

Cross Generations, Reputation Concern and Stock Market Reaction in Family Firm

Cheng-hua, Tsai

Dept. of Tourism and Recreation, ChengShui University
Chengcing Rd., Niasong Dist., Kaohsiung City, Taiwan ,R.O.C.
chenghua@gcloud.csu.edu.tw

Abstract: *Family firms often experience higher reputation levels in communities than non-family firms, since they are often embedded in their social context due to a personalized management and shareholding structure, leading to higher social performance and, consequently, reputation. FA strong family firm reputation improves client relationships and the attraction of clients, thus enhancing overall performance of the business. This research found out the concern many family firms display for their reputation can be traced to the overlap with family members' involvement. Moreover the identification with the family firm and the resulting reputation concern leads to performance-enhancing firm-level phenomena.*

Keywords: *Family Firm, Stock Market Reaction, Social Capital*

1. INTRODUCTION

The Taiwanese corporate sector represents an important research laboratory that provides an opportunity to develop further corporate governance research on the effects of family ownership and control. It allows us to analyze corporate governance effects on organizational outcomes in situations where the managers are frequently family members, where families are also represented on a supervisory board, and where they are often the major providers of capital, if not directly, then through relational holdings in other firms. At the same time, family-controlled firms that are listed on the stock exchange also have minority shareholders, and the governance effects of family control and board characteristics on the stock market reaction is prior research most emphasis on. However, family firm represent a large proportion of firms in Taiwan and have an important economic impact (Claessens, Djankov & Lang, 2000). The success of this organizational form has been attributed to causes ranging from agency cost advantages (Chrisman et al ,2007). Past research has provided a link between reputation and firm performance is persuasive and corporate reputation formation antecedents has been discussed in the family firm literature (Roberts & Dowling, 2002).

Many listed companies in Taiwan still rely heavily on the support of their founding families to finance their operations, in marked contrast to companies in the industrialized countries. In a sample of 141 companies listed on the Taiwan Stock Exchange (TSE), Claessens et al (2000) noted that 34% were family-controlled, where control was defined as having a 20% shareholding. If the criterion for control is reduced to a 10% shareholding then 47% of the companies were family-controlled, and the proportion of family-controlled enterprises rises to 67.5% if the legal definition on insider shareholding is used. In a more recent study, Filatotchev et al (2005) report that, on average, controlling families in Taiwan hold 17.2% of the listed firms' equity, and more than a third of listed firms are members of wider family group networks. Thus there is evidence that family control plays a crucial role in corporate management in Taiwan, although the percentage insider shareholding in publicly-listed companies has decreased significantly during the 1980s and 1990s (Taiwan Stock Exchange, 2002).

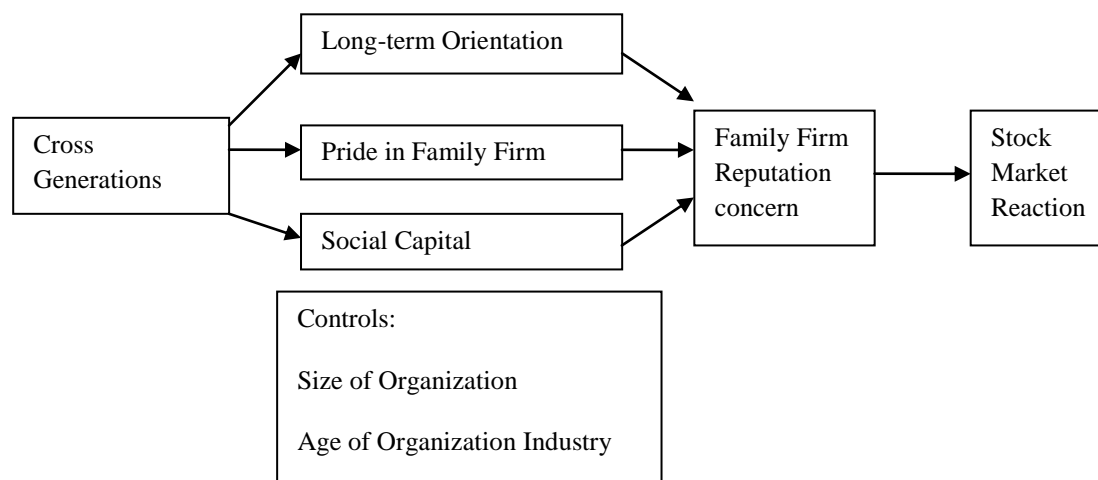


Fig1. *Conceptual framework of generation transfer and stock market reaction*

2. HYPOTHESES DEVELOPMENT

Corporate reputation is a global impression that represents how a collective- a stakeholder group or multiple stakeholder groups-perceives a firm (Rindova, 2005). It could be defined as a “particular type of feedback, received by organizations from their stakeholders, concerning the credibility of the organization’s identity claims.” Following this perspective, reputation arises from information exchange and social influence among various constituents interacting in an organizational field.

Family firms often experience higher reputation levels in communities than non-family firms, since they are often embedded in their social context due to a personalized management and shareholding structure, leading to higher social performance and, consequently, reputation. Family firms are often regarded as trustworthy and are considered to derive value from good reputations in their communities (Tagiuri et al,1996) A strong family firm reputation improves client relationships and the attraction of clients, thus enhancing overall performance of the business(Eddleston et al,2008)

The concern many family firms display for their reputation can be traced to the overlap with family members’ involvement. We suggest that the identification with the family firm and the resulting reputation concern leads to performance-enhancing firm-level phenomena.

2.1. Long-Term Orientation Concern

In family firms, a long-term orientation is often prevalent. Several authors report that family firms display a longer-term planning horizon (Zellweger,2007;Miller et al.,2005)Not being subjected to short-term performance pressures provides incentive for a more careful evaluation of projects with a higher performance potential in the long run(Mill et al.,2005)

Since the names of family members will continue to be identified with the organization even beyond the professional tenure of managers (Westhead, Cowling,&Howorth,2001),there is strong identification of family members with the firm. This long-term identity overlap between the individual, the family, and the firm, in particular when the family name is the firm name, is expected to lead to a heightened concern for corporate reputation.

Investigating the relationship between time and reputation, the concept of reputation”stickiness,” where ”evaluations(positive or negative) become entrenched such that they have an ongoing impact on the firm’s performance.” In other words, the long-term orientation and the associated concern for the family’s social identity create reputation stickiness. The tight overlap among individual family members, the family, and the firm over a long time span could lead to deep entrenchment of reputation. This understanding of reputation that builds overtime and across generations is in line with Fombrun(1998) and Fombrun and Shanley(1990), who propose that firm reputation is, by definition a perception of the past and present that is developed over time.

The long-term orientation of family firms is expected to lead to a heightened concern for family firm reputation, which will ultimately positively affect firm performance (Anderson et al.,2003), as argued

above. Accordingly, we propose that concern for family firm reputation mediates the relationship between long-term orientation and family firm performance.

Hypothesis 1: The effects of cross generations of family firm reputation are mediated by long-term orientation concern.

2.2. Family Member Pride Concern

Consistent with social identity theory, pride is an important consequence of heightened identification with a group. In other words, status and prestige related to identification lead to self-esteem, exclusivity and pride. Cable and Turban(2003) note that people derive pride from organizational membership and that employers are an important part of employees self-concept. The expression of pride may serve a complementary adaptive function, drawing attention to the individual and alerting the social group that he or she merits increased acceptance and status (Tracy, 2004). In the family firm context, family members who experience high levels of pride should also develop a strong concern to maintain their own and the organization's reputation. If pride is an affective emotion that positively relates to a person's self-esteem (Brown et al.,2001), concern for reputation is the action-oriented effect of pride that makes people undertake initiatives to assure performance.

Since a family firm member gains self-worth by belonging to the family firm, viewing the firm as an extension of one's self and family(Dyer et al, 2006), there are natural incentives for family members to feel pride and , in turn, to protect the family firm's reputation t assure its performance.

Hypothesis 2: The effects of cross generations on family firm reputation are mediated by family member pride concern.

2.3. Social Capital

Social identity theory predicts that intergroup relations will self-categorize people via an accentuation effect, primarily along those dimensions that will result in self-enhancing outcomes. Interaction with external parties enhances one's self-esteem by comparing the in-group and the outside-group on a variety of dimension. While some of these comparisons with the outside-group lead to positive in-group and negative outside-group evaluations, external relationships are maintained through networks with reputable individuals and organizations in order to enhance one's self-esteem and reputation.

Social capital as the "sum of the actual and potential resources embedded within, available through and derived from the network." Social capital has been positively associated with performance in nonfamily firms. Within family business literature, it has been proposed that family firms derive richer social capital than their nonfamily counterparts (Simon & Very, 2007). In family firms, social capital is likely to produce a competitive advantage since it is naturally embedded within the family unit and in the ties the family has with external stakeholders. The family firm can build more effective relationships with suppliers, customers, and support organizations (e.g. community financial institutions) while maintaining legitimacy with other important constituencies (Arregle et al., 2007).

Social capital can influence performance via a variety of vehicles, there is a stronger concern form family firm reputation such like one source of reputation is the organization's external relationships. This may be particularly pronounced for family firms, since the desire for succession to the next generation should lead to a strong desire to maintain a good reputation in the community and consequently, strong external relationships. These relationships can be complex, including ties to local communities, engagement in politics, charitable actions, and banking services. These collaborative choices of organizations convey important information to key constituents and enable some firms to build reputation. Family firms often invest in good relationships with the greater community and consequently benefit from reputation effects. Concern for the family firm's reputation can also enable future network relationships as part of the company's attempt to maintain trust.

Hypothesis 3: The effects of cross generations on reputation are mediated by social capital concern.

2.4. Stock Market Reaction

Efficient Market Hypothesis (EMH) assumes that market prices reflect all available information and expectation and that any new information is properly incorporated into prices without any delay. Sharp fall of security prices during the turbulent times is a very unique opportunity for testing validity

of EMH. Unexpected events can put more stress on the financial market, and market participants may lose their ability to assess rationally the valuation implications of event. In response to unfavorable events, stock price are expected to behave differently in the efficient market since new information will have different economic impact on individual firms.

The efficient-market hypothesis states that it is impossible to consistently outperform the market by using any information that the market already knows, except through luck. Information or news in the EMH is defined as anything that may affect prices that is unknowable in the present and thus appears randomly in the future. Moreover, Thaler's model of price reactions to information, with three phases, underreaction- adjustment- overreaction, creating a price trend. One characteristic of overreaction is that the average return of asset prices following a series of announcements of good news is lower than the average return following a series of bad announcements. In other words, overreaction occurs if the market reacts too strongly or for too long (persistent trend) to news that it subsequently needs to be compensated in the opposite direction. As a result, assets that were winners in the past should not be seen as an indication to invest in as their risk adjusted returns in the future are relatively low compared to stocks that were defined as losers in the past.

Hypothesis 4: Cross Generations on family reputations will cause the reaction on stock market price.

Hypothesis 4A: The higher similarity of reputation concern between generations, the lower reaction on stock market price.

Hypothesis 4A: The lower similarity of reputation concern between generations, the lower reaction on stock market price.

3. MEASURES AND ANALYSIS

The items assessing the respondent's family firm pride pertaining to being a member of specific family firms were adapted from Smithey Fulmer et al.(2003). To measure social capital, we followed Tsai and Ghoshal(1998) and measure social resources embedded not only in interfirm relationships but also in close relationships with community leaders and social organizations. We measure the family firm's link to community leaders, banks and business networks, including other firms.

Our item for long-term orientation was inspired by Zellweger (2007) and based on the impact of an increased time horizon on strategic opportunities of firms. For the family firm reputation concern item, we followed Dyer &Whetten(2006) and measured the degree to which family firms displayed concerns about the firm's image and reputation. Consistent with this perspective, we measured the degree to which firms were recognized as family firms in their respective communities. We investigated whether the family aspect was emphasized in communication with external stakeholders, for instance, in marketing and branding. We consider that the higher the reputation of the family firm in the community and the greater the firm emphasizes the family aspect, the higher the family's concern for company reputation.

According to EMH, market participant should recognize the different implications of new information on stock price. In terms of systemic negative news like a rejection of motion, market should incorporate this new information into prices by differing systematic risk of each stock. To test the hypothesis that percentage drop in individual stock prices should be related to systematic risk of each stock, we estimated betas of each stock by using the market model. Based on 60, 120 and 240 daily observations (leaving the two weeks as a pre-event period), the market model is used as following ordinary least square regression form in estimation of betas.

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}$$

where:

R_{it} = Daily returns to stock i calculated over period t

R_{mt} = Daily returns to the market index calculated over period t

α_i = The intercept

β_i = Systematic risk of stock i

ε_{it} = A zero mean random disturbance term

t = 60 days, 120 days, and 240 days

However, according to Thaler’s model of price reactions to information, with three phases, underreaction- adjustment- overreaction, creating a price trend. The stock prices might overreact or under react to new coming information. In order to examine whether expected changes in value of stocks are less or more than true economic value, then predictable market adjustments are expected after the first trading day of event. Abnormal returns for each stock on the first day of event were estimated by following formula.

$$AR_i = Ri - (\alpha_i + \beta_i R_m)$$

where:

R_i = Daily returns to stock i on the first trading day of event

R_m = Daily returns to the market index on the first trading day of event

α_i = The market model intercept estimated over period t

β_i = Systematic risk of stock calculated over period t

t = 60 days, 120 days, and 240 days

Table1.Summary of Constructs

Construct	Scale Measurement	Source of Scale
Long-term Orientation	4 items	Zellweger(2007)
Pride in family firm	4items	Smithey Fulmer (2003)
Social capital	4 items	Tsai and Ghoshal (1998)
Family firm reputation concern	5 items	Dyer &Whetten(2006)
Stock Market reaction	2 equations	Huseyin&Semra(2006)
Company Size	Single question	
Company Age	Single question	
Industry	Single question	

4. CONCLUSION

The management literature has long debated how to create the ideal governance structure, defined as the set of organizational incentives, and decision making and operational control systems designed to protect shareholders’ interests while also creating value. Due to the separation of management and ownership, owners are encouraged to create governance structures intended to overcome the problems associated with opportunistic behaviors on the part of agents and information symmetries which arise from diffused control. The literature has examined a wide variety of governance structures(e.g. board size and compensation, executive ownership, duality, and institutional owners), as well as other organizational mechanisms, such as decision making incentive and control systems(Beatty &Zajac, 1994) which can substitute for governance structures to ameliorate these concerns.

Moreover, social identity theory suggests that family members’ high incentive to assure a positive organizational reputation is strongly connected to family members’ self-esteem. In addition to family firm reputation concern derived from the rich inventory of social performance indicators of organizational reputation. These are long-term orientation, family firm pride and social capital of family members.

Hence, we utilize social identity theory as our theoretical framework to suggest that business owners view their organizations as extensions of themselves. Family members face high exit costs if they leave the organization. Upholding the firm’s reputation then becomes a significant concern (Dyer, 2006) since the family’s image and their own are inseparable. Social identity theory suggests that family members’ high incentive to assure a positive organizational reputation is strongly connected to family members’ self-esteem. In addition to family firm reputation concern when ownership transfer to next generation.

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