Good Governance of Family-owned Businesses Is Critical to Emerging Market Economies

CG Insights Series - Top corporate governance experts report on the latest research in emerging markets.

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The most interesting piece on corporate governance I read recently was...

An article in the Economist magazine about in-fighting in the family that controls Macao's gambling industry as the founder grows old and battles illness. The story highlights the fact that the family succession issue in Asia is extremely challenging and that it must be addressed. In Asia, where more than 70 percent of businesses are family-owned, many of the dominant firms are in transition now, as the founders are quite elderly. If family disputes lead to decisions that damage the businesses, this could cause broader damage to these economies.

Right now, I am working on...

A follow-up to my earlier research about what happens to family-owned companies in Asia following transition to the second generation. The earlier research revealed that in the five years after the company founder turns over the reins to the next generation, companies in the sample declined in value by an average of nearly 60 percent. 60 percent! The new research looks at each of the 250 companies in the sample in depth to understand what went wrong, and whether a shift to a better governance model could have mitigated the dissipation of value. Some of the initial findings point to smaller declines in value for companies with better corporate governance structures during the transition period. For example, firms that recruited non-relatives to the board of directors after the founder stepped down typically fared better.

I think the most relevant CG research topic for emerging markets now is...

Identifying corporate governance models that work in emerging markets. Simply importing international governance standards and forcing emerging market companies to adopt these standards will not be useful. The companies will remain opaque. We need to recognize the unique nature of these companies and their national and cultural contexts, and look at how to modify western governance models to fit them.

The latest development in the field of family business governance research is...

A shift toward quantitative methodologies.

Research on corporate governance in family businesses traditionally was a sort-of sub-science, where storytelling was the main method of analysis. Academics and researchers would use descriptive case studies to look at what went right and what went wrong. It was effective as far as it went.

More recently, financial economists are teaming up with researchers to try to understand more about what's going on in family-owned companies—and to find ways to measure this. What are the constraints? How does the family structure affect governance? If the heir to the business is an only child, does it matter whether the child is a boy or a girl? If there are multiple children, does the added human capital compensate for the potential downsides of in-fighting?

Financial economists are starting to pay more attention to these issues because of how critical successful family-owned businesses are to emerging market economies. More rigorous econometrics and larger sample sizes will enable more quantitative research—yield a deeper and more nuanced body of information.

These quantitative studies are important because they can help governments and regulatory bodies identify corporate governance strategies and approaches that can help these businesses retain their value and continue to be successful even as they transition into the second or third generation.

For more on family business governance research, Dr. Fan recommends:

"The Great Succession Challenge of Asian Business": Dr. Fan's talk at the World Bank in January, 2011
Hughes, James E. Jr. Family: The Compact among Generations, Bloomberg, New York, 2007
Studwell, Joe. Asian Godfathers, Profile Books, London, 2007.