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CORPORATE GOVERNANCE AND PERFORMANCE IN HONG KONG FOUNDED FAMILY FIRMS: EVIDENCE FROM THE HANG SENG COMPOSITE INDUSTRY INDEX

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ABSTRACT

Background of Problem: This research investigates the corporate governance and performance between founding family firms and non-founding family firms in Hong Kong, and the performance inside founding family firms under three different management status. Agency costs will be generated by the divergence between CEO interest and those of the outside shareholders if the owner-manager sells equity claims on the corporation. There are two different mainstreams of views regarding relationships between ownership and performance in family business: negative and positive effect generated from family ownership and control. To what extents the two different views are relevant to Hong Kong family firms are still unclear.
Research Method and Data: By focusing on Hong Kong business, this research seeks to study 75 Hong Kong listed companies in HSCII for 5 years, yielding 347 observations, using archival data. The empirical result suggests that the founding family firms in Hong Kong may not outperform nonfamily firms, and the founding family firms with founders as CEOs are one of best performers among founding family firms. This research not only studies the performance behaviours of Hong Kong founding/ non-founding family business and inside founding family business, but also sets a foundation for further research. This research gives insights for entrepreneurs to manage their businesses and plan the succession of founding family business in Hong Kong. This research into corporate governance is different to that of countries such as USA, Taiwan, and Mainland China. The founding family firms in Hong Kong may not outperform the nonfamily firms and the founding family firms with the founder as CEO is one of the best management techniques inside founding family firms. This research shows agency costs inside founding family firms affects performance and succession of family firms, as descendants may not be the best successors for firm value maximization, and business continuity. Owners of Hong Kong founding family business should pay more attention on business governance and succussion planning.

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INTRODUCTION

Family-controlled firms play a particularly important role in Asian countries (Chang, 2003; Joh, 2003; Filatotchev, Lien, & Piesse, 2005). but, most studies of corporate ownership rely on Chinese firms such as Mainland China, Taiwan, not specially in Hong Kong firms (for example, Filatotchev et al. 2005, Xia 2008, Wu 2009, Chu 2009, Fan 2013). Many studies have produced interesting results about Chinese family businesses. This research is aimed at finding the ownership-performance

relationship inside Hong Kong founding family business under the Hang Seng Composite Industry Index.

LITERATURE BACKGROUND TO THE RESEARCH

In East Asian markets, more than 65% of listed firms are controlled by major shareholders and of those firms, 60% of the managers are family members of the major shareholders (Bruton, Ahlstrom, & Wan, 2003). Emerging in the 1950s to 1970s, family businesses are one of the main business styles in Hong Kong, and most of them have reached a developing or mature stage.

Over 65% of firms are founding family firms in Hong Kong (Claessens, Djankov, & Lang, 2000), which means that family business is the main model in the Hong Kong. In general, some people regard family business as one of best business governance models (such as Lee Kum Kee, Li & Fung), but there is no evidence to prove it yet in Hong Kong and there are some cases about family generated problems affecting the performance of their companies, such as Kwok's family, Kung's family and Chen's family. Most studies of corporate ownership rely on Chinese firms such as Mainland China, Taiwan, not specially in Hong Kong firms (for example, Filatotchev et al. 2005, Xia 2008, Wu 2009, Chu 2009, Fan 2013). To what extent the differences of agency effect across individual countries in family firms is still ambiguous.

This study focuses on Hong Kong founding family firms to fill in the gap of ownership-performance relationship and try to fulfil one of the knowledge gaps about the effect of agency cost among Asian countries. It is hoped this study not only extent the knowledge of family business and agency theory, but will also give insight for entrepreneurs to build the firm structure, avoid agency costs to shareholders, and transition their business to next generation or public business.

RESEARCH PROBLEM AND QUESTIONS

The research questions of the governance and performance between founding family business and non-founding family business, and inside founding family business in Hong Kong addressed in this research are:

Research Question (1) Do founding family firms outperform non-founding family firms in Hong Kong? The first question aims to find the performance behaviours of founding family comparing with non-founding family business. Thus the following hypothesis will be tested.

H_1: In Hong Kong, founding family firms are positively associated with performance.

Research Question (2) In Hong Kong founding family firms, to what extent does the relationship between different forms of management and performance exist? The second question aims to find which management status is the best choice during the operation of founding family business, especially giving the insight for the succession plan during transition. Thus the following hypothesis will be tested.

$H_{2\text{-}a}$: In Hong Kong, founding family firms managed by founders are positively associated with performance.

$H_{2\text{-}b}$: In Hong Kong, founding family firms managed by descendants are positively associated with performance.

H2-c: In Hong Kong, founding family firms managed by professional managers are positively associated with performance.

This research is replicating Anderson and Reeb (2003) research in the U.S., but the secondary data of Hong Kong governance and performance is different than the U.S., the findings in this research may not cover all of the findings in Anderson and Reebs (2003) research, such as the nonlinear regression analysis. However, the analysis of the management status is more detailed in this research, and these findings give insights for Hong Kong founding family business in management and succession planning issues, which are urgent topics in Hong Kong family business (Fan, 2013).

METHODOLOGY

In the data collection section, the Hang Seng Composite Industry Index is used. The dependent variable is composited by Tobin's Q, ROA (return on Assets) and, ROE (return on Equity). The owner and management status are the independent variables. The research also considers six control variables, which include industries, firm size, firm age, board size, board structure from percentage of independent non-directors, and board structure from number of family members on the board. Since the data used to test the hypothesis is financial data and economic data, secondary data is collected from annual reports of companies in the Hong Kong Hang Seng Composite Industry index. After the data collection, descriptive and frequency analysis are presented to analyse the behaviours of the sample. In order to test the hypothesis, independent T-test, regression analysis is used.

ANALYSIS OF RESULTS

There are a total of 75 firms in 9 industries, and 3 industries including Properties & Construction (20), Consumer Goods (18), and the Services (15) industry constitute over 20 % of the population. Over 65% of firms are Founding Family Businesses, inside the founding family business (49), there are 23 firms with a CEO founder, 17 firms with a CEO descendant, and 9 firms who hired their CEO.

In relation to the age of the firms, some firms are over hundred years (197 years) old, but some firms are established in the 21st century (only 4 years old). The average age is 41.47. In firm size, Total Assets are from HKD 1,830,352,000 to HKD 720,854,400,000, and its average is almost HKD 6,977,302,675. This study will standardize the Total Assets with Ln, so it can be more suitable to build the regression function.

In the board structure, the average board size in 11 ranging from 5 to 21. As requested by the Law of Company Corporations, all firms have Independent Non-Executive Directors from 21% to 60% in relation to board size. In founding family firms, the Percentage of Family Members on the Board is from 0% to 59% with an average of 17.41%.

In regards to firm performance, Tobin's Q is ranging from 0.53 to 5.27, and the average is 1.67. This means that the population's average market value is greater than the value of the company's recorded assets. ROA_PAtS is ranging from -6% to 28%, the average ROA is 8.23%. ROE_PAtS is ranging from -17% to 92%, the average ROA is 14.34%. It shows that the firms in this study are performing well during 2008 to 2012, since the average growth of Hong Kong GDP is 2.8% (Census and Statistics Department General Statistics Section, 2012; Census and Statistics Department General Statistics Section., 2013).

TABLE 1 DESCRIPTIVE ANALYSIS OF FIRM

	N	Minimum	Maximum	Mean	Std. Deviation
Age	75	4	197	41.47	35.445
Board Size	75	5	21	11.11	3.198
Percentage of Independent non-Executive director	75	.21	.60	.3650	.09812
Percentage. of Family Members in Board	75	.00	.59	.1741	.16893
Total Assets	75	1.83E9	7.21E11	6.9773E10	1.16252E11
Tobin's Q	75	.53	5.27	1.6687	1.07852
ROA_PAtS	75	-.06	.28	.0823	.06519
ROE_PAtS	75	-.17	.92	.1434	.14449
Valid N (listwise)	75				

There are 228 out of 347 data from the Founding Family Businesses, which are over 65% of the population. Inside the founding family businesses, there are 103 observations with a CEO founder, 86 observations with a CEO descendant, and 39 observations with a hired CEO. There are a total of 347 observations from 9 industries. Particularly 3 industries among the 9 industries including Properties & Construction (20), Consumer Goods (18), and Services (15) industry are over 19 % of the population. The data is an average from 2008 to 2012.

TABLE 2 OWNER FREQUENCIES ANALYSIS OF OBSERVATION

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Non Founding Family Business	119	34.3	34.3	34.3
	Founding Family Business	228	65.7	65.7	100.0
	Total	347	100.0	100.0	

TABLE 3 MANAGEMENT STATUS FREQUENCIES ANALYSIS OF OBSERVATION

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	CEO Non-FFB	119	34.3	34.3	34.3
	CEO founder	103	29.7	29.7	64.0
	CEO descendant	86	24.8	24.8	88.8
	CEO hire	39	11.2	11.2	100.0
	Total	347	100.0	100.0	

TABLE 4 FISCAL YEAR FREQUENCIES ANALYSIS OF OBSERVATION

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	2008	58	16.7	16.7	16.7
	2009	71	20.5	20.5	37.2
	2010	72	20.7	20.7	57.9
	2011	73	21.0	21.0	79.0
	2012	73	21.0	21.0	100.0
	Total	347	100.0	100.0	

TABLE 5 INDUSTRY FREQUENCIES ANALYSIS OF OBSERVATION

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	ENE	5	1.4	1.4	1.4
	MAT	23	6.6	6.6	8.1
	IND	15	4.3	4.3	12.4
	CSG	77	22.2	22.2	34.6
	SER	69	19.9	19.9	54.5
	TEL	14	4.0	4.0	58.5
	P&C	95	27.4	27.4	85.9
	IT	24	6.9	6.9	92.8
	CGM	25	7.2	7.2	100.0
	Total	347	100.0	100.0	

Most of the boards are composited with around 11 members with average 11.13, and the largest board size is 22 members, and the smallest is 5. Most of companies are composited with 4 to 5 Executive directors. For Independent Non-Executive Directors, most of companies will hire 3 to 4 members because the HKEX specifies a provision on this. The largest number of Independent Non-Executive Directors is 8 members.

Because there are 119 non founding family firms and some founding family firms without family members in boards, there are 123 observations with 0 family members on the board. Generally, there are 1 to 3 family members in board of founding family firms. The Descriptive Analysis of Observation is the same as the descriptive of the Firm, as the Descriptive Statistics of the Firm is generated from the averaged data of observation.

TABLE 6 DESCRIPTIVE ANALYSIS OF OBSERVATION

	N	Minimum	Maximum	Mean	Std. Deviation
Age	347	4	197	41.90	35.880
Board Size	347	5	22	11.13	3.289
Percentage of Independent non-Executive director	347	.14	.67	.3666	.10317
Percentage. of Family Members in Board	347	.00	.64	.1744	.16968
Total Assets	347	7.26E8	8.04E11	7.1384E10	1.21745E11
Tobin's Q	347	.08	6.57	1.6089	1.17057
ROA_PAtS	347	-.61	.37	.0784	.08298
ROE_PAtS	347	-1.62	1.47	.1342	.18422
Valid N (listwise)	347				

For the performance between non founding family business and founding family business, Tobin's Q and ROA of Non Founding Family Business is larger than the Founding Family Business. But the ROE_PAtS of Non Founding Family Business is less than the Founding Family Business.

TABLE 7 GROUP STATISTICS OF OWNER

	Owner	N	Mean	Std. Deviation	Std. Error Mean
Tobin's Q	Non Founding Family Business	119	1.6426	1.14116	.10461
	Founding Family Business	228	1.5914	1.18773	.07866
ROA_PAtS	Non Founding Family Business	119	.0727	.08641	.00792
	Founding Family Business	228	.0813	.08117	.00538
ROE_PAtS	Non Founding Family Business	119	.1160	.17868	.01638
	Founding Family Business	228	.1437	.18673	.01237

For the performance among management status, firm performance of a CEO founder is better than others in all variables including Tobin's Q, ROA and ROE. In Tobin's Q, the CEO Non-FFB (1.64) is only the next to the CEO founder. In ROA, a hired CEO is the worst performing with 6.37%, and in ROE, CEO Non-FFB performs worst with11.6%.

TABLE 8 CORRELATION DATA

Correlations

		Owner	Ln_Age	Percentage of Independent non-Executive director	Board Size	Percentage. of Family Members in Board	Management Status	LN_TA	Tobin' s Q	ROA_PAIS	ROE_PAIS
Owner	Pearson Correlation	1	-.044	-.162**	.075	.743**	.807**	.039	-.021	.050	.071
	Sig. (2-tailed)		.411	.002	.166	.000	.000	.470	.699	.356	.185
	N	347	347	347	347	347	347	347	347	347	347
Ln_Age	Pearson Correlation	-.044	1	.134*	.144**	.019	.042	.411**	-.190**	-.049	-.124*
	Sig. (2-tailed)	.411		.012	.007	.720	.438	.000	.000	.365	.020
	N	347	347	347	347	347	347	347	347	347	347
Percentage of Independent non-Executive director	Pearson Correlation	-.162**	.134*	1	-.573**	-.193**	-.169**	-.108*	.086	.144**	.081
	Sig. (2-tailed)	.002	.012		.000	.000	.002	.044	.108	.007	.131
	N	347	347	347	347	347	347	347	347	347	347
Board Size	Pearson Correlation	.075	.144**	-.573**	1	.077	.181**	.549**	-.214**	-.071	-.091
	Sig. (2-tailed)	.166	.007	.000		.154	.001	.000	.000	.187	.092
	N	347	347	347	347	347	347	347	347	347	347
Percentage. of Family Members in Board	Pearson Correlation	.743**	.019	-.193**	.077	1	.488**	.061	-.139**	-.021	-.029
	Sig. (2-tailed)	.000	.720	.000	.154		.000	.259	.010	.703	.584
	N	347	347	347	347	347	347	347	347	347	347
Management Status	Pearson Correlation	.807**	.042	-.169**	.181**	.488**	1	.217**	-.116*	-.003	.031
	Sig. (2-tailed)	.000	.438	.002	.001	.000		.000	.031	.952	.568
	N	347	347	347	347	347	347	347	347	347	347
LN_TA	Pearson Correlation	.039	.411**	-.108*	.549**	.061	.217**	1	-.392**	-.223**	-.130*
	Sig. (2-tailed)	.470	.000	.044	.000	.259	.000		.000	.000	.016
	N	347	347	347	347	347	347	347	347	347	347
Tobin' s Q	Pearson Correlation	-.021	-.190**	.086	-.214**	-.139**	-.116*	-.392**	1	.523**	.482**
	Sig. (2-tailed)	.699	.000	.108	.000	.010	.031	.000		.000	.000
	N	347	347	347	347	347	347	347	347	347	347
ROA_PAIS	Pearson Correlation	.050	-.049	.144**	-.071	-.021	-.003	-.223**	.523**	1	.849**
	Sig. (2-tailed)	.356	.365	.007	.187	.703	.952	.000	.000		.000
	N	347	347	347	347	347	347	347	347	347	347
ROE_PAIS	Pearson Correlation	.071	-.124*	.081	-.091	-.029	.031	-.130*	.482**	.849**	1
	Sig. (2-tailed)	.185	.020	.131	.092	.584	.568	.016	.000	.000	
	N	347	347	347	347	347	347	347	347	347	347

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Founding-family firm appears to bear a positive association with accounting measures of firm performance (ROA, ROE), and negative association with market measures of firm performance (Tobin's Q). There are positive relationships between founding-family firm and firm size, board size, but negative relationships with Independent Non-Executive Directors and firm age. In consistent with previous analysis, there is a negative relation between family ownership and percentage of independent non-executive director, firm age. Because firm age, firm size, percentage of family member in board and market performance are negatively correlated, the following section will use multivariate analysis to examine the relation between family presence and firm performance.

TABLE 9 RESULTS OF THE HYPOTHESES TESTING

Hypotheses	Descriptions	Testing results
H1	In Hong Kong, founding family firms are positively associated with performance	Not supported & not statistically associated
H2-a	In Hong Kong, family firms managed by founders are positively associated with performance	Supported & significantly and positively correlated in marketing performance
H2-b	In Hong Kong, family firms managed by successors are positively associated with performance	Not supported & not statistically associated
H2-c	In Hong Kong, family firms managed by professional managers are positively associated with performance	Not supported & not statistically associated

In relation to the Hypothesis posed, the results are as follows:

Result 1: The marketing performance (Tobin Q) of non-founding family firms may be better than that of the founding family firm. The accounting performance (ROA, ROE) of the founding family firm may be better than that of a non-founding family

firm. But there is not a significant difference between ownership for the firm performance in regards to market and accounting indexs.

Result 2: The performance (Tobin Q, ROA, ROE) of founding family firm with a CEO founder is better than that of a founding family firm with a CEO descendant and CEO hire. There is a significant difference between CEO founder and CEO descendant/ CEO hire in regards to market and accounting indexs.

Result 3: The market performance and accounting performance with ROE of CEO descendant is worse than CEO founder. In ROA, CEO descendant may be only better than CEO hire. But there is not a significant difference between CEO descendant and CEO hire for the firm performance in regards to market and accounting indexs, except for the relationshp between CEO descendant and CEO founder.

Result 4: The market performance of CEO hire may be only better than CEO descendant. In ROE, CEO hire may be only better than CEO descendant. But there is not a significant difference between CEO hire and CEO descendant for the firm performance in regards to market and accounting indexs, except between CEO hire and CEO founder.

Result 5: In OLS Regression with dummy variables, Owner, Board Size, Percentage of Family Members in Board, Management Status are significant with Tobin Q. Owner, Ln_Age, Board Size, Percentage of Independent non- Executive director are significant with ROA. Owner, Percentage. of Family Members in Board, Ln_Age are significant with ROE.

Result 6: In IV-2SLS Regression, the result is consistent with the OLS results.

Result 7: There is no nonlinear regression model constructed with the collected data, since some data is missing, such as the fractional equity ownership of the firm's founding family, R/D expenses, depreciation, and amortization, and so on.

TABLE 10 CONTRIBUTIONS OF THE RESEARCH

Index	Contributions	Implications
1	Some research findings in this study do confirm expectations from the extant literature but they extent knowledge body in family business research in Hong Kong	Academic
2	The finding of performance in management status and in governance may enrich the theory of agency cost in Hong Kong.	Academic
3	The finding of performance in management status and in governance may enrich knowledge body of business governance in Hong Kong.	Academic
4	The research also gives further research suggestions on the ownership and performance, and the succession of family business.	Academic
5	The finding of performance between founding family and non-founding family business may give insight to entrepreneur or scholars about the founding family behaviours of Hong Kong.	Industrial
6	Since Hong Kong is facing a succession era in 21 century, the research may give the insight for the sustainability development of family business.	Industrial
7	The studies also focus on the board structure of Independent Non-Executive Director and Family Members in Board, which may give insight for entrepreneur to build their board of the companies.	Industrial

CONCLUSIONS

This research into corporate governance and performance in Hong Kong founding family firms finds that the behaviours of Hong Kong founding family firms are different with other founding family firms, such as USA, Taiwan, and Mainland China. The founding family firms in Hong Kong may not outperform the nonfamily firms and the founding family firms with founder as CEO is one of best management status in side founding family firms. The agency cost inside founding family firms affects the performance and succussion of family firms. Owners of Hong Kong founding family business should pay more attention on their business governance and succussion planning, as descendants may not be the best successors for firm value maximization, and founding family business continuity.

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