WHEN FAMILY FIRMS ARE ACQUIRED

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ABSTRACT

We examine the acquisitions of 71 publicly traded family owned targets for the period 1984-2006 to study the conflicting roles of entrenchment and alignment of interests in these firms. While targets experience positive returns at the acquisition announcement, we find that the target abnormal returns are U shaped, with both low levels and high levels of ownership receiving the higher returns. We also find that the returns for children of the founder are almost five times as great as that of the founder controlled firm, demonstrating that founder run firms leave little excess value to be generated by an acquisition. **JEL Classifications:** G34

INTRODUCTION

The family owned firm makes up more than 90 percent of all business in the United States, ranging from small mom and pop stores to giants such as Wal-Mart and Marriott. They generate about half of the Gross Domestic Product and half of the total wages. However fewer than 30 percent of successful family businesses make it to the second generation, 12 percent to the third, and about 3 percent make it to the fourth generation or beyond (Family Business Institute, 2013). Thus, succession issues and exit strategies become crucial. We focus on one strategy: the sale of the family business by either the founder or by subsequent generations. As Mickelson and Worley (2003, p. 252) note, "in general, there are few empirical articles on M&As involving family firms". We help to fill that gap by investigating the types of public family firms that have chosen acquisitions as an exit strategy. In particular, we examine the premium paid to the targets' shareholders when family owned firms are acquired. Our major contribution is determining that there are large differences by degree of ownership as well as by generational distance. We explain these differences using both the finance literature on corporate governance and acquisition returns to targets as well as the family firm literature on firm valuation and the competing effects of alignment versus entrenchment.

The finance literature reveals opposing conclusions pertaining to ownership structure and firm value, and implicitly, the market for corporate control. Some theoretical results show an alignment of interests and resolution of agency issues (Jensen and Meckling, 1976; Fama and Jensen, 1983; Stulz, 1988). Thus, according to traditional agency theory, an alignment of interests should exist in a family owned business, which should presumably lead to superior firm performance. Indeed, Bhattacharya and Ravikumar (2001) model a family business where the household's human capital is a specific business skill that is transferred through the generations. Thus, while other research (Chang, 1998; Fuller, Netter, and Stegemoller, 2002) examines returns to shareholders when private firms are acquired, we are able to extend these findings to public family firms. In such cases of alignment of interests, any change in family interest via a merger could negatively impact firm value.

Alternately, a family owned firm could have an entrenched family that is detrimental to firm value. Entrenchment can result in wealth expropriation by the family members, nepotism, or other behavior that is not conducive to firm value maximization. Empirical investigations document entrenchment issues (Slovin and Sushka, 1993) and a decline of firm value with the presence of a founding family board member (Yermack, 1996). Our study allows us to provide evidence on the alignment of interests vis-à-vis the entrenchment hypothesis.

Not surprisingly, we find that the family owned targets experience significantly positive abnormal returns at the announcement of the acquisition. Since past researchers also document a non-linear relation between ownership and performance, we parse our data and examine returns by level of ownership. We find that announcement returns are U shaped with the medium level of ownership receiving less than 12 per cent, while the lowest level of ownership results in 19 per cent and the highest level of ownership receive 31 per cent. The family firm literature has found numerous instances of non-linear performance of family firms based on the level of ownership (Ali, Chen, and Radhakrishnan, 2007; Maury, 2006; Villalonga and Amit, 2006; Anderson and Reeb, 2003) with the highest valuations with mid-level ownership. Thus, we conclude that for the middle tier where the alignment and entrenchment forces are presumed optimal, since the market rewards the firm with a high value, there is less premium remaining to be extracted.

We also find significant differences in returns by generational distance. Firms controlled by the founder receive positive, but statistically insignificant returns, while the founder's children receive 19 percent and subsequent generations an astonishing 36 percent. These results are also supported by the family firm literature, which finds, in general, that family firms still controlled by the founder have the highest valuations (Villalonga and Amit 2006, Barontini and Caprio 2006). Apparently, given the market's already relatively higher valuation, founder controlled firms receive less of a premium when acquired.

The remainder of the paper is organized as follows. We review both the related finance literature, as well as family firm literature in the next section and use that extant literature to develop our hypotheses. Next we describe our data and methodology, then our results and interpretations. Lastly is the conclusion and discussion section.

LITERATURE REVIEW AND HYPOTHESES

Corporate Governance and Firm Valuation

Family firms are pervasive in the U.S. economy. Arguing that shareholder ownership in the U.S. is not as diffuse as is widely believed, Holderness (2009) examines large-percentage ownership for a sample of Compustat and CRSP-listed firms. He finds that 96% of the firms have blockholders who own at least 5% of the firm's shares, and such firms are three times as many as those with no large-block shareholders. In general, blockholders own about 39% of the firm's shares. Furthermore, he finds an inverse relation between blockholders and firm size and firm age. He suggests as firms get larger, they are less attractive to blockholders who may wield less influence in larger firms. Similarly, as firms age, blockholders exit as firm founders sell their stake piecemeal over time. In his sample, he finds that 53% of U.S. firms have family members as large blockholders of the firm's stock. Thus, exit strategies are important in family firms.

While the majority of the literature finds a positive reaction to target's stock at acquisition announcements (Jarrell, Brickley, Netter, and Scherer, 1988; Kaufman, 1988; Ghosh and Lee, 2000), we focus not on the sign of the return, but on the variation for different levels of ownership. One early theme in the literature predicates a positive relation between firm value and insider ownership. Jensen and Meckling (1976) develop a model where the value of the firm depends on the fractional ownership of insiders, with higher inside ownership predicting a higher firm value. Fama and Jensen (1983) propose that family relationships among owner-managers should reduce agency costs, and they state that family members have advantages in monitoring and disciplining related decision agents. DeAngelo and DeAngelo (1985) also conclude that family involvement is a valuable monitoring and disciplining agent because of a long-term relationship between the family members and the firm. Thus, the agency argument is that the valuation of family owned firms should be high due to the alignment of owner-manager interests with that of the firm.

On the other hand, a second stream of literature deals with the "entrenchment" hypothesis that asserts that while ownership does provide some agency resolution; concentration of such ownership will allow owner-managers (families) to become entrenched and reluctant to relinquish power or to allow change. Stulz (1988) provides a model showing that an increase in the fraction of voting rights controlled by management decreases the probability of a successful tender offer. Thus, the value of the firm is adversely affected if high insider voting rights decrease the probability of a takeover. However, for lower inside voting rights, takeover premiums are larger. Slovin and Sushka (1993) investigate how firm value is affected by change in ownership concentration due to the death of an inside blockholder. They document a positive share price response when the deceased's holdings exceed 10 percent, signifying support of the entrenchment hypothesis. Further evidence of the entrenchment problem is provided by Yermack (1996), who examines the connection between board composition and firm value, proxied by Tobin's Q, to report that the presence of a founding family CEO negatively impacts firm value. In summary, the entrenchment literature suggests a negative relation between firm value and level of family ownership. Hence, we expect higher announcement

returns similar to the disciplinary returns found by Ghosh and Lee (2000).

It is the third strand of finance literature that most closely predicts the empirical findings about family firm valuation, namely that there is a curvilinear relationship between ownership concentration and firm value. Stulz (1988) advances a model demonstrating that an increase in the fraction of voting rights controlled by management decreases the probability of a successful tender offer. Thus, the value of the firm is adversely affected if high insider voting rights decrease the probability of a takeover. However, for lower inside voting rights, takeover premiums are larger. Thus, depending on whether the initial inside ownership is large or small, the value of the firm increases or decreases. Morck, Shleifer, and Vishny (1988) argue that determining this association depends on the two opposing forces at play. If management tends to allocate the firm's resources for their own best interests, then they will be in conflict with outside shareholders. This leads to a negative impact on firm value. Yet, as the equity ownership of the managers increases, they will be better aligned with outside shareholders and therefore, firm value should increase. They find that their proxy for value, Tobin's Q, first increases and then decreases, with an increase in ownership.

A significant curvilinear relation between Q and fractional insider ownership is found by McConnell and Servaes (1990). They find that for lower levels of inside ownership, the relation between fractional ownership and Q ranges from a one-to-one increase to a three-to-one increase. Similar to Stulz (1988), they find that this association reaches a maximum prior to a 50% ownership. However, in contrast to Stulz's prediction that firm value is less when insiders own 50% of the stock than when they own 0% of the stock, McConnell and Servaes (1990) find that this curve does not reach its minimum even when insider ownership reaches 75%. We use their cutoffs of 50% and 75% when dividing our family ownership into tiers.

Family Firm Valuation

Much of the family firm literature supports a curvilinear relationship between the level of ownership and firm value. Anderson, Mansi, and Reeb (2003) demonstrate that the relation between ownership and debt costs is non-monotonic, and find that debt costs first decrease and then increase with an increase in family ownership levels. In a similar vein, Anderson and Reeb (2003) find that performance first increases and then decreases as ownership levels increase. Villalonga and Amit (2006) discuss two agency problems. Agency I is the classic owner-manager conflict, while the Agency II problem is the family-minority shareholder conflict. Their goal is to determine which of these two are more detrimental to shareholder value.

Maury (2006) examines empirical evidence of family owned firms in Western Europe. As he states, "the results in this paper are consistent with the argument that family control can reduce the classical agency problem between owners and managers (Fama and Jensen 1983), and give rise to conflicts of interest between minority shareholders and the controlling family when family control is tight (Shleifer and Vishny, 1997). He hypothesizes that there is an ownership range in which family controlled firms will outperform comparable firms with nonfamily controlling shareholders. He finds that the benefits to family control arise in non-majority controlled firms are reflected in higher valuations at lower control levels but in higher profitability at higher control levels. Along these lines, Faccio, Marchica, and Mura (2011) find that firms controlled by large, undiversified shareholders make more conservative investment decisions than those controlled by large, diversified shareholders. In instances when

an owners' wealth is largely concentrated in the firms they own, then the risk-averse owners will avoid risk much more than if they held a diversified portfolio. Examining the relation between owners' portfolio diversification and corporate risk-taking, the authors find that evidence that firms with large undiversified shareholders make more conservative investment decisions than those controlled by large, diversified shareholders. Moreover, the difference is both statistically and economically significant.

Cronqvist and Fahlenbrach (2008) examine large blockholders and their impact on various firm level policies to find that blockholders influence firm investment, financial, compensation policies. They also find significant heterogeneity across different blockholders. They find that some blockholders have an aggressive investment style, while others have an aggressive financial style. Large shareholders who are associated with higher CEO pay have a more aggressive stance toward firm growth. Investigating whether large blockholder presence is related to firm performance, they find that the presence of a blockholder in the 75th percentile is related to a 4% higher ROA, while having a blockholder in the 25th percentile is related to a 3% lower ROA. Firms with blockholders who have a more aggressive investment, financial, or executive compensation stance have higher ROA and Tobin's Q ratios.

Claessens et al. (2002) disentangle the incentive and entrenchment effects using 1301 firms from East Asia. They find that firm value increases with the cash-flow ownership of the largest shareholder, consistent with a positive incentive effect. But firm value falls when the control rights of the largest shareholder exceed its cash-flow ownership, consistent with an entrenchment issue. Ali, Chen and Radhakrishnan (2007) also find that compared to non-family firms, family firms face less severe agency problems due to the separation of ownership and management, but more severe agency problems that arise between controlling and non-controlling shareholders.

Examining tax aggressiveness and founding family presence, Chen et al. (2009) find that family firms are less tax-aggressive compared to non-family firms. Family firms have higher effective tax rates and lower book-tax differences. They find that family firms without long-term institutional investors and those expecting to raise capital show even lower tax aggressiveness. The authors conclude that family firms are have a strong incentive to reduce any appearance of entrenchment and are therefore willing to forgo the tax savings to avoid any associated price discounts.

Given the literature above, we conclude that there is a preponderance of support, theoretical as well as empirical, in both the general finance literature as well as the more recent family firm literature to support the concept of a concave relationship between family percent ownership and firm value. At some point, the negative effects of entrenchment overwhelm the positive effects of alignment. At the optimum point of ownership level, then, the firm's value is at its highest. Therefore, it seems reasonable that the premiums paid to family firm targets will also be curvilinear, and in fact will be convex. At the optimum value of the family firm, there is little additional value to be had. At low levels of ownership, the traditional agency problem exists, so that the acquisition can provide improved corporate governance. Additionally, at high levels of ownership, improved corporate governance can also be provided reducing the impact of entrenchment. This leads to our first hypothesis:

H1: There is a curvilinear, U- shaped, relationship between family ownership and abnormal returns from acquisition announcements.

Generational Distance, Transparency, and Firm Valuation

The literature also suggests other factors that influence family firm valuation. Perhaps the most significant factor found in the majority of the studies is whether the original founder is still in control or if control has passed to the children or subsequent generations. Generational distance may reflect a simultaneous entrenchment and waning of incentive alignment problem if subsequent generations result in "trust fund babies" sitting on the board of directors who enjoy the reputational status of their governance positions without the ensuing responsibility.

When Villalonga and Amit (2006) compare family firms to non-family firms, they find that the classic owner-manager conflict in nonfamily firms is more costly than the conflict between family and non-family shareholders in founder CEO firms. However, the conflict between family and nonfamily shareholders in descendant CEO firms is more costly than the owner manager conflict in nonfamily firms. Thus, founder CEO firms have a higher valuation compared to descendant CEO firms. Barontini and Caprio (2006) also find positive effects of founders, but find no evidence that descendant controlled corporations do not outperform or underperform non-family firms.

One of the more interesting hypotheses to explain the firm value difference between founder and subsequent generations is that of parental altruism. Schulze et al. (2001) hypothesize that there is another agency threat in family firms: that founders act altruistically toward their children, thus resulting in next generations not being as good at managing the family firm. Lubatkin et al. (2005) explain that the effects of family on family firms make this governance form theoretically distinct from those of public and private non-family firms. They posit that the nature of altruism and its influence on agency relationships change as controlling equity interest in the firm passes from the 'controlling owner' (a single individual, usually the founder and household head, who controls most of the firm's rights to ownership and control to the sibling ('sibling partnership') and from the siblings to the extended family ('cousin consortium'). The siblings may well place the wellbeing of their nuclear family ahead of the welfare of the extended family members, and even the firm. The 'cousin consortium' is even less likely to subscribe to the altruistic tendencies of the original founder, hence even less alignment.

Using instrumental variables (IV) methodology, Bennedson et al. (2007) examine the impact of family succession decisions on firm performance, for a unique dataset of firms from Denmark. They find evidence of a large negative causal impact of family successions on firm performance, and operating profit on assets falls at least four percentage points around the time of family- CEO succession. Firm ROA and ROCE (return on capital employed) is also lower for family-CEO firms. They conclude that family-CEOs hurt firm performance.

Blanco-Mazagatos, de Quevedo-Puente, and Castrillo (2007) find that the agency costs are much less severe for first generation compared to subsequent generations. Studying the financing decisions of founders and subsequent generations, they find that while the founder is active in the company, the family business has specific sources of value, and over the course of generations agency costs become more intense because of altruism problems and the dispersion of both ownership and familial ties. Therefore, both the theoretical as well as the empirical studies strongly suggest that the value of the family firm is its highest when the founder is still in control, and that the value decreases for the children of the founder and even more for subsequent generations. Therefore, if the market valuation is highest when the founder still runs the

firm, then there is less additional value to be extracted from the acquirer. When the value of the firm is lower for the subsequent generations, an additional premium can be paid.

Apart from founder succession issues, research also examines the relation between family firms and firm level transparency. Examining the role that firm opacity plays in family firms, Anderson, Duru, and Reeb (2009) hypothesize that entrenched founders and heirs can either maintain and exploit firm opacity to extract benefits at the expense of the minority shareholders, or they can act as committed monitors of firm resources, where the opacity allows the firm to maintain its competitive advantage. While both the entrenchment and the monitoring hypotheses posit a positive relation between founder/heir shareholders and firm opacity, the entrenchment hypothesis predicts a negative relation between founder/heir ownership and performance as opacity increases, as family owners extract benefits from the firm. On the other hand, the monitoring hypothesis predicts a positive relation between family ownership and firm performance with increased opacity, as founders/heirs provide the benefits of monitoring to protect both their interests and those of outside shareholders. Their results show that, for publicly traded U.S. firms, the entrenchment hypothesis dominates the monitoring hypothesis, showing that firms value founder/heir managers only for those firms with high levels of financial transparency.

Along similar lines, Anderson, Reeb, and Zhao (2012) examine the role of informed trading in family firms. They argue that founders and heirs have strong incentives to participate in short-selling, especially those not actively engaged in the day-to-day management of the firm. Furthermore, family firms are also vulnerable to information leakage, especially by disgruntled family members. On the other hand, family firms may be especially careful to protect their reputation and minimize informed trading by family members. The authors suggest that family shareholders can facilitate information leakage and exploit their private information advantage or can limit active traders and corporate insiders from trading on adverse nonpublic information. Their results show extensive informed trading for family firms, which experience almost 17 times more the number of short sales preceding negative earnings surprises. Furthermore, prior to positive earnings, family firms are marginally less likely to engage in short selling when compared to non-family firms.

H2: Announcement returns will be lowest for founder controlled firms and for transparent firms.

DATA AND METHODOLOGY

Data

We obtain announcements of acquisitions of family owned targets from the *Securities Data Corporation (SDC)* International Mergers and Acquisitions database. Specifically, we search for announcements of acquisitions of family owned targets by publicly traded US firms. While the literature provides no clear-cut definition of a family firm, we use the restrictive definition of a minimum of 20% ownership as used by La Porta, Lopez-De-Silanes, and Shleifer (1999) in their international survey of corporate ownership. While other research in this area uses a lower cut-off point to determine family ownership, these papers restrict their sample to S&P 500 firms or Fortune 500 firms. By beginning the selection process with the SDC designation of 20% family ownership, we are able to include much smaller firms. Using the

20% designation, we still find the "typical" U-shaped effects and thus believe that the inclusion of smaller size firms outweighs any disadvantage of excluding smaller blockholder families. We then verify SDC announcements with *Lexis Nexus* and *Infotrac* searches. The publicly traded sample is limited to firms for which return data are available from the University of Chicago Center for Research on Security Prices (CRSP) database. The final sample contains 71 family owned, public target firms. Our sample period spans the period of January 1, 1984 to December 31, 2006, allowing us to identify a wide array of acquisitions of family owned targets. Given the liquidity and credit crunch in the markets beginning in 2007 which especially impacted smaller family firms, we limit our sample to 2006 end. The number of acquisitions for the different time periods is presented in Table 1 (Panel A) below. The number of family acquisitions is much higher for the earlier years of our sample period.

Next, we cull target specific data from a search of a number of sources, namely, *DataStream, First Call, Market Guide, Dow Jones News Retrieval, Securities and Exchange Commission* filings, the *Wall Street Journal* and *New York Times* Indices, the *Directory of Corporate Affiliations, W.T Grimm's Mergerstat Review*, Dun and Bradstreet *Million Dollar Directory, Mergers and Acquisitions* journal, and target company web sites. By this extensive search, we are able to garner a unique dataset on characteristics such as the value of the transactions, the method of payment, the percent of ownership of the family at the time of the acquisition, the age of the company, the relationship between the founder and the family member who sold the firm, the name of the family owner, and the reasons for the sale of the business. We also examine the I/B/E/S database to extract analyst following information for the family firms in our sample. Additional details on ownership levels as well as SIC codes of both the bidders and targets are acquired from SDC. We provide the results of this unique data collection in Tables 1-3.

Panel B of Table 1 presents the ownership structure that we are able to verify for 71 public, family-owned firms in our sample. It is interesting to note that while ownership levels seem to be concentrated in the ranges of 20-39% (29.23% of firms), ownership again peaks at the 50-59% level of family ownership (24.62% of the firms).

We are also able to glean information on motives for selling the family business for 71 public firms in our sample. We classify these into ten broad categories which range from family and succession issues to estate tax reasons, and we present this information in Panel C of Table 1. 28.79% of the family firms list either family disputes or succession issues as reasons for the selling the firm, while another 18.18% of the firms in our sample have simply grown too much for the family to be able to successfully and effectively manage the firm.

Our unique, hand-collected dataset also allows us an insight into the generational distance from the founder for the firms. The existing CEO's relationship to the family founder is detailed in Panel D of Table 1. Most of the firms for which we are able to acquire this information seem to be first-generation firms, and 46.48% of the firms have a founder in place at the time of the merger. Only 12.68% of firms show a fourth-generation link to the founder. The subsequent role of the founding family is also documented for 71 firms in our sample, and we present these results in Panel E of Table 1. Interestingly, most families remain with the firm in one role or the other, with only 7.94% of the family firms choosing to have no role whatsoever in the acquired entity.

We obtain financial statement data from *Standard and Poor's Research Insights*. Descriptive statistics for the target companies are presented in Table 2. For the target companies, average (median) total asset size is $769

($402) million, market value is $350 ($344) million, and net sales is $335 ($281) million. The targets' performance in terms of ROA, ROE, and profit margin are, on average (median) 1.93% (4.43%), 9.94% (2.13%), and 10.86% (10.42%). Family-owned businesses appear to have low debt ratios, as evidenced by the mean (median) debt/total assets ratio of 18.80% (5.20%).

Table 3 presents the deal characteristics for the target family owned firm. The value of the transaction, on average (median), is 15.96% (11.40%) of the acquirer's assets. The target companies are on average (median) 58.06 (54.50) years old. Mean (median) family ownership is 60% (55.0%), demonstrating a fairly large family stake in the target companies. We are able to identify at least 39% of the acquisitions of family firms were financed via stock while cash transactions accounted for only 10% of the deals.

Methodology

Event study methodology is used to identify the wealth effects to targets associated with announcements of acquisitions of the 71 publicly traded family owned firms. The ordinary least squares market model is used to specify the returns generating process. Daily excess returns (ARs) are computed by estimating the market model parameter over the estimation period from t = -110 to t = -11 relative to the announcement day t=0. The standardized cross-sectional method Boehmer, Musumeci, and Poulsen (1991) with Scholes-Williams (1997) betas is used to test for significance. The average excess return for any day is calculated by summing over the ARs for the N firms in the sample and dividing by N. The cumulative average excess returns (CARs) over a multi-day event period are calculated by summing the average excess returns over the T day event window.

RESULTS

Announcement Returns

Panel A of Table 4 presents the cumulative abnormal returns for the targets for two day windows (-1,0), event date (0,0), and three day windows (-1, +1) where day 0 is the day of the initial public announcement of the acquisition. We also provide the number of cumulative abnormal returns which are positive and negative for the (-1, +1) window. Previous research on returns to target firms shows acquisition announcements are considered good news for target shareholders, who experience significant abnormal returns at the time of the announcement (Jarrell et al., 1988; Ghosh and Lee, 2000). Our results confirm these findings. The results indicate that the market perceives that the acquisition will add value for shareholders, as evidenced by a very strong positive reaction at the news of the acquisition announcement, with a CAR of 17.88% for the three day window, significant at the 1% level. The positive to negative ratio indicates that 53 of the 71, or 75%, of the targets experience positive returns at the announcement. Hertzel and Smith (1993) argue that positive information about target value is implied by the willingness of outside investors to take large positions in the firm. Generally, our results support the argument of Morck, Shleifer and Vishny (1988) that value can be created in acquisitions in a limited competition takeover market where outside blockholders are created to limit the extent of managerial entrenchment. We also present the results of the control sample of firms matched on industry and size and search by SIC code in the SDC database to find a pool of potential matches. We

pick public companies with the closest size (assets) within the same 4-digit SIC code (or 3-digit in the case that there were no matches in the 4-digit code) to match with our target firms for the acquisition year. The results for the control sample indicate that the control group experiences positive wealth effects as well. More importantly, the difference between the target group and the control group shows that family targets earned significantly higher CARs at the announcement dates. Thus, family firms are able to extract larger gains than the control sample at acquisition announcements.

Returns by Level of Family Ownership

We test Hypothesis 1, that there is a curvilinear- U shaped- relationship between family ownership and abnormal returns from acquisition announcements, by parsing our sample by percent of family ownership. The hypothesis posits that returns would be lowest for some middle value and higher at both low levels of ownership and high levels of ownership. Therefore, we partition the targets into three levels of family ownership: high (76-100%), medium (51-75%) and low (20-50%). The breakpoints of 50% and 75% were found by Stulz (1988) and McConnell and Servaes (1990) respectively and 20% is the minimum required by SDC. Table 4, Panel B provides evidence on the market reaction to the targets, based on ownership concentration and Hypothesis 1 is confirmed.

For high ownership levels (76% to 100%), we find that the target experiences a highly significant and positive market reaction at the acquisition announcement (31.35%). Family firm literature finds that the higher levels of ownership result in the family majority stockholders benefit at the expense of the minority stockholders. Thus, the high ownership concentration leads to a serious problem of entrenchment, and the market believes that the acquisition is good news as it will alleviate the problems associated with concentrated, inside ownership at the highest levels.

At the low levels of family ownership (less than 50%), we again find highly positive and significant returns although at 19%, it is less than that for high ownership. These returns may be explained by the fact that there may be alignment issues for the target firm. Table 4 also reports the returns when ownership concentration is in the medium range of 51-75%. Here we find that the returns, while positive, are at their lowest at approximately 12%. Both of these findings are also supported by the family firm valuation literature in which the value of the firm is highest for the mid levels of ownership.

Thus, our data support previous findings that there is a curvilinear relationship between ownership and firm value (Maury, 2006; Claessens et al., 2002; Villalonga and Amit, 2006). Previous research (Ali, Chen, and Radhakrishnan, 2007; Anderson and Reeb, 2003) also find that firm valuations are highest at the mid-level of family ownership. We also confirm this in our findings; at the mid range of ownership, the firm value is at its highest with a balance of entrenchment versus alignment forces. Thus, the potential for further gain would be at its lowest, as there are little premiums to be extracted from the acquisition.

Returns by Generational Distance from Founder

We test Hypothesis 2, that announcement returns will be lowest for founder controlled firms, by examining abnormal returns to targets by generational distance from the founder and present these results in Panel C of Table 4. We find that the sale of second and third-generation family firms provide significant and positive abnormal returns, while for founder led firm, the results although positive

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are insignificant. This again provides additional support that founder run firms have higher valuations (Villalonga and Amit, 2006) and that second and subsequent generations suffer from more agency problems (Blanco-Mazagatos et al., 2007). Whether it is do to the lack of altruism exhibited by the founder as suggested by Schultz et al (2001) and Lubatkin et al (2005) is unclear, but the market is clearly signaling that there are wealth benefits from the subsequent generations' exit.

Returns by Method of Payment

Next, we partition the sample by method of payment. There are several articles which discuss how the method of payment affects acquisition announcements for bidders (Smith, 1986; Myers and Majluf, 1984; Travlos, 1987; Chang, 1998), but there is limited work on how method of payment affects target returns (Branch and Yang, 2006). Draper and Paudyal (1999) examine the impact of method of payment on target shareholder returns in takeover bids in the United Kingdom (U.K.). They find that target firms benefit substantially from takeover bids, and that the magnitude of excess returns is impacted by method of payment. Specifically, they find that target prices increase the most if target shareholders receive a mixed payment in form of shares or cash. Davidson and Cheng (1997) suggest that the relation between target abnormal returns and method of payment is indirect. They find that targets receiving cash payments report higher abnormal returns than those receiving stock; however, this relation disappears once the size of the payment is controlled, leading the authors to question the signaling hypothesis suggested by the method of payment. Huang and Walking (1987) find that target shareholders earn the highest abnormal returns for cash payments, with abnormal returns for mixed payments falling between those for cash and stock.

We find positive and highly significant event window CARs for all three transaction types. Stock financed transactions result in CARs of 21.44%, while cash financed transactions result in CARs of 16.78%. These results support the claim that when the target blockholder, in this case the family, is compensated with bidder stock, they have an incentive to mitigate information asymmetry and disclose the true value of assets, given that a substantial part of their likely relatively undiversified human capital will be invested in the post-acquisition entity. Furthermore, in order to accept compensation in shares of bidder stock, the target must perceive substantial wealth gains from the conversion of claims. Payment with stock may also be beneficial to target shareholders in terms of providing them with exit alternatives. Unlike the findings, of Huang and Walking (1987), we find that firms accepting mixed payments receive the lowest abnormal returns (14.70%); however, we also find that very few firms chose to receive mixed payments.

Returns Based on Future Role of Target Family

Panel D of Table 4 provides announcement abnormal returns for targets where a family member will remain in a managerial role versus those where the family will either act as consultants, board members, or nothing. We posit that if the family member is able to add value by continuing in some capacity with the firm, this presence should be rewarded by the market at the time of acquisition. We find that abnormal returns to targets where the family will contribute to the post-merger entity are much higher (23% versus 9%) signifying that the market acknowledges the continued role of the target family.

Cross-Sectional Regression Results

Our univariate results, demonstrate that acquisitions of family-owned firms

are wealth-generating events for targets, that the returns are highest for the highest level of family ownership, stock transactions, second and subsequent generations, and when family members continue in a managerial role. We continue the analysis using a multivariate framework in which we estimate bidder returns as a function of several target and transaction characteristics such as the percent of family ownership, ROE, leverage, transparency, and log of market value. We provide three model specifications to illustrate the robustness of model and variable explanatory power.

Table 5 presents the results of cross-sectional results which are qualitatively similar to our univariate results. The percent ownership is positive, indicating that the higher the level of family ownership, the higher the premium that the firm can extract from the bidder. As we were able to extract information on analyst following for only 34 of our firms, we include a dummy variable for more transparent firms which are followed by analysts. Our dummy variable for transparency indicates that more transparent family firms, as measured by analyst following, are marginally less likely to extract positive wealth effects from an acquisition. We had hypothesized that more transparent firms will extract lower premiums, and thus, we are able to confirm Hypothesis 2. Cash transactions are negative, but not significant. The two additional variables that are statistically significant are if the founder of the firm is still in control and if the family is going to continue in the management post-acquisition. The result for founder is negative and significant and the result for continued presence in management is positive, both of which mirror our univariate returns.

CONCLUSIONS AND DISCUSSION

The research on the acquisition of family owned firms is relatively scarce. Our study focuses on the sale of 71 publicly traded family businesses by either the founder or by subsequent generations. Using a set of hand collected data, we find that the ownership percentages tend to be either relatively low (less than 50%) or completely ownership by family members (21%). Families cite disputes or succession issues (27%) or a need for growth (27%) as primary motivations for the sale of the family business. Over 70% of the firms are led by the founder or a child of the founder, perhaps reflecting the difficulty of survival of family owned firms.

We examine two testable hypotheses in this paper. Our first hypothesis derives from the literature on family firms that finds numerous examples of non-linear performance based on level of ownership (Ali, Chen, and Radhakrishnan, 2007; Maury, 2006; Villalonga and Amit, 2006; Anderson and Reeb 2003). It appears that whereas there are problems of either alignment of interests or entrenchment at the lower or higher levels of ownership, firm value is the highest at the mid-level of ownership. Thus, in our first hypothesis, we suggest that a U-shaped pattern to abnormal returns to target shareholders, with the lowest returns in mid-levels of family ownership. Our results support this hypothesis; for the publicly traded firms, we find that the announcement returns are significantly positive with the high and low ownership percentages receiving the highest returns. Thus, we are able to confirm the findings in prior research regarding the non-linear relationship between ownership and firm value. The lowest percentage reflects the gains to be made by alignment corrections and the highest percentage reflects the gains to be made by the elimination of entrenchment issues.

We draw our second hypotheses from the literature on succession in family firms. In our paper, we term this the generational distance issue. Previous research on

family firms (Villalonga and Amit, 2006; Barontini and Caprio, 2006; Blanco-Mazagatos et al., 2007) reports that firm valuations are highest for founder-controlled firms. Indeed, Barontini and Caprio (2006) find that while founder firms do better, there is no evidence of any differences in performance between descendent-controlled firms and non-family firms. Thus, our second hypothesis states that in acquisitions of family firms, there are lower premiums to be extracted from founder-controlled than descendent controlled firms. Again, our results confirm this hypothesis. The announcement abnormal returns are significantly positive for all firms except when the founder is still in control. This suggests the firm is adequately managed by the founder but there may be significant problems with subsequent generations. The market also rewards the targets when some of the members agree to continue to participate in the running of the firm. We also find that more transparent firms are marginally less likely to extract higher premiums.

Our findings have practical implications for both buyers and sellers of family firms. As mentioned in the introduction, family owned firms comprise a major part of the business landscape in the United States, generating about half of the Gross Domestic Product and half of the total wages (Family Business Institute, 2013). Yet, less than 30 percent of successful family businesses continue to the third generation, and fewer than 15 percent make it to the fourth generation. While our data base is somewhat restrictive, our research offers new venues for subsequent investigation. The upcoming demographic wave of baby boomers retiring combined with a low total fertility rate in the U.S. implies that many more family blockholders will confront an exit without a succession plan involving subsequent generation family leadership at top management levels. Thus, our research provides grounds on which to build upon for analysis of the exit strategies to family blockholders in future papers. This means that the founder of the family firm has to carefully examine all succession and exit strategy issues.

One particular implication is for effective founders of family firms with mid-level of ownership. We find that while the returns to target shareholders are positive for all levels of ownership, the market recognizes the value of optimal family ownership and shareholders at this range of ownership receive the lowest premiums. Thus, such an effective founder may want to weigh the potential (limited) benefit of the sale of the firm against the continued ownership in the firm. Another related implication from this finding is that the market rewards firms where the owners continue some kind of business relation with the acquired firm; hence founders may well consider some kind of continued association with the new firm. Finally, for founders considering exit strategies for their firm; sale by subsequent generations result in substantially larger premiums.

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TABLE 1
Distribution of Announcements and Family Characteristics

A. Number of Announcements by Year

Announcement Year	Number of Acquisitions	Percent of Total
1984-1986	28	39.44
1987-1989	18	25.35
1990-1992	13	18.31
1993-1995	8	11.27
1996-1998	3	4.23
1999-2000	2	2.82
2001-2006	1	1.41
Total	71	100%

B. Percent Ownership of Selling Family

Ownership Distribution	Number of Firms	% of Firms With Available Information
20-29%	15	23.08
30-39%	19	29.23
40-49%	10	15.38
50-59%	16	24.62
60-69%	3	4.62
70-79%	2	3.08
80-89%	1	1.54
90-99%	0	0.00
100%	0	0.00
NA	6	
Total	71	

C. Motives for Sale of Family Owned Business

Motives for selling business	Number of Firms	% of Firms With Available Information
Family disputes	6	9.09
Succession Issues	15	19.70
Access to Capital	1	1.52
Distress	10	15.15
Growth objectives beyond the scope of the family	20	18.18
Desire of shareholders to diversify stake	14	16.67
Estate taxes	1	1.52
Good deal financially	11	16.67
Career Enhancement	1	1.52
NA	5	
Total	71	

D. Relationship of Selling CEO to Founder of Firm

Relationship to Founder	Number of Firms	% of Firms With Available Information
Founder	34	46.48
Child	19	21.13
Grandchild	12	14.08
Subsequent	9	12.68
NA		
Total	71	

E. Role of Founding Family Post Acquisition

Subsequent role of founding family	Number of Firms	% of Firms With Available Information
New executive role	14	38.10
Board member	9	19.05
Consultant	5	11.11
No role	4	7.94
Old Management Remains in place	14	23.81
NA	16	
Total	71	

Note. - This table provides details on the number and characteristics of the target family involvement. Target specific data are culled from a search of a number of sources, namely, *Securities and Data Corporation (SDC)* International Mergers and Acquisitions Database, *DataStream, Lexus/ Nexus, First Call, Market Guide, Dow Jones News Retrieval, Securities and Exchange Commission* filings, the *Wall Street Journal* and *New York Times* Indices, the *Directory of Corporate Affiliations*, *W.T Grimm's Mergerstat Review*, Dun and Bradstreet *Million Dollar Directory, Mergers and Acquisitions* journal, and target company web sites. Panel A provides details on levels of family ownership for 71 target firms for which ownership data were obtainable. Panel B provides details on motives for the sale of the family business for 71 family firms where such information is obtainable. Panel C provides details on CEO's relationship to the founder for 71 firms for which such information is obtainable. Panel D provides details on the subsequent role of the founding family for the 71 firms for which such information is obtainable.

TABLE 2
    Family Owned Firm Characteristics

Variable	Mean (Median)	Maximum (Minimum)	Standard Deviation
Size			
Total assets ($mi)	769 (402)	15,628 (4)	1895
Net Sales ($mi)	335 (281)	9533 (3)	550
Market Value ($mi)	350 (344)	2,206 (2)	350
Profitability			
Return on assets (%)	1.93 (4.43)	19.17 -74.26	16.63
Return on equity (%)	9.94 (2.13)	66.7 (-92.1)	6.78
Net profit margin (%)	10.86 (10.42)	-19.25 (-35.4)	10.21
Leverage and Liquidity			
Cash/Total Assets (%)	10.91 (3.50)	70.00 (0.30)	12.19
Debt/Total Assets (%)	18.80 (5.20)	71.56 (0.00)	19.44

Note. - This table provides summary financial characteristics of the 71 family-owned targets for which Research Insights data are available. The mean values for selected financial characteristics for the target firms are provided for the sample as a whole. All of the financial data are reported for the year prior to the acquisition announcement.

TABLE 3
Deal Characteristics
  A. Financial Variables

	Mean (Median)	Maximum (Minimum)	Standard Deviation
Value of transaction/Total Acquirer Assets (%)	15.96 (11.40)	98.74 (2.00)	9.98
Average age of family owned firm	58.06 (54.50)	182.0 (3.00)	34.79
Percent Family Ownership	60% (55.00)	100 (20.00)	28%

B. Method of Payment

	Number	Percent of Total
Cash	36	10.10
Stock	121	39.09
Mixed	48	15.64
Terms Not Disclosed	108	35.18
Total	313	100%

Note. – This table provides information on the characteristics of the acquisition transactions of family owned firms. Panel A provides financial characteristics of the deals. Panel B provides information on the method of payment in the transaction. Panel C provides the breakdown of the sample into publicly owned and privately held family firms.

TABLE 4:
Cumulative Abnormal Returns to Family Firm Targets

A. Cumulative Abnormal Return for Overall Sample

| | No. | CAR Event Windows | | | |
		(-1, +1)	(-1, 0)	(0,0)	+/- (-1, +1)
Targets	71	17.88 (45.53)***	16.15 (14.63)***	15.02 (55.60)***	53/18 (5.42)***
Control Sample	71	13.26 (25.74)***	12.55 (9.08)***	12.07 (6.50)***	59/12 (6.18)***
		2.28**	2.16**	2.34**	

B. Cumulative Abnormal Returns by Family Ownership for Announcement Date

| | No. | CAR Event Windows | | | |
		(-1, +1) (z-stat)	(-1, 0) (z-stat)	(0) (z-stat)	+/- (-1, +1) (sign test)
High	10	31.35 (24.87)***	25.93 (18.24)***	20.89 (30.30)***	8:2 (2.10)**
Medium	24	11.90 (23.92)***	10.58 (22.31)**	11.35 (31.87)***	16:6 (2.70)***
Low	35	19.45 (29.34)***	18.16 (34.05)***	16.54 (42.08)***	28:7 (4.02)***

C. Cumulative Abnormal Returns by Method of Payment for Announcement Date

Targets	n	(-1,+1)	(-1,0)	(0,0)	+/- (-1, +1)
Cash	45	16.78 (38.50)***	15.25 (36.42)***	14.80 (47.29)***	37 :8 (4.96)***
Stock	15	21.44 (17.99)***	20.20 (21.23)***	18.19 (27.83)***	11 :4 (2.26)**
Mixed	7	14.70 (9.10)***	11.96 (9.77)***	8.63 (8.84)***	4 :3 (0.48)

D. Cumulative Abnormal Returns by Generational Distance for Announcement Date

Targets	N	(-1,+1)	(-1,0)	(0,0)	+/-(-1, + 1)
Founder	15	4.35	3.33	1.89	12 :4
		(1.37)	(1.36)	(0.58)	(3.63)***
Child	18	19.24	21.12	20.15	13 :5
		(8.41)***	(22.37)***	(25.10)***	(2 .25)**
Grandchild or subsequent	32	36.22	23.27	24.07	38 :3
		(25.16)***	(22.83)***	(19.35)***	(6.77)***

E. Cumulative Abnormal Returns by Family Member Role for Announcement Date

Targets	n	(-1,+1)	(-1,0)	(0,0)	+/-
Managerial	47	22.64	21.16	18.02	39 :8
		(4.36)***	(4.20)***	(3.16)***	(3.26)***
Advisory or None	24	8.55	11.46	9.15	14 :10
		(2.99)***	(2.75)***	(2.39)**	(1.36)

Note. – This table provides cumulative abnormal return for the overall and subsamples based on target and transaction characteristics. Excess returns are calculated using the market model estimated from 110 to 11 days prior to the event announcement. CARs represent the cumulative market model-adjusted change over the relevant event window. The CRSP equally-weighted market index is used. The Z statistics (given in parentheses) are based on the standardized cross-sectional method. The number of positive and negative CARs for the (-1, +1) window (+/-) are reported in the last column, with the test statistic for the nonparametric generalized sign test reported in parenthesis under +/-. Panel A provides CARs for the overall sample. Panel B provides CARs by percent of family ownership of the family owned targets for the bidders and targets. Panel C provides CARs by method of payment for the bidders and targets. Panel D provides CARs by percent of generational distance for the targets. Generational distance is measured as distance from current CEO to the founder of the target. Panel E shows CARs for subsamples of targets where a member of the founding family remains in a managerial position versus an advisory position (such as board seat or consulting role) or no position. *,**,*** represents significance at the 10%, 5% and 1% levels, respectively, using a two-tailed test.

TABLE 5
      Cross-Sectional Regression Results

	Model 1	Model 2	Model 3	Model 4
Dependent Variable = (-1,0) CARs				
Constant	0.157 (2.15)**	0.104 (2.55)**	0.116 (2.41)**	0.024 (3.85)***
Pct Own	0.035 (2.07)**	0.027 (1.87)*	0.022 (1.79)*	0.021 (0.56)
Ln(assets)	-0.001 (-1.26)	-0.001 (-0.64)	-0.001 (-1.52)	-0.001 (-1.05)
ROE	0.002 (1.57)	0.001 (1.04)	0.001 (0.89)	0.002 (1.44)
Leverage (Debt/Total Assets)	-0.001 (-0.22)	-0.001 (-0.51)	-0.001 (-0.77)	-0.002 (-0.28)
Cash = 1	-0.001 (-1.14)	-0.001 (-1.20)	-0.001 (-1.46)	-0.001 (-0.63)
FIRST = 1	-0.135 (-2.25)**		-0.083 (-2.08)**	-0.015 (-1.88)*
Manager= 1		0.114 (2.15)**	0.102 (2.27)**	0.058 (2.56)**
Analyst = 1				-0.065 (-1.72)*
R2	4.36%	5.26%	8.90%	3.22%
F	3.15***	3.66***	4.64***	2.98***
N	65	65	65	65

Note. - This table provides the results of cross-sectional regression target event period returns as the dependent variable. Independent variables are: percent family ownership, natural logarithm of assets, Return on Equity (ROE), Leverage (Debt/Assets Ratio), a dummy variable if the method of payment is pure cash, a dummy equal to 1 if the generation that sells is founder or first generation managed (FIRST). And a dummy = 1 if a family member will take a managerial role in the post-acquisition entity versus a consolatory position or no position (MANAGER). *,**,*** represents significance at the 10%, 5% and 1% levels, respectively, using a two-tailed test.