep the control of the firm in excess of their financial interest as shareholders. Dual class shares is the most commonly used control-mechanism among Swedish listed firms (Agnblad, Berglöf, Högfeldt, & Svancar, 2001). This type of control enhancing mechanism is often referred to as disproportional ownership since dual-class shares:

\textsuperscript{11} By separation Fama and Jensen (1983a) mean that a single individual (or a few agents such as a family) should not have exclusive control over the whole decision process, some overlap is however possible.
Introduction and Summary of the Thesis

“allows some shareholders to effectively control a proportion of votes that is larger than their proportion of rights to the firm’s cash flow rights”

(Adams & Ferreira, 2007, p. 5)

The empirical evidence on disproportionate ownership varies across countries but seems to suggest a discount on the market value of equity (see Table 3 in Adams and Ferreira, 2007, for an overview of the empirical literature). Shareholders are better off under proportionate ownership,12 with a one-share/one-vote share structure where each shareholder is entitled to vote in correspondence with the capital shareholding.

Disproportionate ownership can be of explicit as well as implicit character. Explicit control-enhancing mechanisms are mechanisms that can be quantified, such as pyramidal ownership, dual-class shares, various forms of voting agreements, and cross-ownership. The associated effects on the ownership structure are observable even for external agents. The opposite is true for implicit control-enhancing mechanisms; it is hard for an outsider both to detect these mechanisms and to quantify their effects on the governance structure. Diffused ownership, for example belongs to this group. In a firm where no agent or group of agents has enough shares to control the firm, a group of owners can come together and work together with the management to implement different investment projects. It is almost impossible for other shareholders and external stakeholders to assess how much is needed to take control of the firm. Fiduciary voting rights are another example of implicit control-enhancing mechanism where it is difficult for outsiders to examine the effect on the governance system. That is, the division into implicit and explicit control-enhancing mechanisms depends on the level of transparency. (Adams & Ferreira, 2007)

Families often use a combination of control-enhancing mechanisms to control the firm in addition to their cash-flow rights. For example, the use of pyramidal ownership structures as well as dual-class shares is widely used by families to keep the control of the firm even after it goes public. For example, Bjuggren and Palmberg (2010) find that listed family firms to a larger extent than non-family controlled firms, apply vote-differentiated shares. Family-controlled firms with low levels of excess votes (voting rights minus cash flow rights) also have higher levels of efficiency in terms of investment performance. Cronqvist and Nilsson (2003) further show that other types of control-enhancing mechanisms such as right of pre-emption; voting restrictions and shareholder agreements are relatively more common among family firms. These findings support the argument that family firms use different types of control-enhancing mechanisms to extract private benefits from the firm.

12 Proportionate ownership implies that cash flow rights equal the effective voting rights for each shareholder. See Adams and Ferreira (2007) for an empirical and Burkart and Lee (2007) for a theoretical discussion regarding One Share, One Vote. Both these articles provide extensive literature reviews on the subject.
2.4. **Family Firms**

Even though the concept of family firms is elusive, most empirical studies use a definition that relates to family, ownership, control, or management (Miller, Le Breton-Miller, Lester, & Cannella, 2007). Many studies also combine these concepts and include further requirements such as that member(s) of the founding family should be part of the top management or involved in firm strategy decisions. An accurate definition of the concept is, however, crucial since the degree of family capitalism depends on the choice of definition.13

A common perception, both in economics and in business history, is that family ownership and control is a response to “asymmetric information, a turbulent environment, and a legal system unable to secure and enforce property rights” (Colli, 2003, pp. 8-9). Burkart, Panunzi, and Shleifer (2003) have a similar argument and assert that family ownership is a response to poorly developed institutions. Bebchuk (1999) shows in a theoretical model that weak minority shareholder protection leads to concentrated ownership structures due to extraction of private benefits of control. That is, if the legal protection of minority shareholders is weak, as it is in Sweden and continental Europe, the ownership structure will be concentrated with the control of the firm in the hands of a few investors.14 Bhattacharya and Ravikumar (2001) develop one of the first formal models within financial economics to analyse the evolution of family businesses and its impact on primary capital markets. The model shows that the level of financial development determines both the size of family firms and the persistence of family firms. Family ownership is more common where primary capital markets are poorly developed. This holds, even when the firms have access to external capital markets (Bhattacharya & Ravikumar, 2001).

Following a managerial capitalism perspective, family firms should be small firms that exist at the beginning of the life cycle of the economy. Further, family firms have slow growth, rely on internal or locally generated financing, mostly present in labor-intensive and traditional industries, and are less profitable than managerial corporations. Instead, as Colli (2003) points out, there are many large, sometimes listed, family firms that mix traditional features such as dynastic motives and internal succession patterns with more modern characteristics in terms of technology, financing, and globalization. As this dissertation shows, Sweden has many large listed family firms that act on a highly competitive global market, with high profitability. Empirical evidence further shows that family ownership on the stock market is common in many other advanced industrial countries (Anderson & Reeb, 2003; Andres, 2008; 13 Shanker and Astrachan (1996); (2003), for example, presents an interesting review of how different definitions relate to the diffusion of family firms and its contribution to GDP.

14 Holmén and Knopf, (2002 p. 169), show, however, that “Sweden's extralegal institutions and norms protect minority shareholders”. That is, extralegal institutions reduce effects associated with weak minority protection.
Maury, 2006). This characterization of family firms also rules out definitions based on sectoral belonging or profitability.

A fourth explanation of family firms, commonly put forth by business historians is the stages theory. This theory considers the time horizon of family firms and relates to concepts such as endurance and continuity. Family firms are seen as relatively short-time phenomena when only after a few generations the firm turns into a managerial corporation due to difficulties of keeping the family in control of the firm (Colli, 2003).

The problems of finding a definition suitable for quantitative analysis are even greater. For example, there are large cross-country differences when it comes to the effectiveness of ownership. However, the knowledge regarding institutional differences is growing and an institutional perspective is taken into account in contemporary definitions. Most empirical studies define family firms with respect to control, ownership, and/or management of the firm (Villalonga & Amit, 2006). The literature can roughly be divided into three groups; i) founder-ownership in line with (Anderson, Mansi, & Reeb (2003); Anderson & Reeb (2003), ii) control in terms of voting and/or cash flow rights (Claessens, Simeon, Fan, & Lang, 2002; La Porta et al., 1999; Morck & Yeung, 2004) and iii) family involvement (Chrisman, Chua, & Litz, 2004; McConaughy, 2000; McConaughy, Matthews, & Fialko, 2001).

Burkart et al. (2003) nicely summarize the reasons for families to keep control into three groups, i) amenity potential, ii) reputation, and iii) minority expropriation. Amenity potential refers to the benefit that the family can get from the firm without interfering with the profit of the firm. It could be, for example, the extra utility for the founder to have their descendants as managers or in other ways involved in the company. It could also be political, cultural, or social recognition or influence. Ehrhardt and Nowak (2003) argue that amenity potential is one of the most important factors for retained family-controlled firms in Germany. Family control may also be an important reputational factor both in economic and political (see for example Landes, 2006, for a discussion of family dynasties’ economic and political influence, both in Europe and in the USA).

Finally, minority expropriation refers to extraction of private benefits of control that actually affects firm value (Jensen & Meckling, 1976). Examples of costly private benefits of control are electing economically unsuitable family members to positions within the firm; it could also be investments in non-profitable projects, i.e., profits with negative net present values (NPV), excessively high remuneration for work done by family members, or consumption on the job. Disproportional ownership, discussed in the previous

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15 Ehrhardt, Nowak, and Weber (2006) examine family ownership in Germany during 1903-2003 and find that “families are slow to give up ownership, and control of businesses remains strong even after several generations” (Ehrhardt, Nowak, & Weber, 2006, p. 1).

16 See Bjuggren and Palmberg (2010) for further discussion of definitions of family ownership and control.
section, accentuates the incentives for controlling owners to extract private benefits of control from the firm since the owner in control does not have to bear the full cost when extracting rents from the firm.

3. Marginal versus Average Performance Measures

To measure the effects of corporate governance structures, we need an outcome measure, a value that measures the efficiency of the firm. Tobin’s $q$, measuring the ratio between the market value of equity and debt to the replacement cost of capital, is the most common measure of firm performance. Theoretically, one can use Tobin’s $q$ to assess how well the management aligns with the principal object of the firm, which is to maximize shareholder value. In practice, however, Tobin’s $q$ suffers from a number of drawbacks that make it questionable as a measure of firm performance.

First, average measures of firm performance have the disadvantage of mixing inframarginal and marginal returns on capital. For example, the value of Tobin’s $q$ includes distorted effects on returns on capital of imperfect competition. Therefore, it is not possible to measure the effect of managerial performance, which is the point of interest. For further discussion, see Gugler, Mueller, & Yurtoglu (2004b, p. 513). Second, the most serious drawbacks of average performance measures are, to avoid problems of omitted variables, reverse causality and/or endogeneity. A marginal performance measure could be applied to avoid these problems (Gugler & Yurtoglu, 2003). Assuming market efficiency, Mueller and Reardon (1993) derive such a measure – marginal $q$- that can be applied without the problems usually associated with average performance measures.

3.1. Econometric Problems - Endogeneity

Most studies that use corporate governance structures to explain firm performance are criticized for problems of endogeneity (Adams, Almeida, & Ferreira, 2009; Bennedsen, Nielsen, Pérez-González, & Wolfenzon, 2007; Burkart & Lee, 2007; Demsetz & Lehn, 1985; Miller et al., 2007). The main criticism is that governance variables are not exogenous to firm performance when average performance measures are used. This means that, it is not possible to determine whether ownership structure determines firm performance or if certain investors are keener to invest in certain types of firms. If, on the other hand, governance variables were exogenous to firm performance, the omitted variable problem would cause imprecise estimates; the estimates would, however, still be consistent. Endogeneity is usually caused
either by omitted variables or by reverse causality and create problems such as biased and inconsistent estimates with misleading signs. (Adams & Ferreira, 2007)

Problems of omitted variables are often present in corporate governance studies. For example, Gompers, Ishii, and Metrick (2010) and Villalonga and Amit (2009) examine determinants of dual-class shares and show statistically that firm-specific characteristics determine dual-class shares. Hence, to avoid problems of omitted variable bias, one needs to specify a full structural model that includes control variables so that the effects of governance variables can be isolated.

One way to circumvent this problem is to apply a panel data methodology. The fixed effect method, for example, cancels out the unobserved firm-specific heterogeneity by means of differentiation. Until recent years, problems of too short panels in the time dimension have made it difficult to use such models. An even more sophisticated way of addressing problems of endogeneity is to apply some sort of dynamic panel data methodology as suggested by Arrelano and Bond (1991), Arellano and Bover (1995), and Blundell and Bond (1998). This type of methodology increases the requirements on the time dimension in the panel even further, however.

Adams and Ferreira (2007) further emphasize that not all problems are caused by omitted variables. In such cases, applying a panel data methodology does not solve the problems of endogeneity. An instrumental variable (IV) approach is more appropriate. This method implies that, instead of using the real variable that is endogenous, one would use a variable that is exogenous to the residual but correlated with the endogenous variable. To be a valid instrument both the validity and the relevance condition must be satisfied. The relevance condition can easily be tested with t-statistics from the first-stage regression analysis; the validity condition is based on the residual and is hence not testable. Rather, economic theory and faith has to be used to convince the reader that the instrument fulfills the validity condition (Wooldridge, 2002).

In recent years, a number of studies on family ownership and control have proposed a variety of methods on how to deal with problems of endogeneity. Among others Adams et al. (2009), Bennedsen et al. (2007), and Andres (2008) use the instrumental variable approach when analysing the effects of founder ownership on firm performance whereas, Cucculelli and Micucci (2008) controls for “mean reversion effects” in firm performance to remove problems of

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18 The validity condition implies that the instrument (z) is exogenous, i.e., \( \text{cov}(z, u) = 0 \) where \( u \) is the residual from the estimated model. The relevance condition implies that the instrument is correlated with the endogenous regressors. See Wooldridge (2002) for further discussion on the IV approach.
endogeneity. Marginal $q$ is yet an alternative way to handle these types of problems.

3.2. Marginal $q$

With the marginal $q$ methodology, the problems of endogeneity are less severe. The level of investments and the returns on investment are determined by the managers’ incentive to invest. The causality does not run the other way around, i.e., the level of investments does not determine ownership or management (Gugler, Mueller, & Yurtoglu, 2008). Ownership might be endogenous to the “nature of investment opportunities of a firm” (Gugler et al., 2008, p. 691) implying that certain types of owners might be attracted to invest in companies in specific industries or with different risk levels. Financial theory, however, assumes that the cost of capital reflects the risk level, and accordingly all wealth-maximizing firms will have a “predicted ratio of returns on investment to cost of capital” (Gugler et al., 2008, p. 691) equal to one or slightly larger. This means that firms, that do not apply wealth maximizing investment strategies achieve marginal $q$s that deviate from the optimum level of one. The deviation is due to managerial entrenchment and to determine its severity we need to find the marginal $q$.

4. Ownership and Control in Sweden

Family business groups have shown to be important in the early phases of industrial development (Bhattacharya & Ravikumar, 2001; Colli, 2003; James, 2006; Morck & Nakamura, 2007; Payne, 1983). In this stage, the family business group acts as substitute for weak economic institutions, i.e., they are an alternative to poorly developed external capital markets. Emerging markets benefit from the family business groups since they often play the role of central planners in the Big Push as described in Rosenstein-Rodan (1943). By controlling firms in many different industries, the business group can circumvent hold-up problems and pushing the economy towards development and economic growth faster and more easily than freestanding firms (Morck, 2009). In later stages of economic development, the persistence of business groups hampers economic growth; it leads to lower GDP/capital growth and capital allocation

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19 Burkart et al. (2003) provide a theoretical discussion of family firms and put forth the argument that family firms are a reaction to weak institutional settings, i.e., weak shareholder protection. Colli (2003), Chapter 2, presents a similar discussion but from an economic history perspective.

20 See Morck (2009), Section five for further discussion on family business groups and the “Big Push”.
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(Morck & Nakamura, 2007). Hence, a timely breaking up of the business group when the “Big Push” is completed benefits future economic development. Intrinsic in the above discussion is the argument that the family firm, as a business organization is a reaction to poor institutional settings. In the course of economical development, the institutional framework also evolves and the need for family businesses as organizational business form vanishes. For example, Morck, Stangeland, and Yeung (2005a) show that concentrated inherited control has detrimental effects on economic growth, innovations, and capital allocation, on a national level. Fogel (2006) and Morck, Wolfenzon, and Yeung (2005b) find similar results in their research on family business groups, inherited capital, and economic development.

Hence, the question of why (family) business groups exist in developed countries remains. Are there any specific mechanisms that can dissolve them? Högfeldt (2005), Henrekson and Jacobsson (2001, 2003) take a different view of the development of family business when analysing the Swedish corporate governance, arguing that the persistence of family business is due to the political system. They argue that the persistence of concentrated ownership and strong family control is due to Social Democratic policies over the last 70 years. One object for the Social Democrats has been to unite labor and capital, and according to Högfeldt

“[P]olitical support and legitimacy of heavy entrenched private ownership is traded-off against the implicit guarantee that the largest listed firms do not migrate and that they continue to invest.”

(Högfeldt, 2005, p. 570)

In addition to the Social Democratic Party (SAP), the Swedish labor unions have had a unique position on the Swedish labor market. Starting from the Saltsjöbaden agreement in 1938, the Swedish labor unions enforced centralized wage negotiations and wage policies, based on solidarity with low-wage workers.

It was also during this period that some Swedish families (e.g., the Wallenberg sphere) become rooted both as an economic and as a political power. A couple of these families that had taken part in the industrial reformation of the Swedish economy were favored with generous tax and export rules, corporate governance rules advantageous to controlling owners to stay in Sweden. In the short run, the policies were beneficial both for the Swedish labor market and for the economic development in Sweden.

The SAP policy has created a situation where over 60 percent of the firms listed on the Stockholm stock exchange belong to a family/private ownership sphere (Agnblad et al., 2001). In 2008, there were 15 large family business

21 See for example Doukas, Holmén, and Travlos (2002), for a discussion of the development of Swedish ownership spheres and their characteristics.
groups controlling a wide range of companies (both private and publicly listed firms) (Table 1).

<table>
<thead>
<tr>
<th>Rank</th>
<th>1960s</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Wallenberg</td>
<td>Wallenberg</td>
</tr>
<tr>
<td>2</td>
<td>Söderberg</td>
<td>Douglas</td>
</tr>
<tr>
<td>3</td>
<td>Wethje</td>
<td>Ax:son Johnsson</td>
</tr>
<tr>
<td>4</td>
<td>Bonnier</td>
<td>Stena – Olsson</td>
</tr>
<tr>
<td>5</td>
<td>Sachs</td>
<td>Stenbeck</td>
</tr>
<tr>
<td>6</td>
<td>Kempe</td>
<td>Söderberg</td>
</tr>
<tr>
<td>7</td>
<td>Åhlen</td>
<td>Schörling</td>
</tr>
<tr>
<td>8</td>
<td>Klingspor &amp; Stenbeck</td>
<td>Paulsson</td>
</tr>
<tr>
<td>9</td>
<td>Throne-Holst</td>
<td>Persson (H&amp;M)</td>
</tr>
<tr>
<td>10</td>
<td>Jacobsson</td>
<td>Lundberg</td>
</tr>
<tr>
<td>11</td>
<td>Schwartz</td>
<td>Hagströmer/Qviberg</td>
</tr>
<tr>
<td>12</td>
<td>Jeansson</td>
<td>Bennet</td>
</tr>
<tr>
<td>13</td>
<td>Roos</td>
<td>Bonnier</td>
</tr>
<tr>
<td>14</td>
<td>Dunker</td>
<td>Kamprad</td>
</tr>
<tr>
<td>15</td>
<td>Hammarskjöld</td>
<td>Raising</td>
</tr>
</tbody>
</table>

Source: Hermansson (1971) and http://www.zaramis.nu/blog/.

The most important family business group is the Wallenberg sphere. This family controls through its close-end investment fund Investor and other companies about 50 percent of the total market value of the Stockholm stock exchange (Högfeldt, 2005). Other influential families are the Persson family, the founding family of Hennes & Mauritz, the Lundberg family with controlling positions in firms such as the real estate firm Lundberg, the investment company Industrivärdén, and Holmen, a forestry firm manufacturing paper and pulp products. Interesting to note, however, is that, only three of the 15, most influential families from the 1960s are still among the dominant families on the stock market today (see Table 1). This observation lends some support to the argument put forth by scholars of business history, that family ownership, in a historical perspective, is a shortsighted phenomenon. Most families are dissolved or emerge with some other family within a few generations. For example, Åhlen is now part of the Ax:son Johnsson family sphere. In this

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sense, the Wallenberg and the Stenbeckspheres are quite a remarkable observation.

This political view of corporate governance settings is followed up by Morck (2005) and Franks, Mayer, and Rossi (2004) who discuss the disappearance of business group in the USA and the UK. In the USA, a number of tax reforms in the 1930s led to the break-up of pyramids and business groups, whereas in the UK changes in the take-over code eliminated the financial gains of business groups. That is, politicians can break the dominance of family business groups by means of taxation. The question that emerges is, if inherited concentrated ownership has unfavorable effects on economic development, why do not more countries implement tax policies as in the USA and the UK.

In the following section, a historical description of the Swedish corporate governance model is presented. We will see that the Swedish industrial revolution took place quite late in an European perspective and that the Social Democratic Party has shaped the development during the last century.

4.1. A Swedish Outlook

The Swedish industrial revolution took part in the late 19th century. At this point, Sweden was a poor agricultural country located in the periphery of Europe. The transformation from an agricultural economy to an industrial economy had both domestic and international roots. Domestic demand increased considerably during this period, mainly because of a growing population and institutional reforms. For example, both the inheritance law and the elementary school system were reformed; this yielded increased productivity in the agricultural sector and an increased human capital level. At the same time, freedom of trade was enforced and the guild system was abolished. All these reforms enhanced entrepreneurship and the formation of new firms. Another important factor was, however, the increase in international demand for Swedish export products such as iron, wood, and agricultural products. The industrial revolution came relatively late to Sweden but when it finally came the adaptation was fast. Within three decades, the modern Swedish economy was created, based on industries such as manufacturing, mining, steel, forestry, and pulp. Even though new industries have emerged, these industries still constitute the foundation of the Swedish manufacturing landscape (Eklund, 2002).

Sweden has a disproportionate large share of old companies. 31 of the 50 largest firms on the Stockholm stock exchange were established before 1914 and 8 of the firms were founded during the period after the Second World War. None of the firms is younger than 40 years (Högfeldt, 2005). This age structure is quite remarkable in an international perspective; other advanced industrial
economies have a much larger share of younger firms. Sweden also experiences a very slow rate of new firm formation.23

4.2. A Swedish Corporate Governance Model

In Sweden, the Social Democrats ruled during a large part of the 20th century (in fact they only lost power to the liberals few times during the period 1946-2006).24 The political vision during the first half of this period was to create a socialist economy. In line with this vision, the Swedish Ministry of Finance, Ernst Wigforss, pursued industrial policies, which aimed to centralized wage negotiations, dividends restrictions, and reinvestments of profits in large manufacturing firms.25 The policies also included heavy taxation on individual ownership, and the establishment of wage-earner funds. Henrekson and Jakobsson (2003) summarizes the main effects of this vision in three groups,

“(i) individual wealth accumulation was discouraged, (ii) institutional ownership was stimulated relative to individual ownership and (iii) the overall policy magnified the (already strong) dependence on large companies in Sweden.”

(Henrekson & Jakobsson, 2003, p. 96).

The SAPs motto was peace on the labor market, trading benefits for the capitalistic family business groups in return for a promise of keeping the capital (i.e., companies) within the Swedish borders (see quote on page 25). Examples of benefits are tax reliefs, generous export rules, and corporate governance rules encouraging control-oriented owners. At the same time, the policies weakened minority shareholder protection, by allowing for an extensive use of control-enhancing mechanisms. Contrary to (most) other countries, in Sweden however, owners are allowed to combine different control mechanisms. This has created a corporate governance model, characterized by concentrated ownership, an extensive use of control-enhancing mechanisms such as dual-class shares, cross-holdings, and pyramiding, and heavy reliance on retained capital.

The second phase in the development of a Swedish corporate governance model began in the 1980s with a repeal of many of the above laws and regulations. Further, during this second phase, regulations regarding foreign ownership were also abolished, the last one in 1993 (Henrekson & Jacobsson, 2003).

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23 See for example Henrekson (2005) for a discussion regarding entrepreneurship and the welfare state.


25 Lindbeck (1997) provides an overview of “The Swedish Experiment” with special focus on Swedish corporatism, the welfare state, and taxation.
Table 1 presents the ownership concentration among Swedish listed firms during the last four decades. In the late 1960s the largest owner controlled around 30 percent of the outstanding votes and 26 percent of the capital shares, this yielded a historically low level of excess votes. During the 1970s and 1980s the ownership concentration increased slowly from 31 percent at the beginning of the decade to 39 percent in 1981 and reached 49 percent in 1986. During the last two decades, the ownership concentration has slowly decreased and in 2008, the average level of ownership concentration was 33 percent.26

Over the studied period, the share of firms, with a largest shareholder controlling more than 50 percent of the voting rights increased from 14 percent in the 1960s to 45 percent in the mid 1980s. This share has decreased during the last 10 years, and was in 2008 20 percent.

Table 2: Ownership Structure, 1968-2010

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</thead>
<tbody>
<tr>
<td>Votes</td>
<td>30</td>
<td>31</td>
<td>35</td>
<td>39</td>
<td>49</td>
<td>43</td>
<td>34</td>
<td>33</td>
</tr>
<tr>
<td>Capital</td>
<td>26</td>
<td>26</td>
<td>27</td>
<td>31</td>
<td>38</td>
<td>30</td>
<td>22</td>
<td>23</td>
</tr>
<tr>
<td>Excess Votes</td>
<td>4</td>
<td>5</td>
<td>9</td>
<td>10</td>
<td>12</td>
<td>14</td>
<td>12</td>
<td>10</td>
</tr>
<tr>
<td>Cap&gt;50</td>
<td>14</td>
<td>15</td>
<td>16</td>
<td>20</td>
<td>45</td>
<td>40</td>
<td>23</td>
<td>20</td>
</tr>
<tr>
<td>Vote Diff.</td>
<td>32</td>
<td>36</td>
<td>44</td>
<td>54</td>
<td>74</td>
<td>71</td>
<td>68</td>
<td>67</td>
</tr>
<tr>
<td>No. Firms</td>
<td>146</td>
<td>134</td>
<td>130</td>
<td>128</td>
<td>246</td>
<td>216</td>
<td>109</td>
<td>152</td>
</tr>
</tbody>
</table>


In many European countries, the importance of dual-class shares has diminished. The use of shares with unequal voting rights has been stable among Swedish listed firms. During the 21st century, the share of firms applying vote-differentiated shares equals around 70 percent; the wedge between voting and capital rights has been around 12-10 percent during this period.

Interesting to note is that the firms with the most perverse differences in voting rights have changed their policies. In 1995, there were three firms listed on the Stockholm stock exchange that had shares with a factor of 1000 in voting rights to cash-flow rights. The Wallenberg sphere was the controlling owner of two of these firms (SKF and Electrolux) and the second largest owner in Ericsson with 38.9 percent of the voting rights. In 1999, both SKF

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26 Heaney and Holmén (2008) use Swedish data to analyse costs of under-diversification among controlling family owners. They show that pyramidal ownership structures affect costs of under-diversification whereas the effect of dual-class shares is insignificant.
and Electrolux changed the voting rights from a factor of 1000 to a factor of 10. This implied that Wallenberg’s control rights via Investor (a close-end investment company) decreased from 45 to 21 percent in Electrolux and from 44.2 to 34.1 percent in SKF. The minority shareholders in Ericsson had to struggle for five more years to change the vote differential in Ericsson. The SHB sphere was the controlling owner of Ericsson and a change in factor from 1000 to 10 would make the SHB sphere and the Wallenberg sphere equally powerful. Finally, at the annual meeting in 2004, the voting-rights factor was changed from 1000 to 10. The SHB sphere kept control of the company with 20.2 percent of the voting rights; the Wallenberg sphere had 19.7 percent. In practice, the change implied that the two spheres halved their control rights of Ericsson (SIS Ownership Data Corporation, various years).

Descriptive statistics (see Chapters 3, 4, and 5 in this dissertation) clearly show that family firms use vote-differentiated shares as a way to keep the control of the firm. For example, Bjuggren and Palmberg (2010) reports that 79 percent of the family firms apply vote-differentiated shares compared to 59 percent of the non-family controlled firms. In addition, the excess vote differs considerably between the two types of firms. Family firms control on average 44 percent of the voting rights and 27 percent of the cash flow rights, i.e., the excess votes are 17 percent. The corresponding values for non-family controlled firms are 23, 17, and 7, respectively. The descriptive statistics in Bjuggren and Palmberg (2010) clearly shows that there are large differences in ownership structure between family-controlled and non-family controlled firms. Furthermore, the descriptive statistics in Chapter 4 shows that these differences are statistical significant.

5. Outline and Summary of the Dissertation

This dissertation follows the framework set up by Fama and Jensen (1983a, 1983b) by analyzing the firm from a contractual perspective with a focus on how the decision process and residual claimants are organized in complex firms. Family ownership is in this perspective especially interesting, since in these firms there is an identifiable owner or group of owners that is in control of the firm, the board of directors and the management of the firm. It is interesting to evaluate the characteristics of family control and subsequent effects on firm performance and executive compensation. The rest of this section describes briefly the different chapters and ends with a discussion of the overall conclusions.
5.1. **A Contractual Perspective of the Firm with an Application to the Maritime Industry**

This first chapter presents a contractual perspective of the firm that highlights the function of the firm as a common contracting partner to suppliers, customers, labor, capital, and financers. It thereby sets the scene for the rest of the analyses by assessing the contractual nature of the firm. In this chapter, the maritime industry is analysed from a contractual perspective with a special focus on the link between the carrier and the shipper.

A synthesis of different contractual perspectives on the firm as a coordinating institution is presented and the analysis shows that there is a strong relation between specialization and firm structure. For example, firms operating mainly on the spot market are usually smaller whereas firms on the liner and ferry markets are usually relatively large. The existence of temporal specificities therefore affects both the firm structure and the design of the freight contract.

5.2. **The Impact of Vote Differentiation on Investment Performance in Listed Family Firms**

The second chapter investigates the effects of ownership and control because of vote differentiation in Swedish listed family firms. Two questions are posed; does family controlled firms have a more efficient investment performance than non-family controlled firms and is this investment performance negatively affected by a separation of ownership and control because of dual class-shares. Marginal $q$ is used as a performance measure.

The analysis shows that family control has a positive impact on the investment performance when ownership and control is aligned. Separation of ownership and control in terms of dual-class shares has a negative impact on the investment performance.

5.3. **Family Control and Executive Compensation**

The third chapter analyses whether families use remuneration as a way to expropriate minority shareholders, i.e., to withdraw funds from the firm in the form of compensation to the executive management. There are both costs and benefits associated with family control; family ownership implies increased monitoring of the management and at the same time, it implies increased probability of rent extraction from the firm. If the CEO comes from the controlling family, they can, by influencing the board, give the family CEO excess remuneration for his or her service as manager. But since family
ownership implies increased control, the agency theory assumes lower levels of variable remuneration.

The analysis shows that managers in family-controlled firms have a lower share of variable income than managers in non-family controlled firms. It can further be shown that family control has a reducing effect on the level of CEO compensation. Hence, the analysis confirms the agency hypothesis.

5.4. Board of Directors, Dependency, and Returns on Investment

The last step in the analysis of family firms is to investigate the characteristics of family influence on the board of directors. According to the Swedish Code of Corporate Governance, the owners should be represented as board members whereas the management should have at the most one member on the board. The analysis shows that family-related directors as suggested by the Code of Corporate Governance do not dominate the boards in family-controlled firms.

Further, by applying a very detailed definition of board dependency this chapter further adds to the literature on boards of directors and the question whether board dependency actually affects firm value. Supporting the managerial entrenchment hypothesis, the marginal q analysis suggests that management-dependent directors have a negative impact on firm value. Owner dependent and employee elected directors do not affect firm investment performance.

5.5. Concluding Remarks

This dissertation shows that families as owners substantially influence the management of the firm, with implications for firm performance. Family control is enhance the investment efficiency, but only when ownership and control is aligned. This dissertation further shows that family ownership implies an increased monitoring of the management. Further, board dependency affects investment performance negatively. When separating different types of dependency, the regression analysis shows that it is firm-dependent directors, and not owner-dependent directors that are detrimental to firm value.
References


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