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Family Firms and Compliance: Reconciling the Conflicting Predictions Within the Socioemotional Wealth Perspective

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Abstract

We draw on the socioemotional wealth perspective to examine the influence of family ownership on firms' noncompliance with corporate governance codes. Our results yield an inverted U-shaped effect of family ownership on noncompliance. While the family influence and control dimension leads to high levels of noncompliance, socioworthiness stemming from image and reputation dimension lessens noncompliance. In the presence of potential agency conflict, the control dimension prevails over reputation, even in countries with strong governance institutions. Our findings have critical implications for family business theory, for governance policy making and also for better understanding corporate governance in family firms.

Keywords

corporate governance codes, socioemotional wealth, ownership, agency theory, institutions

Introduction

In response to a worldwide wave of governance scandals, financial meltdown, and to enhance corporate governance effectiveness, policy makers and gatekeepers have initiated regulatory efforts to address shortcomings in the corporate governance system. Among others, "soft law," where actors self-regulate without being subject to legally binding rules, has been enacted all over the world and increasingly characterizes corporate governance regulation (Aguilera, Goyer, & Kabbach, 2013). In this realm, corporate governance codes (hereafter "codes") are the most important self-regulatory governance instrument. Codes are a set of voluntary principles, recommendations, standards of best practices, issued by a legitimate collective body. Codes' provisions relate to the firms' internal governance, including the behavior and structure of the board of directors (Aguilera & Cuervo-Cazurra, 2004).

Most codes are based on the "comply-or-explain" principle, which allows compliance with those provisions that best suit firms' features such as size, activity, structure, and organization. Otherwise, firms must explain their reasons for noncompliance. The flexibility of the "comply-or-explain" principle raises questions about firms' motivations for complying when they are not required to do so. Early research on codes examines the relationship between compliance and corporate outcomes (Fernández-Rodríguez, Gómez-Ansón, & Cuervo-García, 2004; Goncharov, Werner, & Zimmermann, 2006). The common denominator is that, although compliance levels are high and grow over time (e.g., in our European sample, 31% of firms fully comply with all codes' provisions), at the end of the day, firms make different choices in deciding

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whether to abide by a code. These differences mean that the economic rationale linking compliance and performance does not fully account for strategic compliance behavior. In fact, the causes determining code compliance in the absence of any legal enforcement remain largely unexplored, in particular, when family ownership is ubiquitous.

The governance literature provides insights on how much attention investors pay to corporate governance practices. For example, Fombrun (2006) describes a Mercer Investment Consulting's survey in which 46% of institutional asset owners take environmental, social, and corporate governance analysis into consideration when making investment decisions. A McKinsey & Company's survey, in 2002, reports that institutional investors were willing to pay a premium for the shares of well-governed companies (Watson & Coombes, 2002). More recently, McCahery, Sautner, and Starks's (2016) survey shows that institutional investors disinvest because of governance concerns, intervene in poorly governed firms, and use proxy advisors to screen firm's governance practices.

In this article, we analyze to what extent and under what conditions family ownership influences firms' compliance with the governance provisions in codes. To our knowledge, few studies have examined family firms' strategic behavior toward corporate governance compliance.[1] Our core argument is that two potentially conflicting key dimensions within the socioemotional wealth (hereafter, SEW) perspective: corporate control and reputation (Berrone, Cruz, & Gómez-Mejía, 2012) explain family influence on the firm's compliance with codes. Next, we introduce the severity of the agency problem as a key firm-level contingency factor shaping the effects of SEW's dimensions on compliance decisions. Finally, we examine whether the nature of the institutional context has any impact on the firm-level SEW and agency predictions regarding compliance.

SEW refers to nonfinancial characteristics of the firm that bear on the family's affective endowments, such as the ability to exercise family influence and control, the family identity, image and reputation, and the family management and succession (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007). In line with Corbetta and Salvato (2004), we argue that family firm's compliance with governance provisions (including board characteristics and structure) is a reflection of families' heterogeneity. In particular, we focus on two family dimensions: their willingness to control the firm and their desire to protect corporate and family reputation.

On the one hand, at the core of the SEW is the notion of family influence and control. The primary goal of family members is to uphold SEW by gaining control over corporate decisions affecting the firm's businesses regardless of their financial outcomes (Gómez-Mejía et al., 2007; Zellweger, Kellermanns, Chrisman, & Chua, 2011). Although family ownership concentration may alleviate the conflicts of interest between family owners and managers, reducing the agency costs, family shareholders may use their power to strengthen their position at the expense of other nonfamily shareholders, despite reputational costs (Chrisman, Kellermanns, Chan, & Liano, 2010; Miller & Le Bretton-Miller, 2006).

On the other hand, institutional theorists view mimetic behavior and conformity with organizational practices as an essential mechanism to gain legitimacy, enhance the probability of firm survival, and access to valuable resources (Miller, Le Breton-Miller, & Lester, 2013). The legitimacy-seeking behavior is particularly salient in family firms, which are more susceptible to institutional pressures (Berrone, Cruz, Gómez-Mejía, & Larraza-Kintana, 2010). In this regard, the SEW perspective suggests that family firms adapt to external pressures because they are committed to the preservation of affective endowments of family owners such as the continuation of the family business (Gómez-Mejía et al., 2007) and family image and reputation (Sharma & Manikuti, 2005). Drawing on this logic, recent research shows that family firms tend to adapt more than their nonfamily counterparts to industry practices in their strategic behavior. In particular, Berrone et al. (2010) theorize, and empirically demonstrate, that family firms engage in substantive institutional compliance in the context of environmental practices, and that this behavior aims to preserve their controlling families' SEW. Similarly, Miller et al. (2013) uncover that family owners are more prone to legitimate their strategic choices through higher conformity to industry and institutional standards because of their interest to look after their SEW, their contested governance nature and limited access to resources.

Thus, the control and the reputation dimensions within the SEW perspective might lead to conflicting arguments on how family-influenced firms will strategize, especially, when it comes to compliance with established norms. Our study seeks to reconcile these

conflicting views by investigating whether and how family ownership induces firms' compliance. Using a cross-section sample of publicly listed firms from the United Kingdom, Germany, and Spain, we show that noncompliance levels rise with family ownership up to a certain point. This result is consistent with the influence and control dimension of SEW, in which, to gain control over firms' affairs, family owners will tend to build governance mechanisms that strengthen their power. Beyond a given threshold, an increasing level of family ownership decreases noncompliance. This finding confirms our prediction that strong family influence aligns with the firm's goals such as the corporate reputation of good governance. Our findings are therefore consistent with the claim that SEW can cut both ways when it comes to governance compliance.

To tease out whether one of these contrasting SEW dimensions prevails, we analyze the firm-level potential agency conflict as an ideal contingency factor to account for the mechanism through which family ownership affects firms' compliance behavior. We argue that in the case of severe agency conflict, the control dimension of SEW is likely to overcome the reputational dimension. In the presence of high agency conflict, family owners will likely strengthen their control positions or, at least, take advantage of it and will thus tend to comply less with stringent governance practices that may weaken family influence over the firm's decisions. Indeed, we find evidence that family owners' opportunistic behavior supersedes their reputational concerns when firms have large amounts of financial resources with low growth opportunities. Moreover, we show that even though strong governance institutions boost average compliance, they are unable to overcome potential firm-level agency problems in family-influenced firms. Our findings hold for alternative specifications and controlling for firm characteristics that might be associated with compliance.

Our study advances family business research in several ways. First, we examine how conflicting predictions emanating from two SEW dimensions, control and reputation, influence family strategic compliance behavior. We offer new evidence that the control dimension seems to drive family influenced governance choices under agency conflicts. Our study also demonstrates that SEW dimensions are not "context-free," particularly when it comes to making governance choices, and therefore, one should take into account not only firm-level conditions but also the country's institutional environment. Second, our research sheds light on the sources of noncompliance, which is relevant to regulation research from both policy and theoretical perspectives. From the policy perspective, codes normatively prescribe the organizational structure of the board of directors and, boards' decisions, and particularly in family firms, this is greatly influenced by the firm's ownership structure (Berrone et al., 2010; Desender, Aguilera, Crespí, & García-Cestona, 2013). Understanding the motivations and contingencies of firms' noncompliance explains the success of this soft regulation. From a theoretical perspective, comparing noncompliance with codes across a family ownership continuum offers a unique opportunity to advance theory concerning the interplay between SEW dimensions under different agency conditions and institutional settings (Aguilera, Filatotchev, Gospel, & Jackson, 2008; Hoskisson, Hitt, Johnson, & Grossman, 2002). Finally, studies examining governance mechanisms have primarily focused on U.S. and U.K. firms. We extend the empirical setting to include other European companies and assess how they cope with U.K.-based "comply-or-explain" principles of corporate governance regulation.

This article continues as follows. We first present our theoretical arguments on how SEW dimensions define noncompliance decisions in family-influenced firms and explore additional firm-level and country-level effects. We go on to describe our empirical setting and methodological approach. We then discuss our findings and main implications for both the management of family business and policy makers. We conclude with a review of our results, policy and managerial implications, and recommendations for future research.

Family Socioemotional Wealth and Compliance With Codes

Early literature on family firms shows that the boundaries between the family and the firm are often blurred (Dunn, 1995; Tagiuri & Davis, 1996). To achieve business and family goals, there is a need to balance family and firms' objectives and needs (Gómez-Mejía, Cruz, Berrone, & De Castro, 2011; Miller & Le Breton-Miller, 2006). These competing goals are embedded and well described in the SEW perspective which is based on the behavioral-agency theory (Wiseman, & Gómez-Mejía, 1998). It proposes that family firms frame strategic choices in terms of assessing how actions will affect potential gains and losses of socioemotional endowment

(i.e., affective-related value or nonfinancial utility of family members) regardless of firm's financial outcomes (Gómez-Mejía et al., 2011). The SEW logic assumes that family decision makers are loss-averse on SEW and that gains or losses of this endowment are evaluated toward a reference point in which losses loom larger than gains.

Turning to the examination of firm noncompliance, we first propose that different SEW's dimensions may explain the trade-off between gains and losses in the socioemotional endowments related to family ownership–compliance behavior. While all five FIBER (Family control and influence, Identification of family members with the firm, Binding social ties, Emotional attachment of family members, and Renewal of family bonds to the firm through dynastic succession) dimensions of SEW (Berrone et al., 2012) are pertinent, we focus on the pursuance of two dimensions: influence and control and image and reputation dimensions, because they are more closely related to the strategic governance decision of code compliance than building social ties, emotional attachment, and dynastic succession. More specifically, the family influence and control and the image and reputation dimensions distinguish between the internal and external affective endowments that might be in conflict in family firms (Block, 2010). (Non)Compliance with governance norms that reduce family influence may harm (benefit) internal affective endowments, but at the same time, they may increase (decrease) companies as well as families' governance reputation (e.g., external affective endowment).

We also explore how the severity of the agency costs and the institutional governance setting might affect the family ownership–compliance relationship. We discuss each of them in turn.

Family Influence and Control Increase Noncompliance

The organizational governance of family firms, and family ownership, in particular, is one of the most important dimensions for distinguishing family from nonfamily firms for two main reasons. First, when the family owns greater stakes in the firm, family members expect to control the decision-making processes in such a way that they can preserve their influence and assets now and for future generations. Second, family desire for control is driven by the family's emotional attachment to the firm, and it is vital to maintain the firm under the family ownership for future generations.

When families control a firm, they are also responsible for its governance decisions. For example, Anderson and Reeb (2003) suggest that, by selecting managers and directors, families can create hurdles for outside shareholders wishing to control the firm, leading to greater family entrenchment. Consistent with this argument, Gómez-Mejía, Núñez-Nickel, and Gutierrez (2001) show that family ownership and control are associated with greater family entrenchment, which is the result of a stronger relational contract between managers and owners. Under the influence and control dimension of the SEW (Berrone et al., 2012), family attachment waxes with ownership as well as does the potential to develop a family-influenced board of directors. However, compliance with corporate governance codes implies waning family's influence and control over the board of directors, and consequently, reducing the SEW endowment. Therefore, implementation and compliance with stringent governance practices may harm family SEW by increasing family-related control costs. Examples of compliance costs for controlling families are the hiring and succession of top management teams, additional information disclosure (Verrecchia, 1983), or the preservation of family-based relationships and privacy (Aguilera et al., 2008).

Similarly, Gómez-Mejía et al. (2011) review family business empirical research showing that families use the board of directors as a vehicle to legitimize the appointment and retention of senior executives and to justify strategic decisions aimed at hanging on to the controlling family's SEW. They discuss several studies in which firms with high family ownership have a strong family influence on the selection of board members, Chief Executive Officer (CEO) duality, and the disproportionate representation of family members. Additionally, Hermalin and Weisbach (1998) document that the fraction of independent directors negatively correlates with insiders' shareholdings, including family members. These governance practices imply low levels of code compliance because governance codes, for example, recommend separation of the position of board's Chairman and CEO as well as ensuring board independence.[2]

We expect a gradual family attachment process as family ownership grows. On this basis, the SEW control endowment increases the more the family expands its ownership, making family principals more likely to

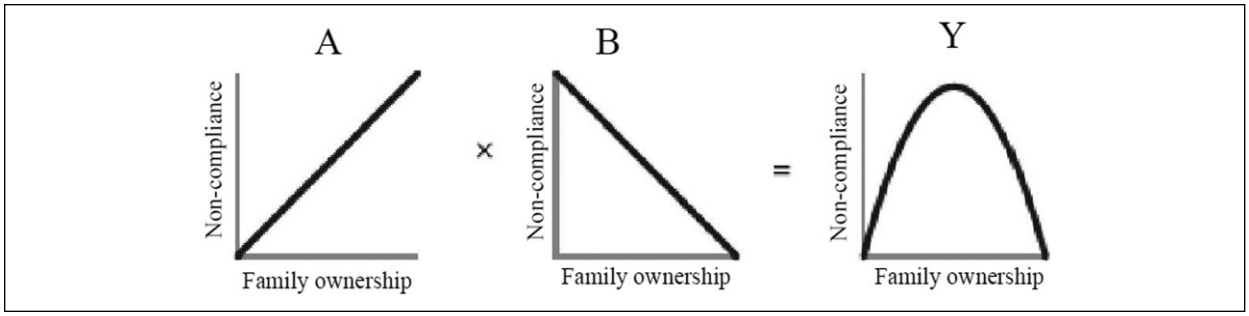

Figure 1. The effects of family ownership on noncompliance.

perceive the board of directors as a mechanism for influencing management and in turn pursuing the family's objectives, weakening the family incentives to comply. Therefore, higher levels of family ownership are consistently related to higher levels of noncompliance (Figure 1, A).

Family Image and Reputation Decrease Noncompliance

Family control is one key characteristic that not only distinguishes family firms from their peers but also allows family members to exert influence over corporate decisions that ultimately preserve the socioemotional endowments. Family image and reputation is another key dimension of the SEW perspective that is likely to have a significant influence on compliance behavior. We argue that greater compliance might enhance family reputation and in turn, it might also mitigate, or even overcome, potential socioemotional losses arising from lower levels of influence on the board of directors and, ultimately, on the control over the firm's decisions.

Families and their firms are often so intertwined that their identities become one. Thus companies commonly bear the family name or even the founder's name, indicating a family or personal identification with the business (Berrone et al., 2012). This family identification with the firm influences internal and external stakeholders' perceptions and expectations of firms' goals and practices, setting the stage for the family to behave more responsibly and ethically than nonfamily firms. For example, Berrone et al. (2010) find that family firms adopt better environmental practices than their nonfamily counterparts to enhance the family image. They also show that this responsible behavior is more marked at the local level where the families have strong social ties and in which the loss of SEW is potentially profound. Similarly, Dyer and Whetten (2006) uncovered that in the Standard Poor's 500, family firms tend to avoid irresponsible practices more than their peers.

Firms' compliance with governance codes entails not only to follow a code's provisions or to explain deviations from it but also how market agents including minority shareholders, financial analysts, stock exchange regulators, and proxy advisory firms, will react to these firms' compliance. In this regard, family owners have a vested interest in protecting their good name, for this helps them conduct business now and in the future generations. In other words, reputation building is a common explanation for why firms, fulfill "their agreements even if they cannot be forced to" (Shleifer & Vishny, 1997, p. 749), as in the context of "comply-or-explain" regulation. Given the increased scrutiny of corporate governance practices, we expect that firms' incentive to signal legitimate governance mechanisms helps one understand compliance with governance codes.

We, therefore, argue that reputational preservation is a plausible explanation of the relationship between family ownership and compliance for the following reasons. First, given that family firms are embedded in a social and business network, external pressures on family members to comply tend to be vigorous and hard to ignore. Second, the separation between a firm's noncompliance and family interests is blurred. For example, an outside investor may not know if a noncomplying decision helps or harms her stakes in a family firm. As a result, noncompliance may be a signal that family members place a high value on the private benefits (e.g., financial perks and benefits not available to outside investors) putting family reputation at risk, and strengthening social and market monitoring and sanctions.

Thus, family owners are more exposed to losses of image and reputation as a result of noncompliance than other types of shareholders. In part, this is because nonfamily shareholders are less likely to be deeply immersed in social and business networks, which place external pressures to comply. Therefore, to protect their SEW, family owners will bear the costs of increasing compliance to enhance family reputation—currying favor with stakeholders by improving shareholders rights (Deephouse & Jaskiewicz, 2013). The reputational effect is particularly salient in a context where code compliance is not enforced, and voluntary compliance gives strong and meaningful support in protecting investors' rights. By contrast, not abiding by regulatory recommendations may involve a loss of reputation and an adverse reaction that lessens families' SEW.

The reputation dimension of the SEW gives strong incentives for compliance. Consequently, low levels of family ownership are compatible with high levels of noncompliance due to the lack of external pressures and few image and reputational concerns. As family ownership rises, the reputation effect increases the risk of SEW loss, and the likelihood of noncompliance falls due to the SEW loss aversion of family owners (Figure 1, B).

In sum, jointly considering these two SEW dimensions (control and reputation) and their effects on compliance, we propose that noncompliance will initially rise as family ownership grows to a certain point of influence and control (Figure 1, A) and that noncompliance will then fall because of a wish to preserve the family's image and reputation (Figure 1, B). This can be depicted as an inverted U-shaped relationship between family ownership and noncompliance. This general argument is illustrated in Figure 1, Y. We, therefore, predict the following hypothesis:

> **Hypothesis 1**: There will be an inverted U-shaped relationship between the degree of family ownership and noncompliance with corporate governance codes.

Agency Problem as a Moderator Between Family Ownership and Noncompliance. The agency perspective of family business literature proposes that family firms are less likely to conform to governance norms, avoiding granting rights to minority shareholders (Anderson & Reeb, 2003; Miller et al., 2013). Different types of owners, especially families, will have different beliefs about how to best manage or influence firms, and what constitutes "good governance" (Desender et al., 2013). In this regard, the corporate governance literature seeks to unpack the characteristics of the agency problem in family firms. In the family–managers relationship, agency costs can be minimized since family members are more likely to monitor. When family ownership is high, the so-called principal–principal agency problem toward nonfamily shareholders exacerbates agency costs. Regardless of the effects on agency costs, family "control and influence is an integral part of SEW and highly desired by family members" (Berrone et al., 2012, p. 262). In Hypothesis 1 above, we proposed a curvilinear relationship on how family ownership affects noncompliance with codes based on two dimensions of SEW. This hypothesis implicitly assumes that all family firms face equal agency conditions when this is likely not to be the case. Therefore, we argue that agency contingencies play a moderating role in our stated ownership–compliance relationship.

Agency costs will be high when family owners can raise their perks and abuse their control to make business decisions that do not enhance shareholder value (projects with returns below the cost of capital or investments in organization inefficiencies). This rent-seeking behavior may hold, especially, when the firm has sufficient free cash flow (FCF) without growth opportunities to invest the cash surplus, leading to the typical overinvestment agency conflict as proposed by Jensen (1986). Therefore, under these circumstances, we argue that family control over firms' assets strengthens as their ownership grows, boosting the incentives for rent expropriation.

We argue that the combination of high FCF and low investment opportunities is a good proxy to capture potential principal–principal agency problems. Conversely, when family firms run short of cash, family owners have less financial scope to spend on their "pet" projects. In this case, the family will have to finance any additional project through the capital markets, which may impose extra monitoring (K. C. W. Chen, Chen, & Wei, 2011). However, when firms have plenty of cash, it increases the potential for opportunistic behavior by family owners in which family utility maximization prevails over shareholder's value maximization (Bertrand & Mullainathan, 2003; Gómez-Mejía et al., 2001). Therefore, assuming that code compliance entails strengthening the protection of minority shareholder rights and reducing the severity of agency problems, we expect that when there is enough cash and few investment opportunities (i.e., the agency problem is more severe), family shareholders would be less inclined to

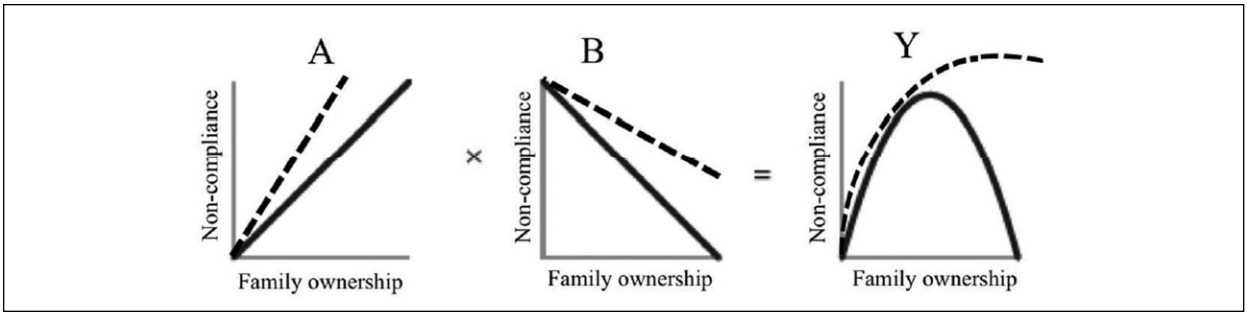

Figure 2. The effects of family ownership on noncompliance under a potential agency conflict.
Note. (Solid line) Effect of family ownership on compliance in the absence of high agency problems (Hypothesis 1). (Dashed line) Effect of family ownership on compliance in the presence of high agency problems (Hypothesis 2).

comply with governance practices that reduce their power and control over firms' assets.

We show in Figure 2, A, dashed line, that when agency problems are severe, family ownership increases the potential extraction of private benefits and, therefore, firms are more likely not to comply with codes that may reduce their influence and control over the firm. The noncompliance levels increase the potential gains from family managerial entrenchment, reinforcing the internal mechanism of family norms of control. Therefore, we propose that the positive relationship between family ownership and noncompliance derived from the SEW's control dimension will be stronger in the presence of severe agency problems.

Under the behavioral agency model (Gómez-Mejía et al., 2007; Neubaum, Dibrell, & Craig, 2012) that sets the ground for the SEW, family principals balance the losses and gains of their socioemotional endowment when making strategic decisions. Therefore, when there is a chance to reduce their SEW (i.e., loss) or to enhance it (i.e., gain), families will not necessarily follow the profit maximization rationale. Indeed, they may even put the firm at financial risk to preserve the SEW (Berrone et al., 2010). We propose that the potential gains from using FCF to finance families' ("pet") projects puts the control and influence dimension as the primary reference point for family members, allaying their concerns about firm reputation (which may lead to financial losses), for two main reasons.

First, although some studies emphasize that protecting other stakeholders' rights can contribute to reputation gains (Aragón-Correa & Sharma, 2003) or increase legitimacy by building responsible relationships with external stakeholders (Cennamo, Berrone, Cruz, & Gómez-Mejía, 2012), this literature recognizes that these benefits (if any) are hard to secure (Harrison, Bosse, & Phillips, 2010). Second, to exert its influence over the firm decision making, family members and owners need sufficient discretionary power to push through their projects in the face of external shareholders (La Porta, López-de-Silanes, & Shleifer, 1999; Schulze, Lubatkin, Dino, & Buchholtz, 2001). Therefore, when there is a potential strong agency conflict, family principals are more likely to carry on governance practices that emphasize their influence and control over the firm's decisions. As a consequence, as the likelihood of opportunistic behavior by family members grow, the incentives to comply and consequently preserve the SEW endowment of the family image and reputation shrink. In sum, we argue that the negative relationship between family ownership and noncompliance due to reputational concerns will be less pronounced in the presence of severe agency problems.

Taking the moderating effect of agency conflict and the control and reputation dimensions of the SEW, we propose that in the presence of severe agency problems, family insiders are more prone to seize a new opportunity to invest in their self-serving projects, regardless of their financial outcomes or reputational risks, straightening the influence and control dimension of SEW (Figure 2, A, dashed line), while reducing the importance of image and reputational concerns (Figure 2, B, dashed line). Correspondingly, we propose the following hypothesis:

> **Hypothesis 2**: In the presence of severe agency problems, the inverted U-shaped relationship between the degree of family ownership and noncompliance with corporate governance codes will be steeper.

Do Countries Make a Difference When It Comes to Noncompliance With Corporate Governance Codes?

The SEW perspective and its embedded agency conflict focus on the relationship between organizational actors, taking for granted the effect of the institutional context in which firms operate (Aguilera et al., 2008). We now extend the tension introduced by the two SEW dimensions (control and reputation) to propose that a firm's institutional environment may play a critical role enforcing compliance or tolerating noncompliance with codes. Prior literature shows that country-level institutions matter both to legitimize the organizational behavior and to enforce norms and practices that reduce agency conflicts (Aguilera & Jackson, 2003). We argue that the strategic behavior of family firms toward code compliance in light of their effort to promote SEW will also be affected by how the country's institutions influence and discipline controlling shareholders. In other words, the governance environment explains how much power a family can use within the family firm and the ability of market institutions to monitor large controlling owners.

The institution-based view assumes that companies are embedded in an institutional environment that shapes internal and external corporate governance mechanisms to foster economic exchanges while reducing agency problems (Lien, Teng, & Li, 2016; Peng & Jiang, 2010). An institutional setting with strong (weak) protection of shareholder rights imposes more (less) pressure for internal mechanisms to enhance firms' governance quality and, at the same time, defines and enforces property rights allowing resources to be allocated efficiently (North, 1990). In other words, countries' rules and values will influence the degree of predictability of investors' strategies and outside stakeholders will rely on external governance mechanisms to enforce their rights when conflicts arise with family owners. Indeed, Doidge, Karolyi, and Stulz (2007) conclude that it is costly to improve investor protection when institutional infrastructure is lacking and because good governance has political costs, suggesting that there is complementarity between country-level investor protection and firm-level governance.

Therefore, in a setting with more developed investor protection and where codes are more institutionalized as a regulatory instrument (due to early adoption and code's implementation processes and sponsors), such as in the United Kingdom, external governance mechanisms help govern firms from insider's misbehavior. In these cases, firms are more likely to abide by codes' provisions to improve their legitimacy and to enhance the diffusion of structures and norms of governance. We, then, hypothesize as follows:

> **Hypothesis 3**: Firms' noncompliance with corporate governance codes is expected to decrease with the institutional development of market orientation.

Data and Variables

Sample and Setting

Our initial sample consists of the largest firms by market capitalization listed in the United Kingdom, Germany, and Spain, in 2007. To have a comparable sample size across these three countries, we selected the minimum common denominator size of 130, which is the number of listed firms in Spain. Thus, our original sample was a total of 390 firms and includes, but is not limited to, firms in their respective leading indexes—that is to say the FTSE 100 (the United Kingdom), DAX 30 (Germany), and IBEX 35 (Spain). Financial firms (e.g., banks and insurance firms) are excluded due to significant differences among the firms of the three countries, particularly with regard to the national regulatory frameworks (Arcot, Bruno, & Faure-Grimaud, 2010). Excluding financial firms and firms with missing data, our final sample consists of 267 firms drawn from industrial and service sectors (78 from the United Kingdom, 94 from Germany, and 95 from Spain).

To examine the effect of the institutional context in the relationship between family ownership and compliance, we propose an institutional continuum covering the strength of corporate governance institutions across the United Kingdom, Germany, and Spain. The country selection criteria account for different economic and corporate governance regimes. The United Kingdom is characterized by dispersed corporate ownership, strong markets for corporate control, and strong contractual incentives as key governance mechanisms coupled with a Common Law setting (Aguilera, & Jackson, 2003; La Porta et al., 1999). Conversely, Spain's ownership structure is typically defined as the counterexample to the United Kingdom in which, blockholders, such as banks and families, predominate and exercise direct control over the firm. Also, in Spain, firms are regulated under

the French Civil Law legal regime and operate in a context with fewer market-oriented rules for information and disclosure of practices, lower legal enforcement and investor protection, and lower takeover activity and floating capital than in the United Kingdom (García-Castro & Aguilera, 2012).

Germany falls in between the Spanish and British cases. Firms typically engage in more strategic interactions with trade unions, labor, suppliers of finance, and other stakeholders (Lütz, Eberle, & Lauter, 2011; Tuschke & Sanders, 2003). As in Spain, German firms have families and banks as block holders that exercise control of firms; yet large German firms have two-tier boards strengthening the separation between management and directors' role. In contrast to the United Kingdom, where the code reflects the demands of external shareholders, such as institutional investors, for stricter governance standards, in Germany, the code is a by-product of external stakeholders coalitions, including banks, large corporate shareholders, and labor that was mainly intended to be more of governance guidelines than a regulatory instrument, without a fundamental change in traditional insiders' behavior.

From the corporate governance codes perspective, the seminal 1992 Cadbury Code of Good Governance, set up by the London Stock Exchange, influenced subsequent codes in the United Kingdom and other European countries; and, according to the European Corporate Governance Institute, up to 2007, the United Kingdom, Germany, and Spain have the highest number of amendments to corporate governance codes. Also, the World Federation of Exchanges considers the London Stock Exchange, Deutsche Boerse, and the BME Spanish Exchange the three largest capital markets in Europe in our sample period.

Our data collection involved three steps. First, we hand-collected data on code compliance at the individual firm level from firm's annual reports. Code provisions were used as primary guidance where firms have the discretion not to comply. Second, we collected the ownership structure of firms, mostly from the Thomson Financial database. To maximize the comprehensiveness and reliability of our sample, we cross-checked it with the Amadeus, Bureau van Dijk, database. When we encountered ownership discrepancies, we went to the firms' annual reports. Last, we collected financial information for 5 years before our compliance data (2002-2007) from both Compustat Global and Amadeus. We list and define the variables below.

Dependent Variable

Noncompliance. We seek to capture firm-level choices of noncompliance with code recommendations and normalize codes' recommendations with a content analysis technique (Neuendorf, 2002), as follows. First, we review all three codes recommendations to find common recommendations across countries. We define common recommendations as those that propose the same (or almost the same) governance practice. Second, in addition to the authors' coding, we had one individual who is trained as a professional auditor in one of "The Big Four," to independently analyze the consistency of items across codes in order to provide reliability and accuracy checks of our coding scheme. Following Kolbe and Burnett (1991), disagreements in coding (which were 10%) were resolved by discussing key terms and jointly reviewing the codes until a consensus was reached. The final coding comprises 22 recommendations capturing the maximum common denominator across six governance categories: (a) procedures regarding the annual general meetings, (b) the appointment of directors, (c) audit committees and external audit, (d) the independence of board of directors, (e) the governance processes, and (f) the remuneration disclosure of directors and top executives.[3]

Next, we hand-collected data on firm-level compliance by analyzing the 2007 annual reports of each firm. Firms' annual reports disclose the recommendations to which the firms did not comply with. If a firm does not comply with a particular recommendation, we coded 1 and 0 otherwise.

We then summed all recommendations which the firm did not comply with and derived the "noncompliance" variable count data. For robustness checks, we run a confirmatory factor analysis of all six categories of governance practices that converge to a single noncompliance factor. We used this factor as an alternative dependent variable and did not uncover any qualitative changes. We also constructed an *adjusted exposure* measure (Chhaochharia & Laeven, 2009) that considers only code recommendations that are not complied by at least one firm. This approach allows us to differentiate between corporate governance at the firm level and at the country level, while keeping comparability. The results were qualitatively unchanged.

Corporate governance codes state that firms must disclose which recommendation(s) they are not complying with and state the reasons why. However, it is often

the case that firms engage in organizational decoupling where "formal structures are adopted in response to the demands of external stakeholders, but actual practices are tailored to the needs or demands of internal organization members" (Westphal & Zajac, 1998, p. 129). To account for this possibility, first, we rely on external auditors' review of annual reports as well as the disclosure of code compliance. Second, although we cannot determine exactly whether firms are rigorously respecting each recommendation,[4] we looked at a subsample of firms to check for discrepancies between declared and real compliance and did not find material changes. We believe that this is due to the nature of noncompliance reporting. Table 1 describes the main codes characteristic in the United Kingdom, Germany, and Spain, showing a remarkable similarity among them despite their very different legal origins.

Independent Variables

Family Ownership. To measure the family influence on firms, we take as the primarily variable the percentage of total outstanding shares held by individuals or families as reported in ThomsonOneBanker, Amadeus, and Annual Reports. Ownership data are lagged by 1 year to avoid reverse causality. This continuous variable captures a wide range of ownership structures, from nonfamily to strongly controlled family firms, under different institutional settings. This feature allows us to use family ownership as a proxy for two dimensions of the FIBER model of SEW (family control and reputation). Our logic is that at low levels of family ownership, family principals are more concerned about increasing their influence on the firm and, accordingly, will try to expand their shareholdings positions as well as to promote governance mechanisms to control firms' decision making (e.g., internal affective endowment). Meanwhile, at high levels of family ownership, as family principals effectively exert the control over corporate decisions, and because of their strong identification with the firm, they are more concerned about corporate and family reputation (e.g., external affective endowment).

The Severity of Agency Problems. To test our Hypothesis 2, we define the variable "high agency." Following K. C. W. Chen et al. (2011), we operationalize FCF as the "cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of equity" (p. 187). Jensen (1986) proposes that firms holding surplus cash for which they do not have present investment opportunities are more prone to face agency problems. Therefore, we measure (a) FCF as cash flow from operations minus cash dividends and divided by lagged total assets and (b) the sales growth rate as a proxy for investment opportunities. To avoid concerns about the endogeneity of FCF and investment opportunities (due to agency problems), we use the industry median sales growth and FCF to proxy for investment opportunities and FCF without agency problems. Then, we generate our "high agency" variable as a binary measure that takes 1 when firm's FCF is above the industry median, and investment opportunity (sales growth rate) is below industry mean, and 0 otherwise. We test our Hypothesis 2 by comparing the interaction of the "high agency" variable with our family ownership variable and its squared term.

Institutional Environment. To account for institutional variation across countries, we built three country dummies, the United Kingdom, Germany, and Spain; and consider Germany as the reference category.

Control Variables

Following earlier literature on corporate governance and voluntary disclosure (Arcot et al., 2010), we include a large set of firm-level controls which are described in Table 2. Without panel data information, our ability to deal with a potential endogeneity between financial variables and the governance practices of firms is limited. One approach we used was to take average values of the past 5 years (2002-2006) for control variables. We also used 1-year lag of firms' financial variables, and the hypothesized results are very similar to those reported below.

Method

We use zero-inflated negative binomial regression analysis to test our hypotheses, as the dependent variable is the number of noncompliance with code's provisions.[5] In our sample, 31% of firms is fully compliant with codes, increasing significantly the overdispersion. We, therefore, opt to run zero-inflated negative binomial that handles the zero counts using both binary (i.e., logit) and count (i.e., negative binomial) process (Hilbe, 2007). In our case, the zero-inflated model will determine if the estimates of our count predictors are the ones that lead to full compliance.

Table 1. Code Characteristics Across Selected Countries.

Code characteristics	The United Kingdom	Germany	Spain
Code name	The Combined Code on Corporate Governance	German Corporate Governance Code	Unified Code on Good Corporate Governance
Date of introduction	1998, Reviewed 2003, 2006, 2008, 2009, 2010[a]	2002, Amended 2003, 2005, 2006, 2007, 2008, 2009, 2010[a]	2006
Antecedents	Cadbury Report, 1992; Greenbury Report, 1995; Hampel Report, 1998; Turnbull Report, 1999; Higgs Report, 2003; Smith Report, 2003	Baums Commission Report (Bericht der Regierungskommission Corporate Governance), 2001; Berlin Initiative Group—German Code of Corporate Governance, 2000; Corporate Governance Rules for German Quoted Firms, 2000; DSW Guidelines, 1998; Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, 1998	Código de Buen Gobierno ("The Olivencia Code"), 1998; The Aldama Report, 2003
Issuing body	Committee related to stock exchange, and business, industry and/or academic association	Committee organized by the government	Committee organized by the government
Objectives	Improve quality of the board of directors and firms' corporate governance practices	Improve quality of the board of directors and firms' corporate governance practices	Improve quality of the board of directors and firms' corporate governance practices
Compliance mechanism	Comply or explain: Creates mandatory disclosure framework (in connection with listing rules) to encourage improved practices	Comply or explain: Creates mandatory disclosure framework (in connection with firms act) to encourage improved practices	Comply or explain: Creates mandatory disclosure framework (in connection with listing rules) to encourage improved practices
Scope of firms considered	All firms incorporated in the United Kingdom and listed on the main market of the London Stock Exchange	German publicly listed firms	Spanish publicly listed firms
Legal origins	Common Law	Civil Law, German origin	Civil Law, French origin

Note. This table presents the main characteristics of each code to understand some differences regarding its evolution and the institutional setting where it is placed (*Source.* Author's analysis).

[a]Although the German Corporate Governance Code and The Combined Code were amended in 2008, 2009, 2010, we have considered, respectively, the 2006 and 2007 amendment in order to align the information set and data to the same period.

Table 2. Description of Variables.

Variable	Description
Dependent Variable	
Noncompliance	Number of recommendations that firms do not comply. Source: Annual Reports.
Exposure	Number of recommendations from the corporate governance codes that firms are expected to "comply-or-explain." Source: German Corporate Governance Code, The Spanish Unified Code, and The Combined Code in the United Kingdom.
Independent Variables	
Family Ownership	Accounts for the percentage of total outstanding shares held by individuals or families. Source: ThomsonOneBanker, Amadeus, Annual Reports.
High Agency	Measures the dominance position of families in a firm. Takes value 1 when they achieve a minimum threshold of 20% of voting shares, and 0 otherwise. Source: As previous.
Country Dummies (The United Kingdom, Spain, and Germany)	Distinguish the three countries, the United Kingdom, Germany, and Spain. In the estimation procedure, we use Germany as the reference category.
Controls	
Herfindahl Index	Calculated by summing the squared percentage of shares owned by each shareholder. Source: ThomsonOneBanker, Amadeus, Annual Reports.
Indexed Firms (FTSE, DAX, IBEX)	A binary variable equals 1 if the firm is a constituent of its country most important stock exchange index.
Institutional Investor Shareholdings	Accounts for the percentage of total outstanding shares held by institutional investors. Source: ThomsonOneBanker, Amadeus, Annual Reports.
Cash Holdings	Average ratio of cash and short-term investments to total assets for the period 2002 to 2006. Source: Compustat Global, Amadeus.
Leverage	Average ratio of total liabilities to total assets for the period 2002 to 2006. Source: As previous.
Size	Average of the natural logarithm of the total assets for the period 2002 to 2006. Source: As previous.
Performance	Average of the annual accounting return on assets for the period 2002 to 2006. Source: As previous.
Analyst Coverage	Measures the number of analysts providing forecasts of annual earnings for publicly listed firms in 2006. Source: Nelson's Directory of Investment Research, 2006.
Cross-Listing	Captures if a firm is listed in the United States or the United Kingdom stock markets such as, NYSE, Nasdaq, AMEX, and London Stock Exchange. If the firm is listed in these markets the variable was coded 1 and, 0 otherwise. Source: Bank of New York Mellon, J.P. Morgan and New York Stock Exchange, London Stock Exchange, Amadeus.
Industry Dummies	Group firms according to the industrial classification of Spanish Stock Exchange are as follows: (1) Oil and Energy; (2) Basic goods, Industry and Construction; (3) Consumer Goods; (4) Consumer Services; (5) Telecom; (6) Real Estate. Source: Amadeus, Compustat Global.

The parameter estimates (β) can be directly interpreted as semielasticity (log-linear model), that is, a unit change in x changes the expected count, y, by a factor of exp (β), the incident rate ratio. The dispersion parameter alpha is significantly different from zero suggesting that our data are overdispersed and that a negative binomial model is more appropriate than a Poisson model.

Results

Descriptive Statistics

Table 3 provides the summary statistics of the variables used in the empirical analyses. The differences in the noncompliance levels between the United Kingdom and Spanish, and between the United Kingdom and German firms are, respectively, −6.04 and −2.18 (the Wilcoxon rank-sum test p value equals .00). Also, the difference between the noncompliance levels in German and Spanish firms is −3.86 ($p < .00$), a univariate result that is in agreement with our institutional contingency Hypothesis 3. Family ownership ranges from the highest in Spain (19.8%) to a middle level in Germany (12%), and the lowest in the United Kingdom (4%). In contrast, British firms present a higher dispersion of ownership relative to German and Spanish ones, according to the Herfindahl index. This result is in line with previous studies on ownership concentration in Europe (Claessens, Djankov, Fan, & Lang, 2002; Richter & Weiss, 2013).

Control variables vary across firms and countries but to a lesser extent than ownership data. One particular variable to underline (and which might explain firm's strategic behavior toward noncompliance), is the analyst coverage. In the United Kingdom, the average number of financial analysts (14) forecasting firms' earnings is substantially larger than in Germany (11) or Spain (7). Table 4 presents the pairwise correlation coefficients among our variables.

An Inverted U-Shaped Effect of Family Ownership on Noncompliance

Table 5 presents the results of zero-inflated negative binomial models predicting *noncompliance* with corporate governance codes' recommendations. Model 1 shows the baseline model while Models 2 and 3 present the full model for the effect of family ownership on noncompliance as hypothesized. In Model 2, the family ownership variable is positive and significant (β = 1.34, $p < .10$) and its squared term is negative and significant (β = −2.15, $p < .05$). Thus, Hypothesis 1 that proposes an inverted U-shaped relationship between family ownership and noncompliance is supported.

To get a clearer picture of the effect of family ownership on noncompliance, we look further at the critical values of family ownership in the significant models in Table 5 using a three-step procedure (Haans, Pieters, & He, 2015; Lind & Mehlum, 2010). To establish a quadratic relationship, first, the squared term needs to be significant and negative (as we show in Table 5). Second, the slope needs to be steep at both ends of data range. To do so, we run a postestimation graph that shows the quadratic relationship between family ownership and noncompliance (Figure 3). Third, the turning point needs to be located within the data range. Based on the coefficients of family ownership and its squared values in Model 2, and using the Fieller (1954) method test to construct the confidence interval (CI) of the turning point, we find that the critical value of family ownership is 31.11% (CI [0, 80.66%], $t = 1.81$, $p < .05$). Therefore, we show that the noncompliance with corporate governance codes increases with family ownership until this point, after which it will decline, supporting Hypothesis 1.

To test Hypothesis 2, we interact a proxy for potential agency problems (the variable *High Agency*) with family ownership aiming to understand whether the family ownership rationale changes when facing potential opportunistic situations. The inverted U-shaped relationship between family ownership and noncompliance is evident and significant in Model 3 (for family ownership: β = 1.34, $p < .001$, for its squared term: β = 1.37, $p < .001$). In line with our prediction, the coefficient of family ownership squared term is lower in the presence of high-potential agency problems than in its absence, making the inverted U-shaped relationship steeper. We also carried out the Lind and Mehlum's (2010) procedure. The turning point is now 48.8% (CI [0, 74.5%], $t = 4.89$, $p < .001$). The inflection point is increasing in the presence of high-potential agency problems. In other words, under potential agency conflicts, family owners influence and control prevail over reputation concerns at higher levels of family ownership, which corroborates our Hypothesis 2.

Regarding the institutional environment, our results show that British firms present lower levels of noncompliance than German ones (i.e., in Model 2, β = −0.79, $p < .001$) and Spanish firms tend to noncomply more

Table 3. Descriptive Statistics by Country.

	The United Kingdom					Germany					Spain				
Variable	*N*	*M*	*SD*	Min	Max	*N*	*M*	*SD*	Min	Max	*N*	*M*	*SD*	Min	Max
(1) Noncompliance	78	0.68	1.08	0	6	94	2.86	2.82	0	11	55	6.73	4.06	0	15
(2) Family Ownership	78	4.08	9.95	0	53.76	94	12.04	20.63	0	71.67	95	19.8	22.94	0	80.66
(3) High Agency	78	0.22	0.42	0	1	94	0.43	0.5	0	1	95	0.35	0.48	0	1
(4) Herfindahl Index	78	869.6	1467.07	8.1	9840.65	94	1374.7	1808.6	0.01	9549.31	95	1696.41	1920.77	0.05	9465.39
(5) Indexed Firm (FTSE, DAX, IBEX)	78	0.28	0.45	0	1	94	0.24	0.43	0	1	95	0.26	0.44	0	1
(6) Institutional Investors Shareholdings	78	70.93	18.08	21.21	99.63	94	32.46	17.9	0	80.48	95	14.45	10.68	0	43.05
(7) Cash Holdings	78	0.11	0.09	0.01	0.39	94	0.1	0.1	0	0.51	95	0.11	0.12	0	0.71
(8) Leverage	78	0.23	0.16	0	0.68	94	0.16	0.11	0	0.51	95	0.18	0.13	0	0.64
(9) Size	78	8.91	1.21	5.9	12.4	94	8.07	1.8	4.69	12.35	95	6.84	1.87	2.71	11.44
(10) Performance (ROA)	78	0.05	0.08	−0.33	0.19	94	0.04	0.05	−0.09	0.27	95	0.04	0.06	−0.15	0.3
(11) Analyst Coverage	78	14.29	7.22	0	40	94	11.17	9.74	0	32	95	7.17	8.26	0	35
(12) Cross-Listing in the United States	78	0.17	0.38	0	1	94	0.05	0.23	0	1	95	0.02	0.14	0	1

Note. ROA = return on assets.

Table 4. Descriptive Statistics and Pairwise Correlation Coefficients.

Variable	M	SD	Min	Max	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
(1) Noncompliance	3.75	3.99	0.00	18.00	1.00																				
(2) Family Ownership	12.98	20.72	0.00	80.66	0.31	1.00																			
(3) High Agency	0.32	0.47	0.00	1.00	0.11	0.12	1.00																		
(4) Herfindahl Index	1300.49	1737.25	0.01	9840.65	0.13	0.02	0.08	1.00																	
(5) Indexed Firm (FTSE, DAX, IBEX)	0.23	0.42	0.00	1.00	−0.13	−0.15	0.15	−0.14	1.00																
(6) Institutional Investors Shareholdings	36.84	27.99	0.00	99.63	−0.57	−0.42	−0.12	−0.23	0.02	1.00															
(7) Cash Holdings	0.10	0.10	0.00	0.71	−0.03	0.14	−0.02	0.01	−0.05	−0.07	1.00														
(8) Leverage	0.20	0.15	0.00	0.68	−0.05	−0.13	0.02	−0.01	0.06	0.18	−0.33	1.00													
(9) Size	7.82	1.86	2.71	12.40	−0.44	−0.35	0.04	−0.06	0.62	0.36	−0.15	0.19	1.00												
(10) Performance (ROA)	0.04	0.06	−0.33	0.30	−0.01	0.05	0.09	−0.05	0.07	0.02	0.13	−0.24	−0.04	1.00											
(11) Analyst Coverage	9.93	8.87	0.00	40.00	−0.35	−0.23	0.15	−0.14	0.64	0.31	0.01	0.04	0.72	0.11	1.00										
(12) Cross-Listing in the United States	0.07	0.25	0.00	1.00	−0.16	−0.13	0.02	−0.13	0.48	0.12	−0.02	0.03	0.42	0.09	0.40	1.00									
(13) Oil and Energy	0.10	0.30	0.00	1.00	−0.02	−0.12	−0.03	−0.04	0.22	0.09	−0.11	0.11	0.22	−0.01	0.10	0.08	1.00								
(14) Basic goods, Industry and Construction	0.29	0.45	0.00	1.00	−0.03	0.02	0.03	0.07	−0.06	−0.04	−0.04	−0.16	−0.05	0.01	−0.11	−0.06	−0.21	1.00							
(15) Consumer Goods	0.21	0.41	0.00	1.00	0.08	0.01	0.06	0.03	0.02	−0.10	−0.03	−0.15	−0.11	0.12	0.01	0.02	−0.17	−0.33	1.00						
(16) Consumer Services	0.21	0.41	0.00	1.00	−0.11	−0.02	0.01	0.04	−0.03	0.12	0.13	0.15	0.07	−0.06	0.17	−0.04	−0.17	−0.33	−0.27	1.00					
(17) Telecom	0.15	0.35	0.00	1.00	0.15	0.11	−0.11	−0.08	−0.15	−0.10	−0.05	0.11	−0.12	0.10	−0.24	−0.11	−0.14	−0.26	−0.21	−0.21	1.00				
(18) Real Estate	0.05	0.22	0.00	1.00	−0.10	−0.04	−0.04	−0.09	0.08	0.07	0.07	0.03	0.09	−0.27	0.14	0.23	−0.07	−0.15	−0.12	−0.12	−0.09	1.00			
(19) Germany	0.34	0.48	0.00	1.00	−0.09	−0.05	0.13	−0.03	−0.03	−0.10	−0.01	−0.11	0.01	−0.05	0.02	−0.06	−0.19	0.21	−0.00	−0.05	0.02	−0.11	1.00		
(20) Spain	0.36	0.48	0.00	1.00	0.57	0.33	0.03	0.16	−0.01	−0.63	0.02	−0.06	−0.38	−0.04	−0.29	−0.15	0.04	−0.05	0.10	−0.12	0.05	0.01	−0.55	1.00	
(21) The United Kingdom	0.29	0.46	0.00	1.00	−0.51	−0.29	−0.17	−0.14	0.03	0.77	−0.01	0.17	0.39	0.09	0.29	0.22	0.16	−0.17	−0.10	0.17	−0.07	0.10	−0.46	−0.49	1.00

Note. ROA = return on assets.

Table 5. Results of Zero-Inflated Negative Binomial Models of Noncompliance.

Variable	Model 1	Model 2	Model 3
Independent Variables			
Family Ownership		1.34† (0.74)	
Family Ownership^2		−2.15* (1.03)	
Family Ownership # High Agency			1.34*** (0.13)
Family Ownership^2 # High Agency			−1.37*** (0.18)
Family Ownership # (1−High Agency)			1.37 (1.16)
Family Ownership^2 # (1−High Agency)			−2.92† (1.54)
Spain	0.42*** (0.10)	0.39*** (0.08)	0.40*** (0.06)
The United Kingdom	−0.76** (0.27)	−0.77** (0.26)	−0.79*** (0.24)
High Agency	0.17 (0.11)	0.17 (0.11)	—
Control variable			
Herfindahl Index	0.14 (0.14)	0.18* (0.08)	0.14† (0.08)
Indexed Firm (FTSE, DAX, IBEX)	0.12 (0.16)	0.11 (0.17)	0.15 (0.14)
Institutional Investors Shareholdings	−1.51*** (0.29)	−1.52*** (0.27)	−1.53*** (0.27)
Cash Holdings	−0.27* (0.11)	−0.26* (0.10)	−0.29* (0.13)
Leverage	0.42 (0.85)	0.46 (0.81)	0.4 (0.78)
Size	−0.08 (0.15)	−0.06 (0.15)	−0.07 (0.14)
Performance (ROA)	0.29 (1.34)	0.65 (1.34)	0.58 (1.16)
Analyst Coverage	−0.02** (0.01)	−0.02*** (0.01)	−0.02*** (0.00)
Cross-Listing in the United States	0.12 (0.40)	0.13 (0.38)	0.14 (0.37)
Industry Dummies	Yes	Yes	Yes
Constant	2.28* (0.98)	2.11† (1.10)	2.22* (1.10)
Inflation model			
Industry Dummies	Yes	Yes	Yes
Constant	−1.76*** (0.05)	−1.83*** (0.08)	−1.89*** (0.08)
AIC	1071.658	1068.579	1065.278
BIC	1082.42	1079.34	1076.04
Number of observations	267	267	267

Note. ROA = return on assets; AIC = Akaike information criterion; BIC = Bayesian information criterion. Standard errors, clustered by countries, are reported in parenthesis, two-tailed tests. A hash tag (#) represents an interaction across variables.
†$p < .10$. *$p < .05$. **$p < .01$. ***$p < .001$.

than German ones (i.e., in Model 2, $\beta = 0.40$, $p < .001$). Thus, Hypothesis 3, predicting that noncompliance is expected to decrease (increase) with institutional development (underdevelopment) of market orientation, is supported. In the United Kingdom, firms tend to emphasize the maximization of shareholder value while in Continental European countries, such as Germany or Spain, an insider orientation tends to prevail where firms focus on a broader set of stakeholders, including families, in which the firm operates as well as on long-term value creation. This suggests that the compliance with governance codes is influenced not only by the endogenous needs of families but also by exogenous pressures from market institutions.

Overall, our results suggest that the significant firm-specific control variables that affect the *noncompliance* behavior are (a) the Herfindahl Index ($\beta = 0.14$, $p < .1$), (b) the institutional investor shareholdings ($\beta = -1.53$, $p < .001$), cash holdings ($\beta = -0.29$, $p < .05$) and the analyst coverage ($\beta = -0.02$, $p < .001$). We control for the level of *ownership concentration* (*Herfindahl Index*) because governance mechanisms that are translated into code recommendations attempt to control conflict of interests between "outsiders" who provide capital for a public firm, such as minority owners, and "insiders" who influence firms' decisions and may act opportunistically. Therefore, one might expect a positive effect of high ownership concentration on the degree of *noncompliance*

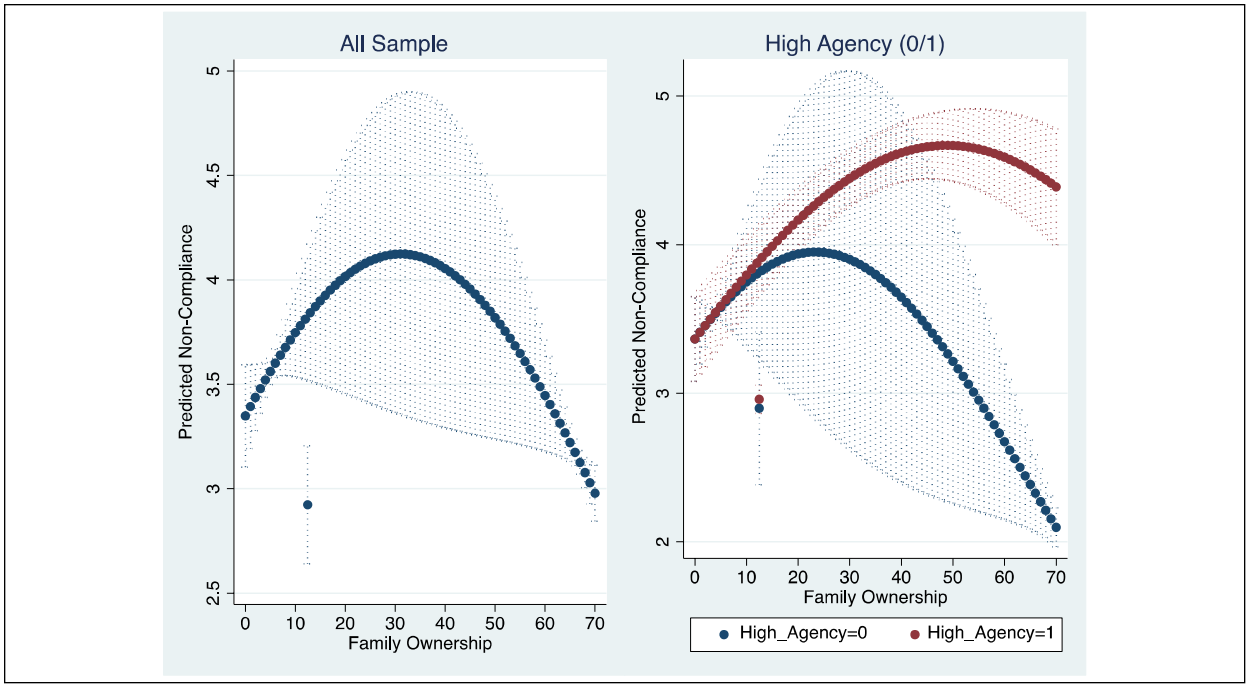

Figure 3. An inverted U-shaped effect of family ownership on noncompliance.

with the codes' recommendations. At the same time, an increase in institutional investors (measured by their shares in the firm) decreases the level of noncompliance. This result not only corroborates prior governance literature on the role of institutional investors as watchdogs in governance matters (Almazan, Hartzell, & Starks, 2005) but also points out that different shareholders tend to balance their interests when affecting the firms' governance practices choices.

Regarding the analyst coverage, the increase of one standard deviation in the number of financial analysts following a firm (8.87) would have a 0.19 decrease in the rate of *noncomplied* recommendations. The previous literature claims that the intermediary role played by securities analysts can influence firms in many ways (Mehran & Peristiani, 2010). In particular, close monitoring by equity analysts may diminish agency conflicts between owners and managers of the firm (Jensen & Meckling, 1976). Empirical evidence confirms that increased analyst coverage increases the informational efficiency of markets (Frankel, Kothari, & Weber, 2006). Hence, the negative effect of analyst coverage on *noncompliance* corroborates the argument that financial intermediaries do play a role in the corporate governance agenda.

Finally, to rule out reverse causality effects, we run a separate regression model to estimate the effect of noncompliance on family-owned firm, while controlling for possible alternative determinants for family firms and the coefficient of noncompliance turns out to be not significant ($\beta = 0.00$, $p < .704$). This result, to some extent, rules out the possibility of reverse causality in our results.[6]

Discussion and Conclusions

Our study investigates the effect of family ownership on firms' noncompliance with corporate governance codes. Considering the multifaceted nature of the SEW perspective that incorporates different priorities and motivations of families (Berrone et al., 2012), we advance research by systematically exploring the singular, and sometimes, conflicting dimensions of SEW (Miller & Le Breton-Miller, 2014). The SEW perspective proposes that family owners are loss-averse on SEW, which is reflected in the strategic choices they make (Gómez-Mejía et al., 2011). If losing control and influence may hurt family socioendowments, one would expect that family owners would try to gain control and influence over the firm through ownership as well as through

governance mechanisms fostering family control. This leads to a positive relationship between family ownership and codes' noncompliance. However, with increasing family ownership, the identification of the family with the firm rises and, therefore, the benefits of compliance on family's image and reputation will quickly escalate driving to lower levels of noncompliance. This outcome is based on the identification of the family with the firm as well as their reputational concerns, which bring greater pressures to adhere to societal rules and norms (Berrone et al., 2010). These two opposite predictions of low compliance for control purposes and high compliance for reputational concerns result in an inverted U-shaped relationship between the level of family ownership and noncompliance. Most important, they unpack the dimensions within the SEW perspective when it comes to family firms' strategic behavior.

The conflicting predictions arising from the two SEW's dimensions are further refined by weighting in the agency conflicts under which family firms make strategic decisions. We propose that when the conditions for private rent extraction by controlling owners from minority shareholders are high, the severity of the agency problem is significant, increasing agency costs. Thus, extending the SEW perspective, we find that the inverted U-shaped relationship between family ownership and compliance is contingent on and strengthened with the severity of the agency conflict. This finding offers further evidence for the argument that governance choices are also influenced by firm-level arrangements (Bruno & Claessens, 2010). Moreover, it reveals that the control SEW dimension dominates the reputational effect of family owners when potential agency problems arise.

Furthermore, we explore the country-level institutional pressures for compliance, showing that countries matter. The countries in our sample, the United Kingdom, Germany, and Spain, exhibit a continuum in the governance institutional spectrum where the United Kingdom presents the lowest levels of ownership concentration and family ownership, while Spain has the highest level of family ownership, and Germany falls in the middle. Other firm-level and country institutional characteristics reinforce this continuum across countries. For example, the number of stock market analysts' coverage, the number of cross-listing firms, the development of financial markets, the market financing of firms compared with bank financing or the tradition of voluntary codes as a self-regulatory instrument, are decreasing across these three countries. Our results support the hypothesis that firms in developed market-oriented institutions and strong shareholder protection environments, are more prone to comply with codes' provisions to boost their legitimacy.

Policy and Managerial Implications

Our study also has important policy-making and managerial implications. From the policy-making perspective, it contributes to understanding how firms under different agency constraints and institutional contexts adopt a soft law regulatory mechanism such as corporate governance codes. On the one hand, in the spirit of the "comply-or-explain" principle, family-influenced firms adjust their governance choices to their constraints, which is not only desirable but also in the spirit of "soft law" regulatory principles where actors self-regulate without possessing full legislative authority (Hopt, 2011). On the other hand, we show that potential agency problems have a significant moderating effect on the family ownership–compliance relationship that should make policy makers aware of what the real reasons for not complying with codes are.

The implication for corporate governance policies is particularly noteworthy in countries where family owners are ubiquitous such as in Continental Europe and in Emerging Economies. Our findings show that public policy needs to recognize the SEW dimensions which call for different corporate governance mechanisms. Family-owned firms while potentially motivated by doing good and pursuing long-term objectives may also seek to extract private benefits of control. This suggests that a particular bundle of corporate governance recommendations designed to restrict private benefits of control to protect shareholders rights may also positively affect the family-owned firm endowment with managerial talent, social capital, and financial resources that are usually otherwise related to long-term goals. This would give rise to different governance practices. Therefore, our theory and empirical results challenge the central "one size fits all" premise of corporate governance reforms, which claim that stringent management monitoring and control are suited to all firms in all countries. Our finding is particularly compelling with regard to the impact of mandatory rules on corporate governance, such as the 2002 Sarbanes–Oxley Act and the 2010 Dodd–Frank Act in the United States. These Acts lack flexibility, forcing publicly listed firms to either abide by the rules or stock exchange.

The failure of policy makers to foresee the diversity of firms' internal governance structures as well as their contextual forces on corporate governance practices may reflect prevailing assumptions about regulation. Regulators have not considered how reforms on corporate governance practices may have dissimilar effects on different types of owners, especially when family ownership is ubiquitous as in Spain and Germany. In the absence of such consideration, future research might address, both theoretically and empirically, how the variety of ownership patterns may relate to different bundles of corporate governance practices to achieve efficient and effective organizational outcomes.

At the managerial level, compliance with codes' provisions increases control over management decisions but, at the same time, it might reduce managerial discretion, making it hard for managers to react quickly when market conditions change (Alonso-Paulí & Pérez-Castrillo, 2012) or to have the discretion to innovate and be flexible. Additionally, since investors' decisions are increasingly dependent on corporate governance metrics (Watson & Coombes, 2002), family owners of publicly listed firms face strong pressure to adopt internationally accepted practices of good corporate governance. Finally, corporate scandals have their origins in poor governance, hence understanding the effect of family ownership on compliance with codes' recommendations may help risk managers as well as top executive teams find ways to achieve good governance and avoid corporate misbehavior. Indeed, future research may delve deeper into how compliance with codes is embedded in the risk management strategy of family-listed firms.

Our study is not without limitations. First, we have cross-sectional data on the compliance level, which precludes us from making strong assertions about the causal relationship between our constructs. We conduct a broad set of tests to mitigate the endogeneity concern. However, we cannot entirely rule out the possibility that our results are driven by the endogeneity of family ownership.

Second, while our study highlights the conflicting predictions of two SEW dimensions, we do not analyze the influence of binding social ties, emotional attachment, or succession. Some of these dimensions would require a longitudinal approach and others such as emotional attachment might be conceptually strongly correlated with reputation. This is an unexplored empirical question.

Finally, one may argue that the implications of compliance for corporate outcomes are unclear (in essence, that our empirical analysis does include a performance implication of noncompliance).[7] To overcome this potential limitation, we ran alternative analysis, including economic outcomes as the dependent variable. Our empirical estimations (available on request from the corresponding author) provide mixed results and do not support the positive relationship between compliance and economic outcomes (return on assets and Tobin's Q). Prior studies on the influence of firm ownership on performance have mainly focused on firm outcomes, rather than processes (Ahmadjian & Robbins, 2005; Yoshikawa & Rasheed, 2010) with inconclusive results. We believe that our study contributes to a better understanding of the mechanisms by which families may influence governance strategies.

Contributions and Future Research

Our study contributes to the family business literature in several ways. First and foremost, we argue on the basis of our findings that family ownership structure is an underlying mechanism that drives firms' compliance behavior. In particular, we demonstrate that there is an inverted U-shaped relationship between family ownership and noncompliance. This allows us to unpack two of the FIBER dimensions in the SEW perspective and show when one versus the other might be activated in making strategic decisions. Second, understanding noncompliance contributes to compliance research, in which deterrence theory has been the predominant academic perspective. Our results highlight the fact that noncompliance is contingent on the regulated entities context, and specifically, on decision makers' identities. Therefore, second-order amendment transforming voluntary provisions into mandatory regulation such as the 2009's German mandatory reform law on directors' remuneration (Hopt, 2011) has a downside effect by forcibly homogenizing heterogeneous firms. Third, we construct a unique data set of publicly listed firms in three European economies with a strong presence of family firms which allows us to add to the comparative corporate governance debate and discuss implications for corporate governance policies outside the United States. We show that governance varies across firms and countries, and more important, that, in family-owned firms, governance choices are contingent on firm's agency context even when country governance institutions are more stringent.

We hope that this article will shape future studies drawing on the SEW perspective by alerting scholars of the importance of delving into the dimensions making up this perspective and at what stage each of them comes to the fore or fades into the background. Thus, future research should examine other SEW dimensions, in addition to the two examined here, and its effects on family firm strategic behavior. Similarly, different institutional contingencies as internal or external pressures might be excellent laboratories to test how family firms' are embedded in SEW, and its specific dimensions, when reaching strategic decisions.

Much of the discussion in the family business literature tries to answer whether family ownership is beneficial (Anderson & Reeb, 2003) or detrimental (Claessens et al., 2002) for firms' value. This research assumes that family firms are homogeneous in their governance choices. However, as our hypotheses suggest, this homogeneous assumption does not take into account differences in governance practices and contingent factors both at the firm and country level that influence family-owned firms' strategic compliance behavior. Therefore, an encouraging avenue to pursue would be to use fine-grained family governance and contingency factors that shape family firm's compliance behavior, to answer alternative and still open questions, such as: (a) What family governance factors affect top-management teams and directors remuneration disclosure? (b) In what circumstances, CEO duality is desirable in family firms? (c) Are independent directors really independent from family owners, and if so, what are the determinants and consequences of such independence? What are the next wave of corporate governance recommendations that are likely to affect family governance, and how? We hope that this article sparks new questions for future research both in compliance as well as in decision making within family firms.

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Notes

1. An exception is the literature on voluntary accounting disclosure and the quality of accounting information (Cascino, Pugliese, Mussolino, & Sansone, 2010; S. Chen, Chen, & Cheng, 2008) which generally finds that, although family firms tend to disclose less, regardless of whether the information reveals good or bad news, they convey higher quality financial information compared with nonfamily firms.
2. Due to space limitation, an appendix comparing code's provisions across countries is available on request from the corresponding author.
3. Because of space limitations, the table that matches codes' recommendations across our three countries is available from the corresponding author on request.
4. For example, in terms of director independence, we have no information if the director has been an employee of the firm or group within the past 5 years, or if the director has, or has had within the past 3 years, a material business relationship with the firm either directly, or as a partner, among other requirements.
5. An alternative estimation is to use Poisson regressions. However, given the overdispersion in our dependent variable (the variance, 15.9, is much greater than the mean, 3.7), negative binomial models are preferred (Cameron, & Trivedi, 2009).
6. The separated analyses are available from the corresponding author on request.
7. We thank one of the reviewers for raising this point.

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