

# **OWNER CONTROL AND FIRM GROWTH: AN EMPIRICAL INVESTIGATION ON THE CONTROL DILEMMA IN PUBLIC FIRMS**

## **INTRODUCTION**

A growing body of research recognizes that controlling owners differ in their strategic preferences and that this matters for firm performance (Connelly et al., 2010; Miller et al., 2011). However, owner control may come with advantages and disadvantages for a firm's growth (Schulze & Zellweger, 2021). Some scholars argue that control in the hand of founders or families, typical controlling owners, harm firm growth (Durand & Vargas, 2003; Feldman & Montgomery, 2015; Wasserman, 2006). They attribute the low firm growth to hold-up problems with stakeholders (Hart & Moore, 1990). Others argue that owner control benefits firm growth through strategic agility (Klein et al., 2019), or enhanced monitoring at reduced cost (Jensen & Meckling, 1976). To resolve these contradicting perspectives, Schulze and Zellweger (2021) suggest that owners are put into a control dilemma: Retaining strong control over their business reduces firm growth while reducing control, for example via independent boards or opening ownership, will benefit firm growth. What we lack of, is empirical evidence on how the control dilemma plays out in owner-controlled public firms and how controlling owners may overcome the dilemma.

My study aims to further develop the owner control dilemma and empirically test how owner control affects firm growth in public firms. To resolve the owner control dilemma, I also explore control mechanisms such as board independence (Blair & Stout, 1999) or the presence of a lead independent director (Krause et al., 2017) with the aim to mitigate control hazards.

I define owner-controlled firms as firms in which a founder, family, or lone entrepreneur is largest owner in at least one of the companies share classes. Supporting our model, I find a positive association of ownership concentration with firm growth and that owner-board chairs negatively moderate this relationship. However, I find no support that control mechanisms such as board independence or lead independent director presence mitigate the effect of owner-board chairs.

My study contributes to literature on the owner control dilemma (Schulze & Zellweger, 2021; Wasserman, 2017) with showing empirical evidence related to public firms and to an emerging field of owner as strategist by evidence that concentrated owners are able to enhance value creation (Foss et al., 2020) if the owner does not retain board control (Feldman & Montgomery, 2015). Further, I contribute to the governance theory of stakeholders (Hoskisson et al., 2018) by arguing that controlling owner-board chairs may increase the hold-up problems.

## **THEORY AND HYPOTHESIS**

While firm growth has been related to various constraints (Delmar et al., 2003; John et al., 2008), the role of owners to facilitate firm growth has so far attracted little attention. This is surprising as there is an increasing consensus that firm owners influence firm strategy (Connelly et al., 2010; Federo et al., 2020) and thus, should also affect firm growth. Schulze and Zellweger (2021) develop a theory on owner-managed firms that tries to explain the paradox why many owner-controlled firms remain small and thus, grow little. The authors refer to the owner control dilemma defined as tradeoff between retaining control in the owners' hands and submitting it to governance structures. In particular, the authors propose control benefits and control hazards that mitigate the potential for owner-controlled firms to grow. In the following, we develop theoretical arguments in the context of public owner controlled firms. Examples known from press are Elon Musk (Tesla) or Mark Zuckerberg (Facebook), who managed to grow their firms at rapidly, clearly showing advantages of control in their hands. Nevertheless, they face increasing fears from stakeholders as for example shareholders push towards establishing a more independent governance through independent board chairs (Krause, 2017), a higher share of independent directors (Rosenstein & Wyatt, 1990), or the presence of a lead independent director (Krause et al., 2017).

### **Control benefits from concentrated ownership and firm growth**

Following Schulze and Zellweger (2021), I argue that ownership concentration in individual owners such as founders, families or lone-entrepreneurs (in the following controlling owners) is positively associated with firm growth for three reasons. First, strategic benefits occur due to the controlling owner having significant firmwide influence over resources and are empowered to pursue potential attractive opportunities (Klein et al., 2019) for value generating activities that contribute to a faster growth of the firm. These opportunities include Diversification (Eisenmann, 2002), M&A (Wright et al., 2002), or R&D activities (Chrisman & Patel, 2012). In addition, due to a usually long ownership tenure of family members, founders and lone-entrepreneurs they acquire superior information and experience (Lubatkin et al., 2006) in identifying these kind of growth opportunities.

Second, incentive benefits occur due the owners' powerful incentive to advance and actively contribute to an efficient use of assets that facilitate firm growth (Schulze & Zellweger, 2021). Firms with concentrated ownership benefit from cost advantages as they avoid agency cost related to incentive alignment and monitoring (Jensen & Meckling, 1976). As individual owners often follow growth over profit strategies (Thomsen & Pedersen, 2000) the means gained through cost advantages can be used to pursue attractive growth opportunities.

Third, commitment benefits occur due to the controlling owner's usually strong bond and passion to the firm and employees, which manifests in acting in a steward-like manner towards firm stakeholders (Cardon et al., 2009; Wasserman, 2003). By staying connected to the company for the long term, controlling owners can focus on long-term goals such as sustainable growth and are less characterized by short-term profit goals (Thomsen & Pedersen, 2000).

In sum, ownership concentration increases strategic, incentive and commitment benefits (Schulze & Zellweger, 2021). Put formally:

***Hypothesis 1.** Ownership concentration is positively associated with the firm's growth.*

### **Control hazards from concentrated control and firm growth**

While concentrated ownership in isolation allows controlling owners to draw on their control benefits to achieve higher firm growth, these control benefits may be reduced when an owner concentrates too much control in their hands such as when being board chair. As board chair, the owner encompasses several aspects rather than only leading the board's control and monitoring tasks (Banerjee et al., 2020). For example, board chairs define the routines and processes for the board, set the agenda and tone for board meetings and debates, and, when they are not the CEO, serve as the main conduit for communication between the CEO and the rest of the board (Tuggle et al., 2010), or give the CEO guidance and counsel to help with resource management (Sirmon et al., 2007) and strategy formulation (Carpenter & Westphal, 2001)

Stakeholders' expectations of the board chair are rising, and one of those expectations is that they will drive the board's work toward more openness (Banerjee et al., 2020). Banerjee et al. (2020) therefore state that a distinct independent board chair reduces the possibility of entrenchment and makes a good impression on outside stakeholders. In contrast, as observed in this study, board chairs who are the majority shareholders themselves face little control in pursuing their interests. In short, combining ownership concentration with the board chair position, the owners are more likely to engage in behavioral opportunism vis-a-vis its stakeholders (Hart & Moore, 1990). This potential for holdup can disincentivize stakeholders from committing their firm specific investments ex ante. However, firm specific investments are needed to retain the competitive advantage and pursue a long term growth aspirations.

First, owner-board chairs with concentrated ownership face too little control for conflicting stakeholder interests to prevail over those of the owner-board chair (Burkart et al., 1997). Owners using their strategic agility to pursue noneconomic goals (Schulze et al., 2001), nepotism (Villalonga & Amit, 2006), use of firm resources for political purposes (Fauchart & Gruber, 2011), or excessive prequities consumption (Gimeno et al., 1997) are exemplary reasons that are likely to generate a wedge between the owner-board chair and stakeholders, making firms less competitive (Bena & Xu, 2017).

Second, while ownership concentration enhances monitoring, the exploitation of stakeholders becomes more likely with monopolizing control too strong (Schulze & Zellweger, 2021). Information asymmetries between the owner-board chair and stakeholders about welfare distribution may create reliability concerns (Thompson & Loewenstein, 1992). Following the ability and incentive of the owner-board chair to pursue self-regarding interests undermines necessary conditions to support cospecialization by stakeholders, weakening firm growth (Bridoux & Stoelhorst, 2014).

Third, while ownership concentration empowers the controlling owner to commit sustainably in decisions and signal continuity, owner-board chairs are able to repeatedly exercise of their control through direct board engagement. Such behavior may lessen stakeholder's perceptions of the controlling owners reliability, deterring their firm-specific investments required for a long term growth (Kydlund & Prescott, 1977). In addition, succession hazards occur when the owner-board chair exits his role. As stakeholders realize that prior commitments and firm-specific investments may expire with the departure of the owner-board chair, they engagement may shirk or behave morally hazardous (Schulze & Zellweger, 2021).

In summary, hazards arising from too strong control concentration increase under the presence of an owner board-chair with concentrated ownership. Put formally:

**Hypothesis 2.** *The owner being board chair negatively moderates the relationship between ownership concentration and the firm's growth, such that ownership concentration will be less positively associated with the firm's growth.*

### **Board composition as boundary condition to mitigate control hazards**

Studies have already proposed devices to regulate and mitigate hold-up problems by protecting stakeholders' firm specific investments (Hoskisson et al., 2018; Schulze & Zellweger, 2021). Blair and Stout (1999) in specific name the board of directors as "mediating hierarchy" whose job is to balance competing interests between team members' (e.g. stakeholders) in a way that everyone stays together in a productive coalition.

**Board Independence.** Board independence is a central part of board composition (Lefort & Urzúa, 2008). Thereby board independence and its influence on shareholder and stakeholder wealth is also a majorly discussed aspect in board literature (Hillman et al., 2009; Rosenstein & Wyatt, 1990). Independence of boards is important to fulfill the function as intermediary between the firm's controlling owner and its stakeholders (Blair & Stout, 1999). Under the presence of an owner-board chair with concentrated ownership there is a lack of independence which lowers the board's ability to effectively overcome hold-up problems. Therefore increasing independence of the board by rising the share of independent directors may be a powerful tool to reduce the negative effect of the owner-board chair on growth.

Independent directors are useful to enhance the owner-board chair's accountability therefore reducing reliability hazards. The appointment of independent directors, may improve the organizational decision-making processes and lessen the degree to which the owners-board chair's judgments are influenced by the risks and incentives associated with high personal ownership (Siegel-Jacobs & Yates, 1996). Further, in order to limit idiosyncrasy and opportunism, independent directors may also benefit a wide range of stakeholders by acting as a means of resolving disputes between stakeholders and the owner-board chair (Schulze & Zellweger, 2021).

Addressing potential self-interested behavior by the owner board chair, a higher number of independent directors should be better able to oversee rent distribution among stakeholders (Blair & Stout, 1999) and limit the owner-board chair's ability to pursue egoistic actions.

Since succession planning is also carried to the overall board, independent directors also take influence on the succession processes and post succession performance (Schepker et al., 2017). Tasked with advising on the board chairs' appointment and acting as advocates for a wide range of stakeholders with an ongoing interest in the company, independent directors should push owner-board chairs to put in place structures and processes that make their companies less vulnerable to their departure (Schulze et al., 2001).

Overall, I hypothesize that board independence will reduce hazards of concentrated control. Put formally.

**Hypothesis 3.** *Board Independence positively moderates the interaction of ownership concentration and owner-board chair on the firm's growth, such that ownership concentration and the owner being board chair will be less negatively associated with the firm's growth.*

**Lead independent director (LID).** Another protection device to alleviate the firm-specific investment dilemma that has gained popularity in the last two decades (Krause et al., 2017) is the LID. I expect LID presence to reduce the negative effect of owner-board chairs with ownership concentration on growth for the following reasons.

The existence of a LID is helpful to increase the owner-board chair's accountability, hence decreasing reliability dangers. The appointment of a LID may enhance organizational decision-making processes and minimize the extent to which owner-board chair's judgments are impacted by risks and incentives of high ownership. The LID may also help a wide range of stakeholders by limiting idiosyncrasy and opportunism of the owner-board chair.

The ability to manage rent distribution among stakeholders should be improved under LID presence as he or she acts as a liaison between the independent directors and the board even though there is no independent board chair.

As the LID is in close interplay with the owner-board chair, he or she should be able to encourage the owner-board chair to implement systems and procedures that lessen the likelihood that their companies will be vulnerable to their departure. Installing the role of a LID also signals continuing involvement of the owner-board chair and control retention (Krause et al., 2017), ensuring previous commitments with stakeholders.

Overall, I hypothesize that a LID will reduce hazards of concentrated control. Put formally.

**Hypothesis 4.** *The presence of a LID positively moderates the relationship of ownership concentration and the owner being board chair on the firm's growth, such that ownership concentration and the owner being board chair will be less negatively associated with the firm's growth.*

## METHOD

### Sample

To test our hypotheses, I use data on US firms listed in the S&P 1500, Dow Jones or NASDAQ between 2007 and 2018. I obtained data on ownership, board directors and corporate governance from the NRG Metrics database and financial data from the Thomson Reuters database. I identified owner-controlled firms as firms in which an individual such as a founder, a family member or lone-entrepreneur is largest owner in at least one share class. After dropping firms with missing data the complete dataset resulted in 413 firms and 1.736 firm-year observations.

### Measures

**Dependent variable.** I use sales growth as measurement for firm growth (Geroski et al., 1997; Zhou & Park, 2020). I calculate sales growth as the percentage change in a firms sales revenues from Year -2 to Year 0 (Bird & Zellweger, 2018; Nobeoka & Cusumano, 1997). This allows us to take into account that our independent variables might have an effect on growth only in the long run over several years. To mitigate the impact of outliers the dependent variable was winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentile of their distribution.

**Ownership concentration.** Following prior studies (Thomsen & Pedersen, 2000), I calculate ownership concentration as the percentage share of voting rights held by the controlling owner.

**Owner board chair.** I coded owner board chair 1 if the controlling owner is board chair in the respective year and 0 otherwise.

**Board independence.** I measured board independence as the percentage of directors on the board that are classified as independent (Dalton et al., 1998). I standardized this measure prior to analysis, as the unstandardized measure exhibited an elevated variance inflation factor (Krause, 2017).

**Lead independent director.** I coded lead independent director 1 if the board has a lead independent director in the respective year, 0 otherwise.

**Owner founder.** I coded owner founder 1 if the controlling owner is also a founder of the respective firm, 0 otherwise. Data on founders, was drawn from the NRG Metrics database and manually collected using web research such as information in proxy statements, websites, or newspaper articles.

**Control variables.** Similar to previous studies I introduce a set control variables for industry and firm characteristics that may influence a firms ability to make performance changes or may offer alternative explanations for firm growth. These include *Firm size* (Delmar et al., 2003), which I capture as the natural logarithm of the number of employees; *Firm age* (Delmar et al., 2003), which I capture as the natural logarithm of the number of years since the firms inception; *Capital intensity*, which I measure as the firms' total assets divided by the total revenue; *industry effects*, which I capture by three-digit NAICS dummy variables; and *calendar-year dummies* to account for economic conditions. As institutional ownership has been studied to have a major strategic impact (Thomsen & Pedersen, 2000), I include *institutional ownership* as percentage share of held voting rights.

## ANALYSIS AND RESULTS

I used generalized estimating equations (GEEs) (Krause et al., 2016; Oehmichen et al., 2021) to model longitudinal data. For our GEE, I used a first-order autoregressive (AR1) correlation structure. The autoregressive correlation structure was chosen to address the time-related correlation within our dataset's subjects (firms) (Oehmichen et al., 2021). I also specified a Gaussian distribution, an identity link function, and error clustering at the firm level. When using an exchangeable correlation matrix, the results remain consistent. The variance inflation factors in all models were less than 3. To account for potential time-delayed effects in the dependent variables, I lag all independent variables by one year. Our results are robust to alternative dependent variables, alternative measures of ownership concentration and sample variation.

Table 1 presents the respective results for testing my hypothesis. model 1 includes all control variables. Model 2 shows supporting evidence for hypothesis 1, predicting that ownership concentration is positively associated with the firm's growth. Model 3 shows supporting evidence for hypothesis 2, predicting a negative effect for the interaction term between ownership concentration and the owner being board chair. Model 4 adds the three-way interaction terms between board independence, owner-board chair presence and ownership

concentration for testing hypothesis 3. Even though the sign of the interaction term is positive indicating a positive relationship with firm growth, the probability of error is elevated. Model 5 adds the three-way interaction term between LID presence, owner-board chair presence and ownership concentration for testing hypothesis 4. In contrast to the predictions in hypothesis 4 there is no supporting evidence.

Table 1: Regression results

| DV = 3 - year sales growth   | (1)   |       |      | (2)          |             |             | (3)           |             |             | (4)          |             |             | (5)          |             |             |
|------------------------------|-------|-------|------|--------------|-------------|-------------|---------------|-------------|-------------|--------------|-------------|-------------|--------------|-------------|-------------|
|                              | Coef. | SE    | p    | Coef.        | SE          | p           | Coef.         | SE          | p           | Coef.        | SE          | p           | Coef.        | SE          | p           |
| Ownership concentration (OC) |       |       |      | <b>0.18*</b> | <b>0.09</b> | <b>0.04</b> | <b>0.41*</b>  | <b>0.16</b> | <b>0.01</b> | <b>0.38*</b> | <b>0.82</b> | <b>0.06</b> | <b>0.40*</b> | <b>0.19</b> | <b>0.03</b> |
| Owner chair                  |       |       |      | -0.01        | 0.03        | 0.64        | 0.06          | 0.05        | 0.17        | 0.07         | 0.29        | 0.30        | 0.04         | 0.06        | 0.49        |
| Owner founder                |       |       |      | 0.03         | 0.04        | 0.48        | 0.03          | 0.04        | 0.40        | 0.04         | 0.35        | 0.30        | 0.04         | 0.04        | 0.38        |
| Board independence           |       |       |      | -0.00        | 0.02        | 0.89        | -0.00         | 0.02        | 0.90        | 0.03         | 0.04        | 0.46        | -0.00        | 0.02        | 0.86        |
| LID                          |       |       |      | 0.05         | 0.03        | 0.16        | 0.05          | 0.03        | 0.17        | 0.05         | 0.03        | 0.13        | 0.03         | 0.06        | 0.66        |
| OC: Owner chair              |       |       |      |              |             |             | <b>-0.37*</b> | <b>0.17</b> | <b>0.03</b> |              |             |             |              |             |             |
| OC: Board independence       |       |       |      |              |             |             |               |             |             | 0.13         | 0.14        | 0.34        |              |             |             |
| OC: LID                      |       |       |      |              |             |             |               |             |             |              |             |             | -0.00        | 0.28        | 1.00        |
| Constant                     | 0.995 | 0.21  | 0.00 | 0.867        | 0.20        | 0.00        | 0.842         | 0.20        | 0.00        | 0.822        | 0.20        | 0.00        | 0.869        | 0.20        | 0.00        |
| Controls                     |       | Yes   |      |              | Yes         |             |               | Yes         |             |              | Yes         |             |              | Yes         |             |
| Year dummies                 |       | Yes   |      |              | Yes         |             |               | Yes         |             |              | Yes         |             |              | Yes         |             |
| Industry dummies             |       | Yes   |      |              | Yes         |             |               | Yes         |             |              | Yes         |             |              | Yes         |             |
| N                            |       | 1'736 |      |              | 1'736       |             |               | 1'736       |             |              | 1'736       |             |              | 1'736       |             |

All continuous variables are standardized; significance levels: \*\*\* = 0.001; \*\* = 0.01; \* = 0.05

## DISCUSSION

The goal of this study was to shed light on the owner control dilemma in public firms and establish potential governance mechanisms to overcome the control dilemma. I show that the control dilemma described by Schulze and Zellweger (2021) evolves in a way that ownership concentration on founders, families, and lone-entrepreneurs indeed enhances the growth of the firm while too strong control concentration, which occurs when the controlling owner is board chair, the positive effect on the firms' growth is reduced. I further show that board control mechanisms were not able to achieve a positive effect on firm growth under the presence of owner-board chair with concentrated ownership.

I aim to make three contributions to research on owner management and corporate governance. First, I contribute to the theory about benefits and costs of owner control (Schulze & Zellweger, 2021). I define concentrated control as a combination of ownership concentration and board control exercised via the board chair position and show that indeed concentrated control comes with benefits and costs. I show that concentrated ownership alone enhances firm value creation while the combination of concentrated ownership and board control harms firm value creation. With that I extend the findings of Wasserman (2017), who found that startups are less valuable if founders retain control through the Board Chair or CEO position. In our study, however, I show that this overlooks the control benefits that come with ownership concentration.

Secondly, I contribute to governance literature of stakeholders (Hoskisson et al., 2018). I find that the owners' control through the board chair position negatively relates to firm growth. I expand knowledge by arguing that under the condition of strong board control in addition with ownership concentration, increasing independence or the presence of a LID (Krause et al., 2017) may not be an effective tool to reduce hold-up problems. I also support the claim that independent board chairs are likely beneficial for firm growth if controlling owners with concentrated ownership are present (Banerjee et al., 2020).

Third, I contribute to the emerging research on owners as strategists. Feldman and Montgomery (2015) found a negative effect of directors with large shareholding on firm value and attribute this to a lack of top-level experience, which I support by showing that controlling owners with concentrated ownership and board control do negatively influence firm growth. I further expand (Feldman & Montgomery, 2015) by showing that concentrated ownership on individuals also brings advantages for the firm if they do not control the board.

As with any study, ours has limitations. First, our study focuses on individual controlling owners such as founders, families, or lone-entrepreneurs. Other types of controlling owners such as institutional investors or states (Aguilera & Crespi-Cladera, 2016) might not encounter similar control benefits and hazards. Analysis including other types of controlling owners may thus constitute an promising path for future research. In addition, our sample used for testing our hypothesis is composed of US firms, which is why our results may not be transferable to companies outside the US. Further research on micro-mechanisms is needed to shed light on how the individual benefits and hazards unfold in firms through control mechanisms such as voting rights or the role of a board chair. To conclude, I hope that our study encourages also others to conduct research about the value creation role of firm owners.

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