

**Master Thesis:**  
**Grey independent directors and  
the management model of family firms**

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## Introduction

Most firms in the world are considered to be family firms. Over the world the most percentage of the firms are family created businesses. Family businesses (FB's) are the predominant form of business organization around the world, and they contribute extensively to global wealth creation (Burkart *et al.* 2003; IFERA 2003; Westhead & Cowling 1998). International family enterprise research academy (IFERA, 2003) reports that in several European countries, family businesses are the majority of all businesses: France (> 60%), Germany (60%), the Netherlands (74%), Portugal (70%), Belgium (70%), United Kingdom(70%),Spain(75%), Sweden(79%), Finland(80%), Greece (80%), Cyprus(80%), and Italy (93%). While in the United States, family businesses account for an overwhelming 95% of businesses (Shanker & Astrachan, 1996). Lank (1993) estimates that 75% of the businesses in the UK, 80% of the businesses in Spain, more than 90 % in Sweden and 99% in Italy are family businesses. Burns and Whitehouse (1996) report that 85 % of the European businesses and 90% of the US businesses are family businesses. Even large companies with a significant number of shareholders still can be controlled by family who can remain as large shareholder and maintain control.

There are moral hazard problems that can be run into when we are dealing with family owned businesses. Board of directors and some other control mechanisms such as law and its enforcements and marker for corporate control can solve these moral hazard problems. Therefore, the boards of directors have to be composed to some extent of independent directors.

Why it is so important? Boards of directors do not manage the business of the company, that is left to the executive management. Board of directors perform two main tasks: the exercise of control and the provision of advice. As noted in the Cadbury Report (1992) the board's role is to give direction and oversee or monitor the management of the business. Boards with more independent directors may contribute to the strategic actions of firms by providing a broader range of expertise, information, and resources that enhance managerial capabilities in coping with uncertainty (Li & Harrison, 2008), by doing so boards improve the understanding, creativity, and coherence of the firm's decisions (Castro et al., 2009). Independent board is considered so when there is enough percentage of independent directors. Some researchers particularly have argued that a board with a high percentage of independent directors provides greater independence and will become more involved in strategic decision-making (Kaymak & Bektas, 2008; Osma, 2008). More diverse groups have more knowledge and skills to solve complex problems (Li & Harrison, 2008), whereas homogeneous groups are more likely to mire in myopic and faulty decision-making that consequently impede the critical evaluation of alternatives (Kim et al., 2009). There is not a certain number of directors that ensures the independence of the board. Even though companies follow specifications the percentage of independent directors required vary from one third of the board in some countries to fifty percent in others.

## Literature Review

Who are independent directors? An independent director is defined as independent of management and free of any business or other relationship that could materially interfere with—or could reasonably be perceived to materially interfere with – the exercise of their unfettered independence (ASX Principles, 2007). Independent director is useful in terms of unbiased opinion in decision making process. Board of directors has two main tasks: The first is in reviewing the performance of the board and the executives . . . The second in taking the lead when potential conflicts of interest arise . . . Independent non executive directors, whose interests are less directly affected, are well placed to help resolve such situations. . . (The Cadbury Committee, 1992). Leach (1991) argues that family members are not disposed to seek the advice of outsiders. Therefore, family owners are sometimes concerned about letting outside independent directors join the board. Moreover, some researchers argue that outsiders lack information and knowledge about the firm and therefore, are less useful than insiders, directors who well know how the firm operates and functions. Independent directors give broader perspective since they have detached views. Their role in dispersed ownership to make managers accountable to shareholders and in firms with large controlling owners is to account for interests of minority shareholders (Fama & Jensen 1983). The rationale behind the need for independent directors can be seen as a way of dealing with the divergence between the interest of shareholders and managers, in that independent directors are seen as useful to reduce agency costs (Jensen & Meckling 1976). Crespi and Pascual (2013) define independent director's role is to limit the extraction of private benefits by controlling large shareholders, who usually appoint the remaining members of the board of directors. The underlying fundamental is that the monitoring activity of boards depends on the effective task of their independent members. Independent directors do not have any financial or familial ties to firm, CEO, family controlling the firm or other board members. Independent directors who joined the board after the CEO, are assumed to be less independent in Core et al. (1999). Because outside directors are independent from management, they are believed to be willing to stand up to the Chief Executive Officer (CEO) to protect shareholder interests. (Duchin, 2010). Another important ability of independent director is to not stop ask questions and challenge decisions made. In various governance codes by outlining what independence was not, it led to a formal structural point of view in that independence equals a position free of any possible conflicts of interest. Van den Berghe and Baelden (2005) suggest that independence of mind should be facilitated and stimulated in a 'culture of open dissent'. Albie Brooks, Judy Oliver & Angelo Veljanovski (2009) conducted survey to obtain the views of as many independent directors as possible. Respondents were asked their views and attitudes concerning the characteristic of independence and its contribution to good corporate governance. Results showed that respondents consider their greatest contribution as an independent director is in the asking of questions and the challenging of actions.

The number of independent director does not necessarily means the increase in the performance of the firm. In fact, many studies have had controversial findings about connection between number of independent directors and firm performance. It is notoriously difficult to find reliable evidence that outside directors matter at all for performance, with most studies finding small, statistically insignificant correlations

(Bhagat and Black, 2002; Hermalin and Weisbach, 2003; Fields and Keys, 2003). Duchin (2010) argues that outsiders significantly improve performance when their information cost is low, and hurt performance when their information cost is high. So it is partially dependent on the transparency of the information available from the firm. By intuition in privately held family businesses the cost of acquiring information may be higher than in publicly held family businesses because of smaller transparency of information.

So we can conclude that independent directors play an important role as equilibrating and controlling mechanism between the shareholders and monitor performance of the CEO. They help the board of directors to perform their two main tasks: the exercise of control and the provision of advice. But what percentage of independent directors are required to help maintain balance? Since the usefulness of independent directors was proven by a lot of researchers many corporate-governance reforms took place. In US boardroom from 1950 to 2005 the average percentage of independent directors has risen from 20% to levels above 70% (Gordon, 2007). However, what are the criteria by which firms distinguish independent directors from dependent? Other problem is that these criteria vary from country to country and from firm to firm. Hwang & Kim (2009) argue that a decent percentage of “independent” directors are not independent if social ties are taken into account. From 87% of boards that are conventionally independent only 62% are conventionally and socially independent. When a conventionally and socially independent board is present, CEO’s total compensation decreases, on average, on \$3.3 million. (Hwang & Kim, 2009). That gives CEO incentive to assign “grey” directors that will be tied to him by any type of social means. Crespi and Pascual-Fuster (2013) have used 8 criteria to distinguish between independent and strictly independent directors. From 32,5% of independent directors on board declared from firms only 14,2% are strictly independent. Therefore, it is not always straight-forward when it comes to the definition of “independence” of directors on the board.

### **Family firms and Non family firms**

It is important to know the difference between family businesses and their counterparts and understand how family involvement in management affects the behavior of boards. A firm usually is classified as a family firm when the family possesses the majority of the shares and perceives the firm as a family firm. Non-family firms usually defined as firms that do not perceive themselves as family firms, and in which a family does not own the majority of the shares. This definition is consistent with Westhead’s (1997) definition. However, our database already contains classification of family and non family firms (dummy). Literature has controversial findings about the age of firms. Daily and Dollinger (1993), Leach (1991) and Ward (1987) reveal that family firms are younger than non-family firms. Wall (1998), Westhead (1997) and Klein (2000), however, find that family firms tend to be older. Family firms in their turn can be separated to public family firms and private family firms. Publicly listed family firms are characterized by mixed ownership (Boardman & Vining, 1989), where ownership is usually split between a blockholding family and other nonfamily blockholders or minority investors. Private family firms are enterprises that are partly or wholly owned and/or managed by a family; their equity shares are not freely floated on a public stock exchange, and they are usually only obliged to disclose rudimentary information about

their financial condition and performance. There is typically less external interest and involvement in their governance.

When it comes to family business it is important for the independent board of directors to deal with moral hazard issues that arise from this fact. Independent boards reduce information asymmetries and sets limits on familial decision making discretion (Bammens, 2011). Bammens & Voordeckers (2011) mention four main moral hazard issues that are encountered in family business settings: (i) risk of owning families expropriating economic wealth from the firms, that harms non-family stakeholders. Specifically, the dilution of residual return rights creates perverse incentives for concentrated owners to reduce effort levels and increase on-the- job consumption (Fama, 1980). (ii) Expropriation risk may reduce firm value in publicly listed family firms because minority investors discount family firm equity shares to reflect the risk of holding these assets (Claessens, Djankov, Fan, & Lang, 2002). Findings by Anderson and Reeb (2004) indicating that the public family firm should consider governance controls to protect and give confidence to minority shareholders. In contrast, private family firms are a “pure” ownership form and less susceptible to the type of principal–principal agency problems commonly found in their publicly listed counterparts. (iii) Risk of owning families pursuing non-economic family objectives which harm non-family stakeholders. Examples of non-economic objectives include, preservation of family character of the firm, family employment and maintenance of family tradition. In case of private family firms the absence of capital market oversight does facilitate the pursuit of noneconomic goals (Chrisman, Chua, Pearson, & Barnett, 2012), which makes private family firms prone to other types of agency costs. (iv) Risk of self control problems amplified by parental altruism. Parental altruism may cause owner-managers to lose self control by favoring and spoiling their employed children that causes inefficiencies, strategic inertia, feelings of distributive injustice, encourages employed children to misbehave. ). Family management may present some special problems, such as a lack of restraint in its generosity to family members. Owners may be excessively altruistic to their children (Schulze, Lubatkin, Dino, & Buchholtz, 2001), which can generate inefficiency and “agency problems with oneself” (Jensen, 1998, p. 48). Finally, risk of problems that arise from intrafamily divergence of interests. It can be seen in sibling partnerships where ownership has been transferred to several sibling. However, each siblings is interested in maximizing his own utility. This disregard for the overall well-being of the extended owning-family becomes even more pronounced in cousin consortia, where ownership has been passed on to members of the third and later generations, with these relatives generally having weak mutual ties and diluted emotional attachments (Bammens *et al.* 2008; Lubatkin *et al.* 2005). This is especially applicable for the privately held firms. Since in publicly traded family businesses, family is considered as homogeneous unity while in privately held family businesses different family members may have different interests compared to others. In sibling partnerships, for example, where ownership has been transferred to several siblings, altruism tends to give each sibling an incentive to maximize the welfare of their own nuclear family unit rather than that of the extended owning-family (Bammens & Voordeckers, 2011). This is especially applicable for the privately held firms. Studies of publicly traded FBs generally view the family as a

homogeneous unity (Anderson & Reeb 2004), in a private setting scholars explored situations in which the interests of some relatives may diverge from the interests of other members of the owning-family (Bammens & Voordeckers, 2011). Mixed ownership can furthermore also generate principal–principal agency costs, because a family may use its insider status or dominant ownership stake to expropriate value from minority investors (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008).

Some researchers also document that family firms have a low survival rate (Birley, 1986; Kets de Vries, 1993; Chu & MacMurray, 1993; Morris *et al.*, 1997) and indicates that the low survival rate is universal and independent of cultural context or economic environment (Lank *et al.*, 1994). In fact, only 30% of the family firms in the US survive the transition to the second generation, and only 10% make it to the third generation (Beckhard & Dyer, 1983a, 1983b). Therefore, the question of succession in family firm is an important decision which can decide the future of a firm. The main decision of the founder is to choose between professional manager or heir. It is usually assumed that professional manager will perform better than heir in any circumstance. Professional managers tend to be adequately trained and frequently have years, if not decades, of relevant industry and firm experience before taking the helm of a public firm. Appointing heir may cause inefficiency because he possibly lack talent, training, determination, and experience. This is consistent with Morck (2000) who also claims that the ability of family management on average, however, is inferior to that of professional management. Burkart (2003) argues that if amenity potential of family is high the ownership and management will never be separated and vice versa, if amenity potential is low the ownership and management always separated. Burkart (2003) also mentions that if shareholder protection (SP) is high the firm is most likely will be sold off by founder and firm becomes widely held professionally managed firm (public family firm). If SP is moderate family stays is large shareholder and monitor manager. Finally, if SP is low family control maintains (private family firms).

Burkart (2003), argues that there are three main theories that explains benefits of a family from maintaining control over the firm. First, there is a significant “amenity potential” of family control, meaning utility to the founder that does not come at the expense of profits. In some industries, such as sports or the media, a family can participate in or even influence exciting social, political, and cultural events through ownership of firms. Ehrhardt and Nowak (2001) find that families nearly universally retain control, with “amenity potential” being the crucial reason. A second reason for the preservation of family control is that the name itself may be a carrier of a reputation, in both economic and political markets. Such “reputational benefits” would be diluted if control is surrendered to an outsider. A third theory of family ownership, namely the possibility of expropriation of outside investors that comes with control. Jensen and Meckling (1976) explain that such benefits of control do come at the expense of profits accruing to the outside investors.

## **The Model of Analysis**

In our research we are focused on family businesses since the majority of businesses and one of the oldest form of business management forms is a family business. The question of independence of directors on the board has been explained in the literature review and there is no need to repeat that independent directors (ID) are really important in decision making process. In the presence of a conflict ID play and equilibrium role, ID impede the extrapolation power of family in a firm.

Crespí and Pascual-Fuster, (2013) have created and defined new variable that represents independent directors who meet eight independence criteria (will be covered in data description section). They gave it a name of strictly independent directors. The variable represents the percentage of strictly independent directors. The database also contains the data on percentage of declared independent directors on the board. We have created a new variable that describes the percentage of grey independent directors on the board.

First of all, we want to get some insight into how the percentages of declared, strict and grey independent directors change over time (2004-2009). We want to examine the corporate governance variables (including grey, strict and declared independent directors) in the dataset on the presence of differences between the means of two population groups which are family firms and non family firms. We also examine corporate governance variables on the presence of differences between means of family firms having strictly independent directors and family firms having grey independent directors.

The corporate governance variables have been divided into three main panels: Panel A — represents variables related to board of directors, Panel B - represents variables related to firm ownership, and Panel C - represents variables related to bylaw provisions.

## **Data Description**

We used the same data set as Crespí and Pascual-Fuster, (2013) used in their paper. It's a broad database on corporate governance of Spanish firms. Database included information on 752 Spanish firms from 2004 up to 2009. All information was acquired from Spanish Stock Market. Other information such as board composition, corporate governance practices and individual information on board members, as tenure or their relationship with significant shareholders, comes from the standardized ARCG that firms have to fill (Crespí and Pascual-Fuster, 2013). ARCG abbreviation stands for annual report on corporate governance practices. This annual report on corporate governance practices (ARCG) which is released by companies since 2004 is filled electronically and publicly available at the CNMV web page. The observed number of independent board directors comes from the firm self-classification of directors, when filling the required forms according their country legislation or disclosing their corporate governance report.

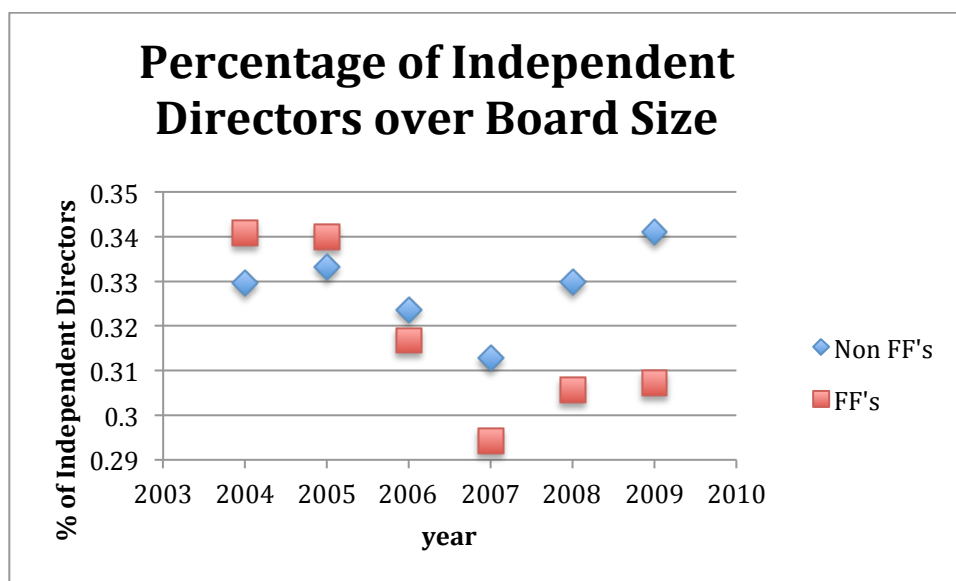
With the information from Spanish Stock Market and ARCG Crespí and Pascual-Fuster, (2013) tested eight independence criteria. The first is based on the rule that a nomination committee is necessary to guarantee independence on the new and renewed board members. Best practices codes include the recommendation of having this committee, with tasks as the independents' appointment. A limited tenure is the second criteria, which is included in the UK combined code and the EU recommendations. The third criteria restricts independence to those that don't have significant business relationship with the company. The relationship with the controlling shareholders is a key element that NYSE rules and other codes define as essential for the independence of directors, so being a director, a manager or employee of a significant shareholder (4th criterion), having any (other) kind of relevant relationship with a significant shareholder (5th criterion) or being paid by the company, its subsidiaries or its associates, for other functions apart from the directorship (6th criterion) do not bring the qualification of real independent member. Companies can be formally board members, through a representative, and our 7th criterion obviously restricts this kind of directors as independents. Our last criterion, the 8th, avoids classifying as independents those that formerly were executives.

Using these criterion as an indicator of strict independence we are comparing family firms having strict independence (firms with comply with 8 independence criterion) with family firms having non-strictly independent directors (grey). We also compare if there are differences between family firms and their counterparts.

### Empirical Results

First of all, let us take a look at Graph 1 which represents the percentage of declared independent directors over years in family and non family firms. As it can be seen from

**Graph 1 The percentage of declared independent directors over the board size (FF – family firms)**

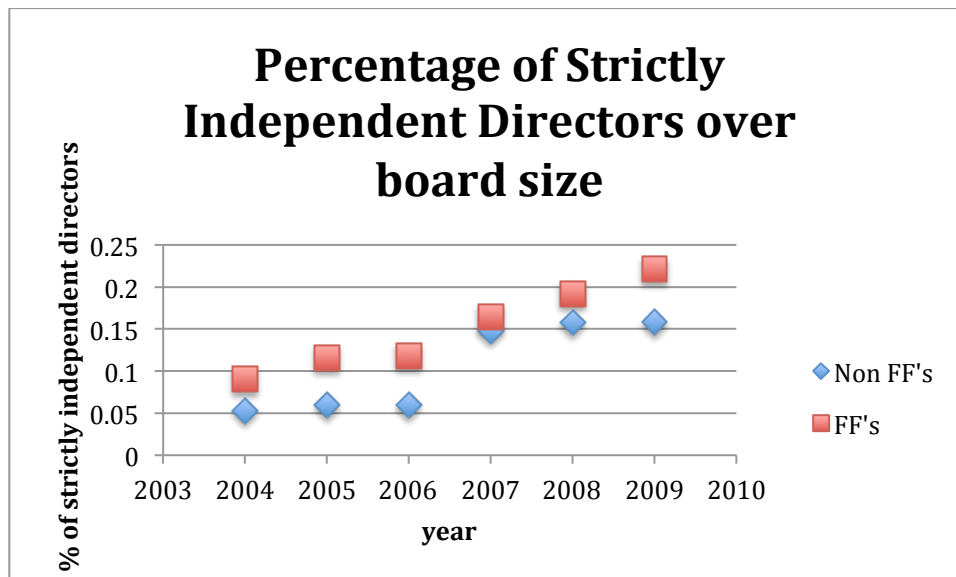




the graph the percentage of declared independent directors over board size in family firms was decreasing from 2004 up to 2007 (peak decrease, 29.5%) and started to increase afterwards up to 2009 (31%). Meanwhile, the percentage of declared independent directors over board size in non family firms has been decreasing up to 2007 (31% in 2007) and increased steadily afterwards (34% in 2009). The sharp downshift in 2007 was probably due to new regulations of corporate governance in Spain which implemented mandatory definition of independent directors. Before that many companies had their own provisions and definitions. Since 2007 a new standardized format of the ARCG motivates the observed reduction of misclassification, when a explicit and mandatory definition of independent director is required (Crespí & Pascual-Fuster, 2013). This misclassification reduction could have dropped the percentage of independent directors over board size as declared by firms. The difference between family and non family firms ranged from smallest (0.01% difference) in 2004 to highest in 2009 (0.03% difference).

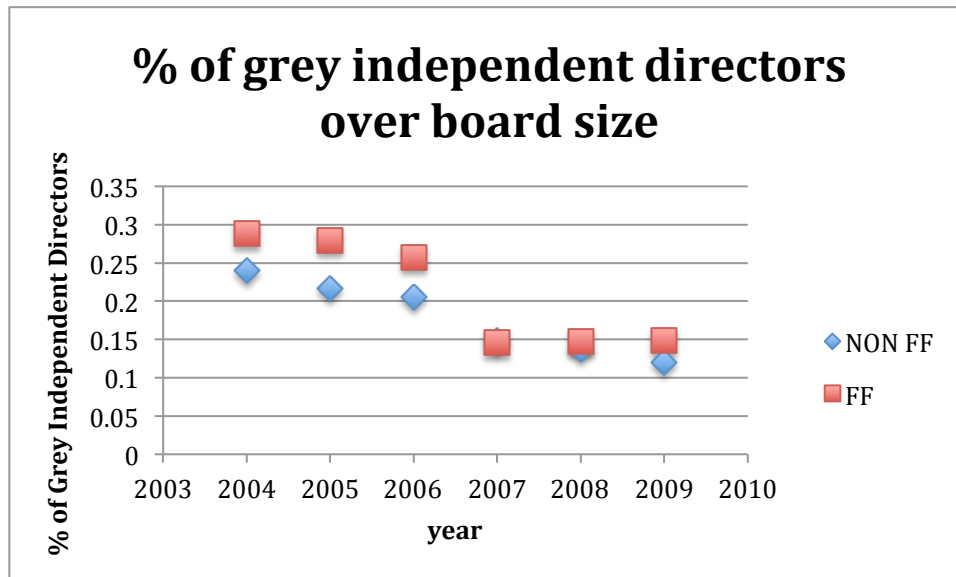
Graph 2 represents strictly independent directors percentage over board size. The percentage has increased significantly over 2006-2007, especially in non family firms (from 5% in 2004 up to 15% in 2007) and increases almost linearly afterwards (23% in 2009). In non family firms the behavior is similar, however, the percentages of strictly independents is lower by about 5% on average up to 2007. Then we see similar spike (although it is smaller) due to new provision implementations which has forced the firms to reconsider their criterion representing independence. After 2007 we examine almost steady position with almost no increase in percentages, 15% afterwards up to 2009.

**Graph 2 Percentage of strictly independent directors over board size  
(FF – family firms)**



Finally Graph 3 represents the percentage of grey independent directors over board size for family and non family firms. Percentage of grey independents in family firms is highest in 2004 (30%) and is falling slowly but steadily up to 2007 (25%) and has fallen drastically, falling down by approximately 10% and remaining same levels afterwards up to 2009. For non family firms the fall downwards was not that high, about 5% fall from 20% to 15% in 2007, and keep falling slowly afterwards up to 2009.

**Graph 3 Percentage of grey independent directors over board size  
(FF – family firms)**



We examined the differences between family and non family firms using variables from our three panels. Table 1 provides empirical results on means, number of observations and p values. As it can be seen because of the differences in number of observations (variances) we performed a t test to test if differences in chosen variables are significantly different or not. Two variables turned out to be significant for Panel A which are: % of declared (L\_053) and % of grey independent directors over board size (Grey). Only variable representing shares of non executive directors (NonExShares) is significant in Panel B as well as variable representing a percentage of firms imposing limit on the voting rights of shareholder (Vcap) in Panel C. The discussion of significant

**Table 1** In this table contains means, number of observations for corporate governance variables. The table compares these governance variables on presence of differences between family firms and non family firms. The last column contains the p-values from the “t” tests performed on 95% confidence interval. Whenever the p-values are higher than 5%, the variable is treated as statistically significant variable (Significance column). The description of variables can be found in Appendix section of this paper.

	Variables	Mean		Observations		P values (t test)	
		FF's	Non FF's	FF's	Non FF's	p-value	Significance
Panel A	L_053	0.3149	0.328	586	166	0.416	Significant
	PIND_okB	0.1133	0.1501	586	166	0.009	Insignificant
	Grey	0.2015	0.1779	586	166	0.133	Significant
	ExComp	532.2269	1102.363	541	165	0.000	Insignificant
Panel B	C1	45.671	33.767	586	166	0.000	Insignificant
	ExShares	34.25	4.6842	586	166	0.000	Insignificant
	NonExShares	15.0977	11.8244	586	166	0.498	Significant
Panel C	Vcap	0.1445	0.1228	586	166	0.460	Significant
	blindajes	0.4337	0.6161	586	166	0.000	Insignificant

In Table 2 we decided to focus on family firms and checked how presence of strictly independent directors and non strictly independent (grey) directors affect the board of directors, ownership and bylaw provisions. All variables in Panel A and C are significant. Only percentage of non executive shares and percentage of ownership of the largest shareholder, both being a part of Panel B, were insignificant. In discussion section the interpretation of results on statistically significant variables will be discussed.

**Table 2** In this table contains means, number of observations for corporate governance variables. The table compares these governance variables on presence of differences on family firms between strictly independent directors and grey independent directors. The last column contains the p-values from the “t” tests performed on 95% confidence interval. Whenever the p-values are higher than 5%, the variable is treated as statistically significant variable (Significance column). The description of variables can be found in Appendix section of this paper.

		Mean		Observations		P values	
		Family firms with		Family firms with		t test	
		strict	grey	strict	grey	p-value	Significance
Panel A	L_051	0.3245	0.3056	48	118	0.4085	Significant
	L_052	0.3441	0.3305	48	118	0.6944	Significant
	CEO	0.75	0.7034	48	118	0.5484	Significant
	ExComp	618.76	497.75	47	118	0.2251	Significant
Panel B	C1	57.77	40.74	48	118	0.0000	Insignificant
	ExShares	38.67	32.44	48	118	0.1314	Significant
	NonExShares	22.88	11.93	48	118	0.0048	Insignificant
Panel C	Vcap	0.0625	0.1779	48	118	0.0556	Significant
	blindajes	0.5	0.4067	48	118	0.2746	Significant

## Discussion

### Family firms vs. non family firms

The percentage of grey independent directors (L\_051) in Panel A for family firms is higher than in non family firms (20.15% vs. 17.79%). Family is using grey independent directors to increase influence power on the board and increase the control over the firm. Therefore, intuitively we could state that percentage of grey independent directors proposed to be higher for family firms. The results are confirming the proposition. Now, if we compare the percentages of declared independent firms, it is higher for non family firms (31.5% vs. 32.8%). Since the declared independent directors consist of grey and strict independent directors and we do not have exact proportions of each variable, we will leave this variable unexplained.

In family firms usually there is a conflict of interests because of different goals that each party tried to achieve. That decreases the goal alignment of the parties. The low goal alignment in its turn leads to the installation of larger and more independent boards of directors (Jaskiewicz and Klein 2007; Pieper *et al.* 2008). Therefore, we can propose higher number of strictly independent directors in non family firms. However, since the differences in means are statistically insignificant we do not make a comparison (the percentages of strictly independent directors is higher for non family firms, even though the differences are insignificant).

We can divide the percentage of declared independent directors over board to percentage of strictly independent directors over the board and percentage of grey independent directors. Therefore, this variable is not capable of providing useful information since we cannot distinguish the exact division proportions between strict and grey directors.

If we take a closer look at Panel B, there are two types of shares one is percentage of executive shares and percentage of non executive shares. As it was discussed earlier in the literature review the management of the company is the responsibility of executive directors and board functions such as exercise of control and the provision of advice is the responsibility of the board. However, we cannot treat shares of executive directors variable as representative of shares owned by a family since executives can as well as can not be part of the family. The variable representing the shares of executive turned out to be insignificant so we ignore it. Furthermore, we do not have information on family ownership, therefore, there is not clear explanation why percentage of non executive shares are higher for family firms compared to their counterparts (15.09% vs. 11.82%).

Another significant variable in Panel C was a variable (Vcap) representing the limit on the voting rights of shareholders. Percentage of firms having the limit on voting rights of shareholders is 14.45% in FF's vs. 12.28% in non FF's. Family has an incentive to impose a limit on voting rights of shareholder to maintain the managerial power and to have more influence in decision making process (to turn it in favor of family if necessary). Higher percentage of limit on voting rights of shareholders can also be used by family as an instrument against the hostile takeovers.

#### **Strictly vs. Grey (non-strictly) independent directors**

Now, if we take a look at family firms what connections can we draw? What conclusions can we make about benefit of having grey independent directors for the firm, if there any?

We want to start with Panel B and discuss some results that seem to be intuitive. The percentage of executive shares is higher for family firms having strictly independents. There can be many reasons to explain why exactly percentages are higher in favor of strictly independent directors on board. Panel C can provide some of reasons: Percentage of firms having the limit on voting rights of shareholders is higher in FF's with grey independent directors. Grey independent directors are used by family to increase the control to some point when it is good enough to extrapolate the company's financial or other type of resources. The decrease in limit on voting rights gives more decision making power to minor shareholders which is not in the best interests of family and its grey directors. The smaller limit on voting rights of shareholders can be caused by decisions achieved through help of strictly independent directors and other factors as well. So since we do not know other factors let us leave explanation of this variable for future research.

The higher percentage of family firms with real independents having golden parachutes protecting the executives against dismissal (0.5% vs. 0.4%) can increase the average tenure of executive directors which will increase the wealth of executive over time including the percentage of shares (38.67% of executive director's shares in FF's with real independent directors vs. 32.44 % of executive director's shares in FF's with grey independent directors. The average compensation of executive directors is more than 100 thousand euros (618,760 vs. 497.750) more per time period for FF's with strict independents compared to grey independents which is a good source of executive wealth

growth over time period. Another explanation is the higher percentage of executive directors on board, however, these two variables can be interrelated.

Finally Panel A gives us some statistics on average percentages of proprietary (32.45% vs. 30.56%) and executive directors (34.4% vs. 33.05%) both higher for FF's with real independents compared to FF's with grey independents. Proprietary directors represent significant shareholder and defend his interests. Usually the most significant shareholders are family members, therefore, we can expect that proprietary directors represent to some extent family interests. The strictly independent directors role is to limit the extraction of private benefits by controlling large shareholders (family members), therefore, in FF's with real independents it is harder for family to maintain control and the need for proprietary director who will defend interests of family is higher. This can explain to some extent by the higher average percentages of proprietary directors. The higher percentage of executive directors can be explained partially by the presence of golden parachutes, however, there can be other affecting variables. Dual CEO is CEO who also remains the chair of the board. The percentage of dual CEO is higher for FF's with strict independents which is not quite what we expected. CEO tries to maximize his own utility and is also interested in assigning grey independent directors. When a conventionally and socially independent board is present, CEO's total compensation decreases, on average, on \$3.3 million (Hwang, 2009). A dual CEO benefits the firm only if he or she works closely with the board to create value. However, it is also easier for the CEO to assert control of the board and consequently make it more difficult for shareholders to monitor and discipline the management (beneficial for family). Therefore, in FF's with strictly independent directors who suppose to monitor and oppose CEO in gaining control, the percentage of dual CEO should be smaller than in FF's with grey independents. We got controversial results.

## **Conclusion**

In this research paper we tried to analyze the corporate governance variables (including grey, strict and declared independent directors) in the dataset on the presence of differences between family firms and non family firms. We also examine corporate governance variables on the presence of differences between means of family firms having strictly independent directors and family firms having grey independent directors. We also got some insight behavior of declared, strict and grey independent directors over time (2004-2009). Here are some main results that we got. The results showed that percentages of grey and declared independent directors has fallen in 2007 due to new regulations of corporate governance in Spain which were implemented in 2007 a mandatory definition of independent directors. The number declared independent directors has decreased since the definition by which they were declared had changed. Since grey independent directors are also being at the same time part of declared independent directors, the percentage of grey independents over the board has fallen as well. The number of strict independents on the board has been rising for the whole period from 2004 to 2009 which shows the rising awareness of necessity for strictly independent directors over the years.

The percentage of grey independent directors (L\_051) in Panel A for family firms is higher than in non family firms (20.15% vs. 17.79%). We were expecting higher percentages for family firms. Family is using grey independent directors to increase influence power on the board and increase the control over the firm. The results confirmed the proposition. Family has an incentive to impose a limit on voting rights of shareholder to maintain the managerial power and to have more influence in decision making process (to turn it in favor of family if necessary) as well as to use it as an instrument against the hostile takeovers. Percentage of firms having the limit on voting rights of shareholders is 14.45% in FF's vs. 12.28% in non FF's which confirms the expectations.

Finally Panel A gives us some statistics on average percentages of proprietary (32.45% vs. 30.56%) and executive directors (34.4% vs. 33.05%) both higher for FF's with real independents compared to FF's with grey independents. Proprietary directors represent significant shareholder and defend his interests. The strictly independent directors role is to limit the extraction of private benefits by controlling large shareholders (family members), therefore, in FF's with real independents it is harder for family to maintain control and the need for proprietary director who will defend interests of family is higher.

We expected higher percentages of proprietary directors in FF's with strict independents. Results confirmed expectations.

Dual CEO is CEO who also remains the chair of the board. The percentage of dual CEO is higher for FF's with strict independents which is not quite what we expected. CEO tries to maximize his own utility and is also interested in assigning grey independent directors. However, it is also easier for the CEO to assert control of the board and consequently make it more difficult for shareholders to monitor and discipline the management (beneficial for family). Therefore, in FF's with strictly independent directors who suppose to monitor and oppose CEO in gaining control, the percentage of dual CEO should be smaller than in FF's with grey independents. We got controversial results.

## Appendix

Variable Name	Description
Ejercicio	Year
L_052	Percentage of proprietary directors over board size
L_053	Percentage of Independent directors over board size (as declared by firms)
PIND_okB	Percentage of independent directors over board size after 8 independence criteria
C1	Ownership of the largest shareholder (%)
CEO	The CEO is the chair of the board of directors
blindajes	There are golden parachutes protecting executives against dismissal
Vcap ExShares	There is a limit on the voting rights of shareholder, independent on the shares she has Ownership of



	executive directors
	Ownership of non-
NonExShares	executive directors

	Average
	compensation of
	executive directors
ExComp	(1000€)

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