

CEO TURNOVER IN FAMILY FIRMS WITH AN INCUMBENT FAMILY CEO THE CASE OF FRANCE, GERMANY AND THE UK

Iram Ansari¹, Marc Goergen² and Svetlana Mira³

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1. INTRODUCTION

This paper studies CEO turnover in listed family firms in France, Germany and the UK. We focus on firms where there is a family shareholder who holds at least 25 percent of the voting rights. Given the high degree of family control in our sample, there is a likelihood that the family prefers to focus on maintaining its private benefits of control (see Grossman and Hart, 1988) rather than on pursuing the maximisation of the firm value, which would benefit all the shareholders. Such private benefits of control may include the replacement of the current family CEO by another family member rather than the most competent candidate available on the executive labour market. Appointing another family member as the new CEO would then be akin to expropriating the minority shareholders (see also Shleifer and Vishny, 1997).

In what follows, we distinguish between replacements of the current family CEO by another family CEO and replacements by a person not related to the family. The main objective of this paper is to test whether five factors advanced by the existing literature explain the choice between another family CEO and a CEO not related to the family. These factors include the power of the family shareholder, the generation of the incumbent CEO relative to that of the founder, board independence, a UK or US cross-listing and past performance. In line with our conjectures, we find that firms that replace their incumbent family CEO with another family member have a more powerful family shareholder (as reflected by the percentage of votes held as well as the degree of deviation from one-share one-vote), are no longer in the founder generation and have low board independence.

¹Cardiff Business School, Cardiff University, and College of Economics and Political Science, Sultan Qaboos University

²Cardiff Business School, Cardiff University, and European Corporate Governance Institute (ECGI)

³Cardiff Business School, Cardiff University

When we divide our sample of firms into three sub-samples according to the firm's nationality, we find the following. First, we find that the significance we observe for the whole sample for one of the above five factors is driven by the firms from a single country. This is the case for family control for the German firms. In other words, this factor only seems to drive CEO turnover in Germany, but not in the other two countries. Second, we also now find that one of the factors that did not have a significant difference in its mean between the CEO replacements by another family member and the CEO replacements by a person not related to the family is now significant. This factor is past performance, as measured by the return on equity (ROE) in the year preceding the year when the incumbent family CEO was replaced. ROE is negative and highly significant for the German firms, suggesting that bad past performance puts pressure on German family firms to replace the incumbent family CEO by a person not related to the family.

This paper is the companion paper to Ansari et al. (2014). Hence, this paper has similar contributions to that paper. These contributions are as follows. First, the paper proposes a measure of board independence which accounts for possible links with the family that may compromise the independence of individual directors and may push them to side with the family shareholder rather than to look after the interests of all the shareholders. Second, this paper studies three very different corporate governance systems, i.e. France, Germany and the UK. France and Germany have several similar characteristics which include concentrated ownership and control, frequent deviations from the one-share one-vote rule (see Grossman and Hart, 1988) and the relative importance of banks as shareholders of corporations. However, there are also differences between these two countries. In particular, Germany has a two-tier board system, with a separate board, the supervisory board, where the non-executive or independent directors sit. In contrast, virtually all French firms, while still having the option between a two-tier board and a single-tier board, have opted for the latter (Goergen et al. 2006). Finally, the UK is very different from both France and Germany with respect to its dispersed ownership and control and the few deviations from the one-share one-vote principle. The novel contribution of this companion paper is to focus on *actual* replacements of the incumbent family CEO. In contrast, Ansari et al. (2014) also study reappointments of the incumbent family CEO, which make up the vast majority of their observations. We show that the generation of the CEO, as well as past accounting performance, have a significant impact on the type of CEO replacement when reappointments are excluded. In detail, we find that family replacements in Germany and the UK are more likely to happen in firms where the incumbent CEO is in the second or a higher generation of the family. This

reflects the fact that German and UK firms, which replace their CEO by another family member, are the oldest ones in the sample. We also find that bad past performance puts pressure on German family firms to replace the incumbent family CEO by a person not related to the family. However, this is not the case for France and the UK.

2. LITERATURE REVIEW AND CONJECTURES

Concentrated ownership and control dominate the corporate landscapes in most countries of the world (see e.g. Goergen, 2012). However, to date little is known about the impact of large shareholders, which include families, on corporate decision making. The theoretical models of Admati et al. (1994) and Kahn and Winton (1998) predict that large shareholders overcome the free-rider problem and reduce the principal-agent problem, thereby increasing firm value. There is support from the empirical literature that large shareholders improve firm value and performance. For example, Anderson and Reeb (2003) find that American family firms in the S&P 500 index perform better than firms not owned by families. The superior performance of family firms is confirmed by Andres (2008) for the case of German family firms. Finally, the theoretical model of Burkart et al. (1997) predicts the potential for value destruction by the large shareholder via excessive interference with managerial decision making. Further, the large shareholder may extract private benefits of control and expropriate the minority shareholders (Shleifer and Vishny, 1997). Faccio et al. (2001) find evidence of such expropriation for the case of East Asian family firms.

Our reading of the literature identifies five factors that may affect the choice of the person replacing the incumbent family CEO. These are family power, the generation of the CEO, board independence, improved shareholder protection via e.g. a cross-listing, and past firm performance. We discuss each of the factors below.

2.1 Family power

As stated above, there may be two sides to large shareholder – including family – control. On the one side, the family shareholder may create security benefits of control by reducing the agency costs. On the other side, the family shareholder may extract private benefits of control from the firm, at the cost of the minority shareholders. When are the private benefits of control likely to exceed the security benefits of controls? This is likely to be the case when the large shareholder's control rights exceed his cash flow rights. This might be achieved via dual-class shares, voting agreements and pyramidal ownership, all of which enable families to retain control while reducing ownership (La Porta et al., 1999;

Claessens et al., 2000; Faccio and Lang, 2002; Villalonga and Amit, 2009). Such deviations from the one-share one-vote principle have been shown to reduce firm value and performance (see e.g. Dittmann and Ulbricht, 2008, for Germany and Boubaker, 2007, for France). They also seem to discourage investors, particularly institutional investors, from investing in the firm's shares (Li et al., 2008). This suggests that the strength of family control is likely to determine whether the incumbent family CEO is replaced by another family member or a person not related to the family. We arrive at our first conjecture:

Conjecture 1: Greater family power is more likely to be associated with a family member replacing the incumbent family CEO.

2.2 The generation of the CEO

While the founder of the firm tends to have the right skills to set up and grow the business, successive generations of the family may find it challenging to continue the business (McConaughy and Phillips, 1999). Hence at that stage, it makes sense for the family to appoint professional managers. Similarly, Dyer (1988) argues for the need of a change in management, from the 'paternalistic' management style of the founder generation to a 'professional' management style, the latter being delivered by professional managers not related to the founding family.

Nevertheless, the family may be more interested in extracting private benefits of control, including filling top management jobs with family members, rather than pursuing the interests of all the shareholders, including those of the minority shareholders. Similarly, the strong emotional ties that the founder may attach to her firm may push her to appoint a family member as the succeeding CEO (Berrone et al., 2007). Still, these strong emotional ties may force the founder to appoint a professional manager if she deems that there is no suitable successor within the family rather than risking the death of the firm. Hence, the existing literature does not provide a clear prediction as to the type of person that is likely to replace the incumbent family CEO. Nevertheless, we propose the following directional conjecture:

Conjecture 2: An incumbent CEO of a later generation than that of the founder is more likely to be associated with a person not related to the family replacing the incumbent family CEO.

2.3 Board independence

A strong case has been made for the importance of the board's independence from both the firm's management and the controlling family in family firms (DeMott, 2008).

Indeed, the independent directors would ensure that the family does not expropriate the minority shareholders. As such expropriation could manifest itself in the form of a family member replacing the incumbent family CEO, strong board independence would make such a choice less likely.

How does one define board independence? Becht et al. (2003) consider a director to be 'independent' if he or she is not an employee of the firm, does not have a business relationship with the firm, and is not related to the founder or the firm's executives. The following five studies also investigate the effect of board independence on CEO turnover: Dalton and Kesner (1985), Park and Rozeff (1994), Borokhovich et al. (1996), Borokhovich et al. (2006), and Hillier and McColgan (2009). The latter is the only study on listed family firms in the UK. The other four studies are on listed US firms. In contrast to the present paper, the definition of board independence adopted by these studies is fairly limited as it considers any director who is not employed by the firm as independent. Park and Rozeff (1994), Borokhovich et al. (1996), and Hillier and McColgan (2009) find that boards with a majority of independent directors tend to choose a CEO from outside the firm. This leads us to the third conjecture:

Conjecture 3: Greater board independence is more likely to be associated with a person not related to the family replacing the incumbent family CEO.

2.4 Shareholder protection

La Porta et al. (1997, 1998) argue that minority shareholder expropriation is more likely to occur in countries with weak legal protection of investors. They argue that investor protection is greatest in common law countries, such as the US and the UK, weakest in French civil law countries and somewhere in between in German and Scandinavian civil law countries. However, La Porta and colleagues ignore the fact that firms can improve the legal protection their minority shareholders enjoy by cross-listing on a stock exchange with more stringent law and regulation (Goergen and Renneboog, 2008). This is the so called bonding hypothesis as proposed by Coffee (2002). He argues that foreign firms, by cross-listing in the US, commit themselves to protect their minority shareholders. As firms cross-listed in the US have to adopt the generally accepted accounting principles (US GAAP), have to meet the requirements of the stock exchange, and to comply, at least to some degree depending on the type of cross-listing, to US securities laws (Reese and Weisbach, 2002), they are likely to offer greater protection to their investors. The literature on cross-listings (see Goergen and Renneboog, 2008, for a review) shows strong support for the bonding hypothesis as it finds that cross-listed firms trade at a premium, have a

lower cost of capital as well as a lower voting premium, i.e. the difference in price between a voting share and a non-voting share. Hence, we conjecture that:

Conjecture 4: Firms that are cross-listed in the US or the UK are more likely to be associated with a person not related to the family replacing the incumbent family CEO.

2.5 Past firm performance

Dalton and Kesner (1985) argue that the firm's performance affects the choice of CEO replacement. When performance is poor, the firm is likely to choose an outside CEO whereas when the performance is good it is likely to choose an insider. In contrast, Boeker and Goodstein (1993) argue that, even when performance is poor, the family is likely to appoint a new CEO from within the firm or within the family. Smith and Amoako-Adu (1999) investigate Canadian family firms. They do not find support for Dalton and Kesner (1985) as a family member is not necessarily appointed when performance is good and an outsider when performance is bad. Hillier and McColgan (2009) find similar results for firms listed on the London Stock Exchange during 1993-1998. Finally, Chen et al. (2013), who study 1,865 firms in the S&P 1500 index during 1996-2005, report that family CEOs in family firms and professional CEOs in non-family firms are less likely to be replaced when performance is poor as compared to non-family CEOs in family firms. While this suggests that performance is unlikely to affect the choice of the new CEO, we nevertheless conjecture that:

Conjecture 5: Poor firm performance is more likely to be associated with a person not related to the family replacing the incumbent family CEO.

3. METHODOLOGY

3.1. Sample Selection

The sample is comprised of listed family firms from France, Germany and the UK replacing their incumbent family CEO during 2001-2010. Family firms are defined as firms with family ownership of at least 25% of the votes and a family member being the CEO of the firm. Following Hillier and McColgan (2009), the CEO is considered to be a family member if at least one of the following criteria is satisfied: the CEO is the founder or a descendant of the founder; the CEO has the same name as the founder; and/or CEO has the same name as another member of the board of the firm.

We start with the population of listed firms in the three countries (1780 French firms, 1307 German firms and 2437 UK firms). After excluding the financial firms and firms

with family ownership of less than 25%, we are left with 227, 151 and 110 family firms in France, Germany and the UK, respectively.⁴ We further drop from the sample those firms whose family shareholder fails to remain the largest shareholder for at least half of the period and firms with an IPO after 2007. This results in a sample of 187 French firms, 120 German firms and 88 UK firms. After retaining only those firms whose incumbent CEO is a family member and who leaves during the period of study, our final sample consists of 113 firms, of which 50 firms are French, 39 are German and the remaining 24 are UK firms. Two German firms experienced two changes of their family CEO during the period of study, resulting in a final sample of 115 replacements of the family CEO in 113 family firms.

Table I

The number of CEO replacements and the reasons for the departures

This table reports the number of CEO replacements and the reasons for the departures. The reasons for the departures are identified primarily with help of LexisNexis. The main reason for departures is the appointment of the departing family CEO to the supervisory board or the chair position of the board. Natural departures include the death of the incumbent CEO, regular retirement, when the CEO is above 65 years of age or older, and earlier retirement, when the CEO is younger than 65 years. A departure is considered to be forced if we find articles/news releases indicating that the CEO was 'replaced', left following 'policy disagreements', left due to 'differences in opinion', or left for some a similar reason. For eight of the departures a reason could not be identified. The median age of the departing CEO is reported in the last column.

	Family replacements	Non-family replacements	% of sample	Median age of departing CEO
Natural departures	18	1	16.5	
Death/suicide	7	0	6.1	48.0
Regular retirement (CEO is 65 years of age or older)	8	1	7.8	68.0
Early retirement (CEO is younger than 65 years)	3	0	2.6	59.0
CEO becoming a chairman/ moving to a supervisory board	22	48	60.9	62.0
Forced departures	4	22	22.6	
Refusal to renew contract	1	6	6.1	56.0
Takeover	0	1	0.9	49.0
Other professional commitments	0	5	4.3	62.0
Personal reasons	3	2	4.3	56.5
No reason found	0	8	7.0	62.0
<i>Total CEO replacements</i>	<i>44</i>	<i>71</i>	<i>100</i>	<i>62.0</i>

⁴ In case of pyramidal ownership, we consider the total votes of the ultimate owner.

By construction, all the departing CEOs are family members. However, they might be replaced by a family member or a person not related to the family. Hence, we distinguish between family replacements and non-family replacements. As per Table I, out of 115 events, 44 are family replacements and the remaining 71 are non-family replacements. Further analysis suggests that the main reason for CEO replacements in the sample is the appointment of the departing CEO to the supervisory board or to the chair position of the board (60.9% out of the 115 replacements). This is followed by forced departures (22.6%) and natural departures (16.5%).

The biographies of the departing and new CEOs, as well as those of the non-executive directors on the board, are obtained from the annual reports (published in different languages) and supplemented with information from Reuters, Thomson One Banker, the company websites and information from country-specific company guides.⁵ We obtain the announcement date of the CEO succession from LexisNexis, the Forbes database and online newspapers. The announcement date is verified across more than one news source.

3.2 Variables

The validity of our conjectures is tested using univariate analysis. We use the above five factors advanced by the existing literature to explain the choice between another family CEO and a CEO not related to the family. These factors are as follows: family power, whether the CEO is from a generation later than the founder generation or not, board independence, a UK/US cross-listing and past performance. Some of these variables are measured in more than one way. The definitions of all the above mentioned factors are provided below and they are also repeated in Table A in the appendix. We start with board independence because of the central importance of this variable in our analysis and the practical difficulties in measuring it.

Typically, board independence is measured as the percentage of non-executive directors on the board of directors. However, as this paper focuses on board independence from the controlling family, we argue that it is important to adjust for the possibility that some non-executive directors have close ties with the controlling family. Although these directors are reported as being independent in the annual reports, they may not be so *de facto*. We make a major effort in identifying the non-executives that are truly independent from the controlling family. A non-executive is considered to be

⁵ We use Hoppenstedt Aktienführer for Germany and Companies Handbooks for the UK. The information for France was supplemented with data available at <http://dirigeant.societe.com/>.

independent from the controlling family if he/she satisfies all of the following six criteria: she/he (1) is not related by blood or marriage to the controlling family; (2) has been a director with the firm for less than nine years;⁶ (3) is not employed or does not act as a director in another firm controlled by the same family; (4) has not been appointed to the board by the controlling family; (5) does not sit on other boards with the family directors; and (6) has not been previously employed by the firm.⁷ This measure of board independence is far more stringent and refined than the traditional definition. Indeed, it takes into account the specific characteristics of family firms and reaches beyond the standard corporate governance regulation. Importantly, it also allows for cross-country comparability which is of a major importance in this paper.

A similar analysis is applied to the 71 non-family replacements of the CEO. In other words, we check whether some of the new non-family CEOs are in reality related to the controlling family. For this purpose, we apply all the above criteria, bar criteria (2) and (6).⁸ All the other four criteria are met by the replacing CEOs, suggesting that they are very unlikely related to the controlling family.

Next, we briefly focus on the remaining variables. Three different measures of the power of the controlling family are used, i.e. *FAMILY CONTROL RIGHTS* measuring the percentage of votes held by the controlling family, *FAMILY CASH FLOW RIGHTS* measuring the percentage of ownership held by the controlling family, and the *DEVIATION FROM ONE-SHARE ONE-VOTE* defined as the percentage of family control rights in excess of the family cash flow rights.⁹ *BEYOND FOUNDER GENERATION* measures the generation of

⁶ The maximum recommended tenure for non-executive directors is nine years in the UK (FRC, 2010); twelve years in France (AFEP&MEDEF, 2010) and no maximum tenure specified for German firms (Government Commission, 2010). Nine years of maximum tenure is adopted given that it is the most stringent recommendation across the three countries.

⁷ Employee representatives on German supervisory boards are ignored (i.e., the size of the management and supervisory board is reduced by the number of employee representative on the board). We argue that the *facto* these directors are not independent.

⁸ Forty-three non-family replacements (63%) out of a total of 71 non-family replacements do not satisfy criterion (6) (i.e., they are former employees of the family firm). Hence, applying criterion (6) would significantly reduce the number of non-family replacements in the sample. More importantly though, it would bias against certain industries and firms where industry and firm-specific training is important. Criterion (2) is also not retained, mainly because the existing corporate regulation stipulates a maximum tenure for the non-executive directors and not for the CEO. In other words, this criterion does not apply to CEOs. Furthermore, in some industries (for example, the pharmaceutical industry) it typically takes ten years from the development of a drug to its first sales. In these cases, the CEO needs to stay in place for at least that time to ensure the commercial success of the product.

⁹ In case of indirect ownership via other intermediary firms that the family also controls, the cash flow rights are calculated as the product of the ownership stakes along the control chain whereas the voting rights are measured as the lowest percentage in the control firm, known as the "weakest link". See La Porta et al. (1999) and Villalonga and Amit (2009) for further details.

the departing CEO relative to the generation of the founder. It is a dummy variable that takes a value of one if the family CEO is in the second a higher generation in year $t-1$, and zero otherwise. *UK/US CROSS-LISTING* is a dummy variable that equals one if the firm is listed on a UK or US stock exchange, in addition to its home stock exchange in year $t-1$, and zero otherwise. It measures the improvement in shareholder protection via cross-listing in the UK or US. Therefore, this dummy equals zero for the UK firms. We also use two measures of past firm performance, i.e. the *RETURN ON EQUITY* and the cumulative abnormal returns (*CARs*). *RETURN ON EQUITY* is measured as earnings *after* interest and tax divided by total equity.¹⁰ *CARs* are calculated using monthly data. The parameters of the Fama and French (1993) and Carhart (1997) four factor model are estimated over months -37 to -13, where month 0 is the month of the CEO replacement announcement. All the remaining control variables are defined in Table A in the appendix.

4. RESULTS

Table II shows the distribution of the 115 CEO replacements across time (Panel A), across industries (Panel B) and countries (Panel C).¹¹ Forty-four of the incumbent family CEOs (38%) are replaced by another family member and the remaining 71 (62%) are replaced by a person not related to the family. Panel A indicates that there is a peak in the number of the CEO replacements in the year 2009 (15% of the replacements) whereas the least number of replacements is reported for the year 2001 (6% of the replacements). The most representative industries in the sample are "Manufacturing" and "Business equipment" (computers, software and electronic equipment) each representing 20.9% of the CEO replacements in the sample. These are followed by the "Other" industries (17.4%). Both types of replacements are fairly well represented across all the industry groups, except for "Telephone and television transmissions" and "Utilities". For the latter two industries there are no replacements of the CEO by another family member. Panel C shows that 43.5% of the replacements took place in the French firms, 35.6% in the German firms and the remaining 20.9% in the UK firms. Most of the CEO replacements for Germany and the UK (73% and 71%, respectively) are by a person not related to the family, whereas for France the number of replacements across the two types is virtually the same. Interestingly, more than half of the overall family replacements (59%) took place in the French firms. This suggests that French firms are more inclined to appoint another family CEO than the German and UK firms.

¹⁰ Total equity is measured as the book value of equity and, if applicable, plus the book value of preferred equity.

¹¹ Two German firms have encountered two CEO replacements each during the period of study.

Table II
Distribution of CEO replacements across time, industries and countries

The sample is comprised of 115 replacements of the incumbent family CEO in 113 listed family firms during 2001-2010. Fifty of the firms are French, 39 are German and the remaining 24 are British. Panel A reports the distribution of the replacements across time whereas Panel B presents the distribution across industries of the 115 replacements. The information in both panels is reported separately for family replacements and non-family replacements of the incumbent family CEO. Replacements in 'Other' industries belong to 2 firms in mining (codes 1422, 1041), 4 in manufacturing of wood related products (codes 2421, 2431, 2435, 2449), 10 in different service industries (codes 7011-8742), 2 in deep sea transportation (codes 4412, 4481), one in real estate (code 6513) and another one in construction (code 1531).

Panel A: Annual distribution of CEO replacements

Year	Family replacements		Non-family replacements	
	N	Percent	N	Percent
2001	2		5	6.1
2002	5		10	13.0
2003	5		3	7.0
2004	4		4	7.0
2005	4		5	7.8
2006	7		9	13.9
2007	1		9	8.7
2008	5		5	8.7
2009	4		13	14.8
2010	7		8	13.0
Total	44		71	100.0

Panel B: Industry distribution of CEO replacements using Fama and French classification

Industry	Family replacements		Non-family replacements		Total	
	N	Percent	N	Percent	N	Percent
Consumer non-durables	5	11.4	12	16.9	17	14.8
Consumer durables	4	9.1	2	2.8	6	5.2
Manufacturing	10	22.7	14	19.7	24	20.9
Oil, gas, coal extraction and products	1	2.3	2	2.8	3	2.6
Business equipment	4	9.1	20	28.2	24	20.9
Telephone and television transmission	0	0.0	1	1.4	1	0.9
Wholesale, retail, and some services	5	11.4	5	7.1	10	8.7
Healthcare and medical equipment	2	4.5	3	4.2	5	4.3
Utilities	0	0.0	5	7.0	5	4.3
Other	13	29.5	7	9.9	20	17.4
Total	44	100.0	71	100.0	115	100.0

Panel C: Country distribution of CEO replacements

Country	Family replacements		Non-family replacements		Total	
	N	Percent	N	Percent	N	Percent
France	26	59.1	24	33.8	50	43.5
Germany	11	25.0	30	42.3	41	35.6
UK	7	15.9	17	23.9	24	20.9
Total	44	100.0	71	100.0	115	100

Table III reports descriptives for the firm and CEO characteristics (Panel A) and the proposed factors determining the CEO replacement choice (Panel B). The average *MARKET CAPITALIZATION* of the firms in the sample is €399 million compared to the average market capitalization of €1.42 billion for all the firms listed on the three stock exchanges. This suggests that the firms in our sample are very small: they belong to the 1st percentile of the market capitalization of all the firms on the three stock exchanges. Nevertheless, there is a large variation in the size of the firms included in the sample, with market capitalization ranging from a minimum of €0.32 million to a maximum of €5.3 billion. Average *ASSETS GROWTH* in the year before the replacement is 4.86%. *LEVERAGE*, defined as long-term debt divided by the book value of equity, is low with a mean of 28.26% and a median of 13.92%. The average *HERFINDAHL INDEX* is also low with a mean of 0.15 indicating that the average firm operates in a highly competitive industry. However, the maximum *HERFINDAHL INDEX* is 0.75, indicating a close to monopoly industry.¹² The average age of the firms in the sample (at the time of the CEO replacement) is 65.74 years, with a median of 46 years. The youngest firm in the sample is 8 years old and the oldest firm is 324 years old.¹³ In terms of the CEO characteristics, the average age of the departing CEO is about 59 years (median of 62 years), with average tenure of 21 years (median of 20 years). The replacing CEO, however, is younger with an average age of 46.93 years and with a median age of 47 years.

The descriptives for the three different measures of the power of the controlling family are reported in Panel B. The panel suggest that *FAMILY CONTROL RIGHTS* (i.e., voting rights) are on average 61.54%, which exceeds *FAMILY CASH FLOW RIGHTS* (i.e., ownership) by 6.86%. Exactly half of the sample firms have a CEO from a later generation than that of the founder (i.e., first) generation and only 14% of the firms are listed on a UK or US stock exchange in addition to their home exchange. The average *REPORTED BOARD INDEPENDENCE* is 53.81%. However, when we adjust for ties with the controlling family, *ADJUSTED BOARD INDEPENDENCE* is reduced by 24.08%, reaching an average level of 29.42%. In terms of past performance, the average *RETURN ON EQUITY* in the year preceding the year when the CEO was replaced is 2.37%, with a median of 8.06%.

¹² This value relates to a German company, Basler AG, which appointed a non-executive successor CEO.

¹³ The oldest firm in our sample is Toye & Co (a UK firm) founded in 1658.

Table III
Summary statistics for the 113 sample firms

This table provides summary statistics for the 113 firms included in the sample using the first CEO replacement only. All the variables are defined as in Table A. Descriptive statistics on firm characteristics and CEO characteristics are reported in Panel A. Panel B reports the descriptive statistics for the conjectured factors of the CEO replacement choice. Due to missing values, the actual number of observations for some variables is smaller than 113.

	Mean	P50	S.D.	Min	Max
<i>Panel A: Firm and CEO characteristics</i>					
Market capitalization, million €	398.97	52.53	961.52	0.32	5,300
Total assets, million €	680.81	108.53	2,620	3.03	26,000
Assets growth, %	4.86	4.37	28.30	-69.65	154.41
Industry-adjusted market-to-book value	-0.08	-0.49	2.04	-8.58	6.22
Leverage, %	28.26	13.92	70.70	-271.22	434.14
Herfindahl index	0.15	0.10	0.14	0.01	0.75
Firm age	65.74	46.00	58.47	8	324
Departing CEO characteristics					
Tenure	21.27	20.00	11.11	2.00	48.00
Age	59.43	62.00	9.77	34.00	80.00
Replacement CEO age	46.93	47.00	8.56	29.00	75.00
<i>Panel B: Determinants of the CEO replacement choice</i>					
Power of the controlling family					
Deviation from one-share one-vote, %	6.86	0.00	11.25	-2.70	52.96
Family control rights, %	61.54	61.56	16.01	26.00	99.36
Family cash flow rights, %	54.44	54.81	15.39	17.67	99.36
Beyond founder generation	0.50	0.00	0.50	0.00	1.00
Board independence					
Reported board independence, %	53.81	56.35	16.05	0.00	83.33
Adjusted board independence, %	29.42	28.59	20.73	0.00	77.78
Difference in board independence, %	24.08	17.43	22.21	0.00	83.33
UK/US cross-listing	0.14	0.00	0.35	0.00	1.00
Past performance					
Return on equity in the previous year, %	2.37	8.06	37.95	-255.29	53.59
CAR[-12;-1]	1.12	1.71	2.49	-4.07	5.03

Table IV compares the characteristics of the 44 CEO replacements by a family member and the 71 CEO replacements by a person not related to the family. The results suggest significant differences between the two types of replacements in terms of firm and CEO characteristics (Panel A) and proposed factors of the CEO replacement choice (Panel B). Panel A shows that firms with a family replacement have a significantly higher *MARKET CAPITALIZATION* and *MARKET-TO-BOOK VALUE* (both for the mean, not the median). We also find that such replacements occur in firms that are significantly older than the replacements by a person not related to the family (both mean and median). The average firm age for the family replacements is 78.72 years, whereas the respective firm age for the other type of replacement is lower with 57.70 years. In addition, we find that

the CEOs that are replaced by a person not related to them are significantly younger compared to the CEOs that are replaced by a relative. However, the replacing family CEOs are significantly younger compared to the replacing professional CEOs. The differences are significant at the 5% level or better for the mean and median values. This pattern reflects the “generation pass the baton” replacement type among families: the older generation (i.e., the generation of the departing CEO) passes the “baton” to the younger generation (the new CEO). Panel B suggests that *FAMILY CONTROL RIGHTS* and the *DEVIATION FROM ONE-SHARE ONE-VOTE* are higher for the family replacements compared to the replacements by a person not related to the family and the difference is significant at the 10% level or better. This supports our Conjecture 1 that the replacing CEO is more likely to be another family member if the family power is great. Interestingly, we find that the majority of the family replacements (61%) take place in firms in the second or a higher family generation, whereas the equivalent percentage for the non-family replacements is much lower (44%). The difference is significant at the 10% level. These results do not support Conjecture 2 as well as previous evidence that the generation of the family that succeeds the founder tends to use a more professional form of management (e.g. Dyer, 1988; and McConaughty and Phillips, 1999). To the contrary, in the case of our sample, firms with older CEOs (see Panel A) and of a later generation than the founder generation (Panel B) are more likely to be replaced by another family CEO.

In terms of reported board independence, we find no significant difference between the two types of CEO replacements. However, when we adjust for ties with the controlling family, the results show that family replacements have lower board independence compared to non-family replacements and the difference is significant at the 1% level or better. In detail, the average board of directors for the case of non-family replacements is comprised of about 36% of truly independent directors from the controlling family. However, the equivalent percentage for the family replacements is almost half that percentage (about 18%). In line with the results presented by Ansari et al. (2014), this study shows that adjusting for board independence from the controlling family matters in the case of the CEO replacement decisions. More independent boards are associated with appointments of non-family CEOs. Finally, we do not find any difference between the two types of CEO replacement in terms of past performance (this applies to both ROE and the CARs). Overall, the results reported in Table IV support Conjecture 1 (power of the controlling family) and Conjecture 3 (board independence), but reject Conjecture 2 (family generation). In addition, no significant differences are found in relation to a UK/US cross-listing and past firm performance (Conjecture 4 and 5).

Table IV
Mean and median differences between the characteristics of 44 family replacements and 71 non-family replacements

This table compares the mean and median values of the characteristics related to the 44 family replacements and the 71 non-family replacements of the incumbent family CEO in France, Germany and the UK. Table A presents the definitions of all the variables reported in this table. We use a *t*-test to assess the difference in means whereas a *z*-test (Mann-Whitney U test) is used to test the difference in medians. Dummy variables are marked with § and differences in this case are tested using a proportion test. ***, **, * denotes significance at the 1%, 5%, and 10% level, respectively (two-tailed test).

	Family replacements		Non-family replacements		Mean differences (t-test)	Median differences (z-test)
	Mean	Median	Mean	Median		
<i>Panel A: Firm and CEO characteristics</i>						
Market capitalization, million €	169.12	47.02	534.20	68.69	-2.02**	-0.79
Total assets, million €	334.96	123.86	885.61	105.52	-1.11	0.09
Assets growth, %	5.35	3.03	4.25	4.63	0.20	-0.11
Industry-adjusted market-to-book value	-0.58	-0.54	0.19	-0.44	-1.94*	-0.98
Leverage, %	33.92	15.42	25.47	9.75	0.61	0.97
Herfindahl index	0.15	0.11	0.15	0.10	0.09	0.79
Firm age	78.72	57.5	57.70	32.00	1.90*	1.87*
Departing CEO characteristics						
Tenure	22.93	20.50	20.62	19.50	0.83	0.65
Age	62.89	65.00	57.87	59.50	2.50**	2.83***
Successor CEO age	44.55	43.00	48.64	48.00	-2.30**	-3.10***
<i>Panel B: Determinants of the CEO replacement choice</i>						
Power of the controlling family						
Deviation from one-share one-vote, %	10.09	7.42	5.42	0.00	2.15**	2.25**
Family control rights, %	65.70	65.00	59.58	60.35	2.00**	1.69*
Family cash flow rights, %	55.61	53.22	53.78	55.70	0.62	-0.33
Beyond founder generation [§]	0.61		0.44		1.85*	
Board independence						
Reported board independence, %	56.54	57.14	52.24	55.55	1.38	1.06
Adjusted board independence, %	17.87	16.67	36.16	38.46	-4.85***	-4.50***
Difference in board independence, %	36.98	33.33	16.81	12.50	4.96***	4.16***
UK/US cross-listing [§]	0.09		0.17		-1.17	
Past performance						
Return on equity in the previous year, %	8.60	8.29	-1.35	7.97	1.38	0.23
CAR[-12;-1]	1.30	1.71	1.02	1.77	0.51	0.23

Table V highlights the country differences as to the association between the CEO replacement choice and the five factors conjectured to explain this choice. The table reports the mean and median comparisons across the three countries, i.e. France, Germany and the UK. Panel A presents the results for family replacements, Panel B for the non-family replacements and Panel C shows the mean and median differences across the two types of CEO replacements. The univariate country specific analysis suggests significant differences across the three countries. First, we find that the difference

between the *FAMILY CONTROL RIGHTS* for the family replacements and the non-family replacements reported in Table IV is driven solely by Germany. In detail, we find that there is no significant difference in the *FAMILY CONTROL RIGHTS* across the two types of replacements for France and the UK. However, the mean *FAMILY CONTROL RIGHTS* for the family replacements for Germany is 73.50% which is 12.33% higher compared to the equivalent mean for the non-family replacements (the difference is significant at the 5% level). This suggests that the German family firms with a high percentage of *FAMILY CONTROL RIGHTS* are more likely (compared to the French and the UK firms) to appoint another family member as the new CEO. In other words, *FAMILY CONTROL RIGHTS* matters in terms of the CEO replacement in Germany, but not in France and the UK. Second, the results also show that the *BEYOND FAMILY GENERATION* is significantly higher for the family replacements compared to the non-family replacements for Germany and the UK, but not for France. The average *BEYOND FAMILY GENERATION* dummy in the UK, for example, is twice as high for the family replacements than for the non-family replacements (0.86 and 0.41, respectively); the difference is significant at the 5% level. This suggests that the proportion of firms with a CEO in the second or higher generation is significantly higher for the family replacements for Germany and the UK. This reflects the fact that German and UK firms which replace their CEO by another family member are the oldest ones in the sample (the descriptives are not tabulated).¹⁴ Third, the results suggest that *ADJUSTED BOARD INDEPENDENCE* matters across the three countries. We find that non-family replacements take place in firms with higher *ADJUSTED BOARD INDEPENDENCE*. However, the *DIFFERENCE IN BOARD INDEPENDENCE* is positive and significant (at the 1% level) for France only, but is insignificant for Germany and the UK. This suggests that the French firms have the highest systematic bias in terms of classing their non-executives as being independent when *de facto* they have close ties to the controlling family. For example, when the *REPORTED BOARD INDEPENDENCE* is adjusted for ties with the controlling family, the average board independence in the French firms with a family replacement drops from 62.06% to 12.97%, a reduction by 47.51%. Hence, adjustments for family ties are especially important for France, highlighting the greater family power in French firms. Fourth, in terms of shareholder protection as measured by the *UK/US CROSS-LISTING* dummy, we find that this

¹⁴ Additional analysis shows that the average age of the firms with a family replacement is 60 years for France, 93 years for Germany and 124 years for the UK. For the case of the non-family replacements, firm age is as follows: 60 for France, 62 for Germany and 46 years for the UK, respectively. However, these numbers should be treated with caution because of the large numbers of missing values.

matters only for France. Only 12% of the French firms with a family replacement are cross-listed on a UK or US exchange compared to 42% of the French firms with a non-family replacement. The difference in the *UK/US CROSS-LISTING* dummy across the two replacement types is significant for France (at the 5% level), but insignificant for Germany and the UK. This supports La Porta et al.'s (1997, 1998) thesis that French or Latin law offers weaker investor protection than German law. Finally, we find that past performance matters for the case of the German firms. Based on the *RETURN ON EQUITY* in the year prior to the year of the replacement, the results show that German firms with a family replacement perform better than the equivalent firms with a non-family replacement. The difference is positive and significant at the 5% level. This suggests that bad past performance puts pressure on family firms to replace the departing CEO with a person not related to the family. Past accounting performance matters, but only for the German firms.

Table V

Differences in characteristics between family replacements and non-family replacements for each country in the sample

This table reports the mean and median comparison between the characteristics of family replacements and those of non-family replacements for each country in the sample. There are 50 replacements in the French firms, 41 replacements in German firms and the remaining 24 replacements are in the UK firms. Panel A presents the mean and median values for the family replacements, Panel B reports the results for the nonfamily replacements and Panel C reports the mean and median differences between the two types of replacements. Differences in means are assessed using a *t*-test whereas differences in medians are tested using a *z*-test (Mann-Whitney U test). Dummy variables are denoted δ and the difference in this case is tested using a proportion test. Table A presents the definition of all the variables. ***, **, * denotes significance at the 1%, 5%, and 10% level, respectively (two-tailed test).

	France		Germany		UK	
	Mean	Median	Mean	Median	Mean	Median
<i>Panel A: Family replacements</i>						
Power of the controlling family						
Deviation from one-share one-vote, %	8.75	9.40	17.86	20.41	2.82	0.00
Family control rights, %	67.11	67.80	73.50	75.76	48.18	51.14
Family cash flow rights, %	58.35	53.32	55.64	56.69	45.36	45.54
Beyond founder generation [§]	0.50	0.50	0.73	1.00	0.86	1.00
Board independence						
Reported board independence, %	62.06	60.00	57.09	53.84	35.95	33.33
Adjusted board independence, %	12.97	10.00	28.16	25.00	16.43	0.00
Difference in board independence, %	47.51	47.22	28.93	25.00	19.52	20.00
UK/US cross-listing [§]	0.12	0.00	0.09	0.00	0.00	0.00
Past performance						
Return on equity in the previous year, %	8.22	9.07	14.50	14.43	0.70	1.56
CAR[-12;-1]	0.77	1.16	2.32	2.51	1.73	2.47
<i>Panel B: Non-family replacements</i>						
Power of the controlling family						
Deviation from one-share one-vote, %	7.10	5.59	5.46	0.00	2.97	0.00
Family control rights, %	65.29	69.95	61.17	64.65	48.72	50.07
Family cash flow rights, %	57.07	57.29	55.71	56.10	45.75	47.62
Beyond founder generation [§]	0.46	0.00	0.43	0.00	0.41	0.00
Board independence						
Reported board independence, %	44.40	48.33	61.66	61.25	46.87	50.00
Adjusted board independence, %	30.12	37.50	38.41	40.00	40.04	40.00
Difference in board independence, %	16.72	11.12	23.17	18.18	6.82	0.00
UK/US cross-listing [§]	0.42	0.00	0.07	0.00	0.00	0.00
Past performance						
Return on equity in the previous year, %	12.50	11.55	-15.54	6.22	2.47	9.33
CAR[-12;-1]	1.41	2.12	1.14	2.04	0.20	-1.09
<i>Panel C: Mean and median differences</i>						
Power of the controlling family						
Deviation from one-share one-vote, %	0.80	0.67	2.03*	2.27**	-0.04	-0.76
Family control rights, %	0.46	0.05	2.16**	2.13**	-0.09	-0.16
Family cash flow rights, %	0.31	0.14	-0.01	0.06	-0.07	-0.22
Beyond founder generation [§]	0.29		1.66*		1.99**	
Board independence						
Reported board independence, %	3.84***	3.38***	-0.95	-1.11	-1.92*	-1.64*
Adjusted board independence, %	-2.91***	-2.52**	-1.90*	-1.95*	-2.61**	-2.36**
Difference in board independence, %	4.68***	3.84***	0.91	0.81	1.57	0.74
UK/US cross-listing [§]	-2.43**		0.26		0.00	
Past performance						
Return on equity in the previous year, %	-1.15	-0.86	2.48**	2.06**	-0.15	-1.43
CAR[-12;-1]	-0.84	-0.87	1.49	0.81	1.16	1.31

5. CONCLUSION

This paper is based on a novel data set of family firms from France, Germany and the UK. Family firms are defined as those where the largest shareholder is a family and which exercises at least 25% of the votes. We focus on those firms where the incumbent CEO is a member of the controlling family and is replaced during the period of study of 2001-2010. Following our reading of the existing literature, we propose five different factors that may influence the choice of replacement between another family member and a person not related to the controlling family. These factors are the family power, the fact whether the incumbent CEO is of the founder generation or a later generation, board independence, improved investor protection via a UK or US cross-listing and past performance.

We find evidence that greater family power is more likely to be associated with the

incumbent family CEO being replaced by another family member. In contrast and contrary to our expectations, family replacements take place in firms with an incumbent CEO in the second or a higher generation. However, the difference is significant at the 10% level only. While we do not find that reported board independence has any influence on this choice, we find strong evidence that our adjusted measure of board independence matters as it has an impact on the choice of the CEO replacement. Indeed, our adjusted measure of board independence takes into account the ties that a director, reported as independent, may have with the controlling family. This result has major policy implications as it suggests that existing measures and reporting of director independence are biased, misleading investors into think that such independent directors have the interest of all the shareholders at heart, when in fact they look after the interests of the controlling family.

However, we do not find any evidence that improved shareholder protection via a UK or US cross-listing affects the choice of the CEO replacement. The same can be said for past performance, whether it is measured by the return on equity or the cumulative abnormal returns for the period preceding the announcement of the CEO replacement.

Still, there are differences across France, Germany and the UK in terms of the significance and importance of the five conjectured factors. In particular, the significance of family power seems to stem mainly from the German firms whereas no such significance is observed for the French and UK firms. Whereas the incumbent CEO's generation did not seem to matter for the whole sample, it seems to matter for Germany and France. For the latter two countries, a CEO from a later generation is more likely to be replaced by another family member. Nevertheless, this result is contrary to our conjecture as well as the existing evidence. Finally, we also find evidence that for Germany past performance matters in the sense that better performance is more likely to be associated with the incumbent CEO being replaced by another family member.

To sum up, this paper has important policy implications and we urge regulators as well as bodies behind codes of best practice in corporate governance to reconsider their definitions of and the ways in which they measure director independence. In other words, as this paper clearly illustrates it is dangerous to define board independence while omitting the particular characteristics of family firms.

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APPENDIX

Table A

Definitions of the Variables

This table reports the definitions of all the variables used in this study.

Variable	Definition
Power of the controlling family	Family power is measured by the following three measures: family cash flow rights, family control rights and the deviation from one-share one-vote. These measures are defined below.
Family cash flow rights	The number of shares of all classes held by the family as a percentage of total shares outstanding in year t-1. This number includes all shares held by family representatives (such as co-trustees, and family designated directors). (Sources: Osiris, Thomson One Banker, Hoppenstedt Aktienführer, annual reports)
Family control rights	Votes held by the family plus votes via pyramidal ownership (measured by the weakest link in the control chain) as a percentage of the total votes outstanding in year t-1. (Sources: Osiris, Thomson One Banker, Hoppenstedt Aktienführer, annual reports)
Deviation from one-share one-vote	The difference between family control rights and family cash flow rights in year t-1.
Beyond founder generation	This is a dummy variable that equals one if the incumbent family CEO is in the second or a higher generation of the family in year t-1, and zero otherwise. The generation of the founder is considered to be the first generation. (Source: annual reports)
Board independence	
Reported board independence	The number of directors that are reported as being independent in the annual reports as a percentage of board size. For Germany, board size is the sum of the size of the management board and the size of the supervisory board minus the number of employee representatives. (Source: annual reports)
Adjusted board independence	The number of directors that are de facto independent of the controlling family as a percentage of board size. A director is de facto independent if she/ he satisfies the following six criteria: she/he (1) is not related by blood or marriage to the controlling family; (2) has been a director with the firm for less than nine years; (3) is not employed or does not act as a director in another firm controlled by the same family; (4) has not been appointed to the board by the controlling family; (5) does not sit on other boards with the family directors; and (6) has not been previously employed by the firm. (Sources: annual reports, IPO prospectuses, Thomson One Banker)
Difference in board independence	The difference between the adjusted board independence and the reported board independence
UK/US cross-listing	A dummy variable that equals one, if the firm is cross-listed on a US or UK stock exchange in year t-1, and zero otherwise. (Source: Osiris)
Return on equity	Earnings after interest and tax as a percentage of the book value of equity (voting and non-voting shares) measured in year t-1. (Source: Datastream)
CARs	The cumulative abnormal returns are based on monthly data for the Fama and French (1993) and Carhart (1997) four factor model, where month 0 is the month of the succession announcement. The parameters of the four factor model are estimated over month -37 to month -13. (Sources: Datastream and Kenneth French's website)
Assets growth	Percentage change in total assets from year t-2 to year t-1. (Source: Datastream)
Industry-adjusted market-to-book value	Market value of voting and non-voting shares divided by their book value adjusted by the respective industry market-to-book value by country in the year t-1. (Source: Datastream)
Leverage	Book value of long-term debt as a percentage of the book value of the voting and non-voting shares in year t-1. (Source: Datastream)
Herfindahl index	The Herfindahl index of the market shares (sales) of all the firms in the industry. It is measured in year t-1, except for CEO replacements in years 2008 to 2010 where this is 2006 as the index is only available until that year. (Source: EU-KLEMS)
Family age	The number of years since the firm was founded. (Source: annual reports, Datastream)
Tenure	Number of years the individual has been a CEO in year t. (Sources: annual reports, Thomson One Banker)
Age	Age of the CEO in years, measured in year t. (Sources: annual reports, Thomson One Banker)
Total assets	Total assets of the firm in year t-1. (Source: Datastream)
Market capitalization	Market price at the end of the year multiplied by the number of total shares outstanding in year t-1. (Source: Datastream)