CORPORATE GOVERNANCE IN LARGE UK FAMILY FIRMS

Researched and written by Josip Kotlar, Francesca Cuomo, Silvia Gaia and Alessandro Zattoni

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CORPORATE GOVERNANCE IN LARGE UK FAMILY FIRMS

A research report commissioned by the IFB Research Foundation

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ABOUT THE IFB RESEARCH FOUNDATION

The IFB Research Foundation is a charity (no. 1134085) established to foster greater knowledge and understanding of family firms and their contribution to the economy and society, as well as the key challenges and opportunities that they face.

The Foundation's vision is to be the UK's centre of excellence for family business research, and to this end its publications are designed to create a better understanding of family business for the benefit of all stakeholders.

Alongside Family Business Research and White Papers, providing thought leadership on key family business characteristics and issues, its work covers a broad range of publications, including:

• Family Business Sector Report – benchmarking the size and importance of the sector.

• Family Business Challenges – offering practical guidance for family business owners on a broad range of topics, including family business dynamics, governance, performance, succession and wealth management.

• Family Business Case Studies – showcasing family business exemplars.

The Foundation disseminates knowledge and best practice guidance through printed publications, online media accessible via the IFB website and other activities.

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ABOUT THE IFB

The Foundation is independent of, but works closely with the Institute for Family Business (IFB), the UK family business organisation.

The IFB's mission is to help family businesses remain successful across the generations. The IFB provides a safe space where family businesses can share their challenges and successes openly.

Family businesses are the backbone of our economy and communities, and the IFB works closely with them championing their contribution and voicing their needs.

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FOREWORD

A Message From the Chair of the IFB Research Foundation

This new report takes a first look at the corporate governance arrangements of the UK's largest family firms. While family business is trusted more than business in general,[1] better governance can help build on such trust. The analysis in this report shows that the boards of these firms are characterised by a high degree of independence. It also draws attention to some of the ways that family firms can raise their governance standards - by increasing gender diversity in their Boards and disclosing more information about their reporting practices.

The IFB Research Foundation is a charity which carries out independent research to better understand family businesses and their impact. In the coming year, we will follow-up this initial survey with more in-depth research on family governance in the UK's largest family firms. The Wates Principles[2] encourage large private firms to adopt corporate governance arrangements on an "apply and explain" basis. Going forwards, new research will be needed to assess the impact of these new regulations and guidance on large family firms. But it is clear that the quality of future research in this area depends on the availability of more and better data on large family firms.

I hope you find this report informative.

Sir Michael Bibby
Chairman, IFB Research Foundation

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EXECUTIVE SUMMARY

This report presents an updated database of family firms ranked among the largest 1,000 companies registered in the United Kingdom (UK) (as measured by turnover) and it examines their corporate governance arrangements.

The project has led to the development of a large database covering key information about large UK family firms' ownership, corporate governance and important dimensions of strategy and performance.[3] Using these data, the report provides an overview of the population of large UK family firms and several analyses.

The main findings from this research include the following:

Family Firm Representation Among the Top 1,000 UK Companies

The proportion of family firms among the top 1,000 UK companies by turnover is 20.1% (N = 201 family firms), slightly lower than the 22.3% of UK companies reported in 2015 (Repgraph, 2016).[4]

Among the 201 family firms in the list, 22 are classified as First-Generation Entrepreneurs (FGEs), compared to 20 in the 2016 report.

Compared to 2015 (Repgraph, 2016), the following changes are observed in the population of large UK family firms:

- 127 family firms were already present in the 2016 ranking.
- 74 new family firms entered the 2018 ranking, including seven FGEs and 29 family firms owned by UK families.
- 82 family firms dropped out from the list of top 1,000 UK companies, including 77 family firms and five FGEs.

The 201 family firms in the list include a mix of family firms owned by UK-national families and foreign-national families. Specifically, these are delineated as follows:

- 111 family firms (55.2%) are owned by families with UK nationality, including 20 out of 22 FGEs.
- The remaining 90 family firms are owned by foreign-national families from 27 countries. Among these, 34 firms (16.9%) are owned by families from countries that belong to the European Union, and 23 firms are owned (11.4%) by US-national families.

Corporate Governance in Large UK Family Firms

Large UK family firms have, on average, larger boards of directors compared to all private family and non-family firms in the UK.

In relation to board diversity, our results show:

- There are low levels of gender diversity in the boards of directors of large UK family firms compared to FTSE 100 companies;
- Large UK family firms have relatively older board members compared to all private family and non-family firms registered in the UK. However, we also observe a higher level of age diversity compared to all private family and non-family firms in the UK.
- The average tenure of board members is under seven years.
- The boards of directors of large UK family firms are comprised mainly of UK nationals.

Large UK family firms have a relatively high level of board independence from family owners and shareholders:[5]

- The level of family involvement in the boards of directors of large UK family firms is low on average, suggesting a high level of board independence from the owning family.
- The average ratio of shareholders who are also members of the board of directors is low on average, suggesting a high level of board independence from shareholders overall.
- A few large UK family firms have a family member serving as the CEO, while CEO-duality (the dual role of the CEO as Chair of the Board of Directors) is also rare.
- Among the 35 family firms that report explicit data on board independence, the average level of board independence is higher compared to all private family and non-family firms in the UK.

There is very limited information about corporate governance codes available from secondary data sources. Nonetheless, the analysis of family firms' reported compliance reveals some initial insights:

- 38 of the 201 largest family firms in the UK explicitly report the adoption of the UK Corporate Governance code.[6]
- Among the remaining 163 family firms, 12 are subsidiaries of parent companies adopting the UK Corporate Governance code, and four family firms have at least one subsidiary adopting the UK Corporate Governance Code.
- 41 family firms report the adoption of other governance codes, including other country/region specific codes, stock exchange specific codes, 16 general other governance codes, and two UK other codes.
- Overall, the study highlights a limited level of transparency regarding the adoption of corporate governance codes among large UK family firms, as most companies do not disclose any information about their reporting practices. This is an area currently undergoing legislative change in the UK,[7] with the issuance of standardised guidelines also being undertaken for large private firms. Therefore, further attention to this is needed in future research.

1. INTRODUCTION

Family firms are the most widespread form of business worldwide. They make up almost 90% of all the businesses in the private sector in the UK and make a major contribution to the UK economy.[8] Family businesses also make up 26% of all companies that went public on the London Stock Exchange from 1995 through 2011,[9] suggesting that family firms are prevalent among both private and listed companies.

Yet there is a lack of empirical evidence about large UK family firms and their corporate governance, despite the fact that corporate governance is widely recognised as a main driver of family firms' strategic behaviour and performance.[10]

This project starts to address this gap by assessing the corporate governance arrangements of large family firms in the UK. The main purpose of this project is to develop an updated database of large family firms in the UK and their corporate governance.

Specifically, this report addresses the following research questions:

1. What is the proportion of family firms among the largest 1,000 UK companies?
2. How has the proportion of family firms changed over time?
3. How are large UK family firms' boards of directors structured?
4. To what extent do large UK family firms report the adoption of standardised corporate governance codes?

The database of large UK family firms developed in this study includes additional information about strategy and performance, as outlined in the methodology section. This provides the basis for future research to examine the relationships between family firms' corporate governance arrangements, important aspects of corporate strategy, innovation, and performance.

2. METHODOLOGY

We build on the 2016 IFBRF UK Large Family Business Report (Repgraph, 2016), with the aim of updating the list of family firms ranked among the top 1,000 largest companies based in the UK[11] by turnover to the latest year available, and we provide data about corporate governance arrangements, strategic behaviour and performance. Consistent with Repgraph (2016), in this study we focus on individual firms; hence we include all companies registered as legal entities in the UK, whether or not they are linked by cross-shareholdings or pyramidal ownership structures (i.e., business groups).

This section outlines the definition of family firms used in our study, the sources of data used to build the database, the main steps we took in our data collection and analysis, and the list of variables included in the database.

2.1 Definition of Family Firms

Consistent with the definition of family firms adopted by the European Commission[12] and Repgraph (2016), this study classifies family firms according to the following criteria:

- 50% family ownership (ultimate voting rights) in private firms
- 25% family ownership (ultimate voting rights) in listed firms

Following prior research,[13] we identified family members based on the condition that any shareholder, manager or director had the same family name of the company's founder. Whilst this is a common proxy used in the literature, due to the difficulty to identify family ties among individuals who do not share the same family name, our results may underestimate the actual level of family involvement.

Moreover, consistent with Repgraph (2016), we differentiate First-Generation Entrepreneurs (FGEs) as a distinct sub-group of family firms, defined as those family firms that are owned and led by a founding entrepreneur with no discernible involvement of other family members.[14]

2.2 Data Sources

For the purpose of our study, information about large UK family firms was collected from the following data sources:

- FAME and Thompson Eikon:
  - Information about firm ownership
  - Accounting data and key ratios
- Companies House director database and BoardEx:
  - Information on corporate governance
- Company websites and reports:
  - Additional data not available in existing databases, including firm policies (e.g., strategy, innovation, entrepreneurship, corporate social responsibility, etc.), adoption and compliance with governance codes, and firm performance.

2.3 Data Collection and Analysis

The data in this report relates to the latest data available in 2018.[15] The data collection and analysis process were organised around the following steps: First, detailed data were collected at firm level to identify the top 1,000 UK companies by turnover. Second, data were collected at individual level for main shareholders and board members for each firm, then aggregated in order to have a summary at firm level. Third, in order to merge the data from different sources and at different levels, firm IDs and years were used in order to have/generate panel data. This enabled the merging of the data by firm ID and year, using statistical analysis software. Finally, descriptive and bivariate analyses were conducted, and the results of these analyses are reported here.

2.4 Variables

The data have been analysed according to three groups of variables: family ownership, corporate governance, strategy and performance.[16]

Table 1 shows a breakdown of each group of variables, while specific definitions and measurement operationalisations are reported in Appendix I.[17]

Table 1. Overview of variables in the study

Categories	Variables
Family Ownership	% family ownership (including direct and indirect ownership) Family owners' nationality First-Generation Entrepreneurs (FGEs)
Corporate Governance	Board size Board independence Board tenure Family CEO CEO duality Board diversity (gender, age, and nationality of board members) Adoption of the UK Corporate Governance Codes Other adopted governance codes
Strategy and Performance[18]	Turnover
Listing Status	Private/listed (including name of stock exchange market)

3. RESULTS: LARGE UK FAMILY FIRMS

3.1 Large UK Family Firms

According to the latest data available in 2018, the proportion of family firms among the top 1,000 firms by turnover is 20.1% (201 companies), including 179 family firms and 22 First-Generation Entrepreneurs (FGEs).[19]

The minimum and maximum turnover of family firms in the list are m£923 (ranked 996th) and m£22,200 (ranked 32nd), respectively. The turnover of the UK company ranked 1,000th in the top 1,000 companies is m£919.[20]

The full list of all 201 large UK family firms, along with their ranking by turnover, changes compared to the 2015 data presented in Repgraph (2016), and key information for each company, is presented in Appendix II.[21]

The list includes both private and listed companies, as shown in Figure 1. Among the 201 family firms identified in our study, 173 family firms (86.1%) are privately held, 28 family firms (13.9%) are listed on stock exchange markets, including 25 family firms listed on the London Stock Exchange, and three family firms are listed on American stock exchanges (one on NASDAQ and two on NYSE). Overall, the proportion of family firms among listed companies (12.5%) is about one-half of the proportion of family firms among private companies (22.3%).

Figure 1. Summary of top 1,000 firms' ownership and listing status

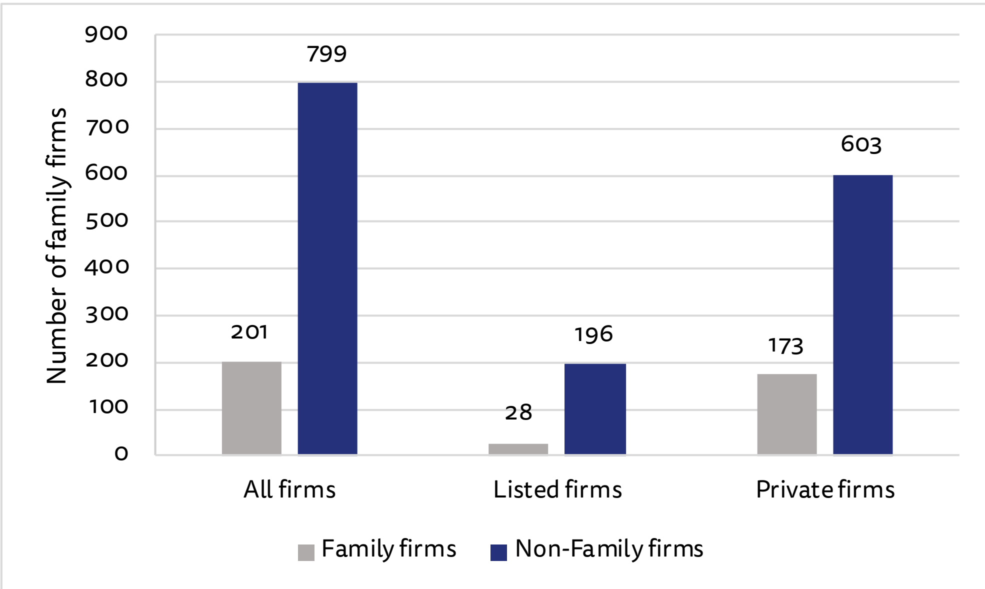


Table 2 reports the breakdown of large UK family firms included in the list of top 1,000 UK companies by turnover. This compares with the results reported in 2015 (Repgraph, 2016):

- 111 of the large UK family firms in our list (55.2%) are owned by families with UK nationality.
- 22 family firms are classified as FGEs, compared to 20 in Repgraph (2016).
- 20 out of 22 FGEs are owned by families with UK nationality, compared to 20 in Repgraph (2016).[22]

Finally, family firms owned by non-UK families have a higher turnover than those owned by UK families (m£3,364 versus m£2,228).

Table 2. Profile of large UK family firms 2018

	Number of firms	Percentage
Nationality of family owners		
UK-national	111	55.2%
Foreign-national	90	44.8%
Listing status		
Listed	28	14.0%
Private	173	86.0%
Type of family owners		
First-Generation Entrepreneurs (FGEs)	22	11.0%
Families	179	89.0%
Total	**201**	**100%**

3.2 Nationality of Family Owners

A closer look at the nationality of family owners shows that 90 (44.8%) family firms are owned by foreign-national families. Among these, 34 firms (16.9%) are owned by families from countries that belong to the European Union, and 23 firms (11.4%) are owned by US families. Overall, Figure 2 and Table 3 indicate a high level of international diversity within the population of large UK family firms.

Figure 2. Nationality of family owners in large UK family firms

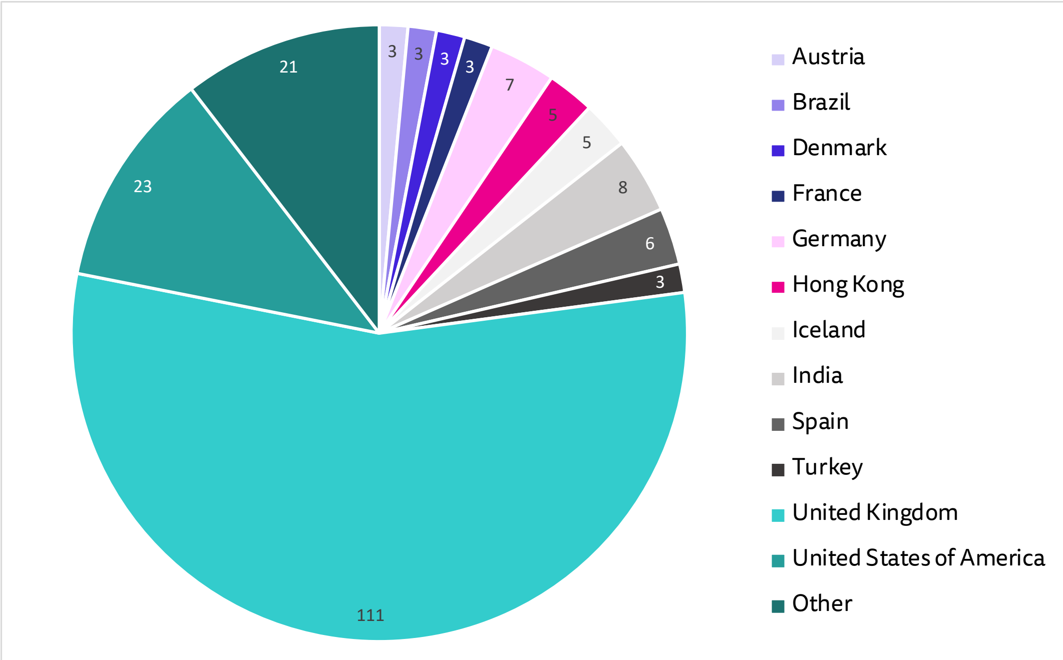


Table 3. Nationality of family owners in large UK family firms

Country	Number of firms	Percentage
UK	111	55.2%
US	23	11.4%
India	8	3.9%
Germany	7	3.5%
Spain	6	3.0%
Hong Kong	5	2.5%
Iceland	5	2.5%
Austria	3	1.5%
Brazil	3	1.5%
Denmark	3	1.5%
France	3	1.5%
Turkey	3	1.5%
Canada	2	1.0%
Greece	2	1.0%
Russia	2	1.0%
South Africa	2	1.0%
Sweden	2	1.0%
Other*	11	5.5%
Total	**201**	**100.0%**

* Includes Taiwan, Singapore, Japan, Chile, Lebanon, Switzerland, Mexico, China, Netherlands, Ireland and Italy; Each country is represented by one large UK family firm.

3.3 Population Changes 2015 – 2018

Our study shows that, based on the latest turnover available in 2018, the total population of family firms among the top 1,000 UK companies (by turnover) is 201 (20.1%), including:[23]

- 127 family firms already present in Repgraph (2016), including 15 FGEs and 62 family firms (non-FGEs) owned by UK families.
- 74 new family firms that entered the list in the 2018 ranking, including seven FGEs and 29 family firms owned by UK families. 35 new entrants are ranked among the top 500 UK companies, whilst only three new entrants are among the top 100 UK companies.
- 82 family firms dropped out from the 2016 ranking, including 77 family firms (among which 18 dropped out due to special circumstances) and five FGEs.

Changes in the turnover of large UK family firms between the 2015 data reported in Repgraph (2016) and the updated data from the current study are summarised in Table 4. Overall, the top 1,000 UK companies have increased their turnover since 2015, but at the same time the minimum level of turnover for inclusion in the top 1,000 list increased from £626 million in the 2016 report to £919 million.

We found that there has been a slight decrease in the proportion of family firms in the top 1,000 that are owned by UK families: a decrease from 130 (13.0%) in Repgraph (2016), to 111 (11.1%).

We observed important changes in family firms' rankings among the top 1,000 UK companies by turnover:

- The distribution of family firms in the ranking has changed slightly, with a lower number of family firms placed at the highest and lowest ends of the ranking:
    - o The number of family firms in the top 100 ranking positions has decreased from 14 to 11.
    - o The number of family firms at the lowest end of the ranking (positions 801-1,000) has decreased from 46 to 40.
- Among the 127 large UK family firms (including FGEs) that were also included in Repgraph (2016), 98 decreased their rankings and 28 improved their ranking.
- Among the six family firms that are not owned by UK families that improved their rankings, only one company is owned by an EU family.
- Overall, changes in certain industries and mergers and acquisitions activity provide the main explanations of observed changes in family firms' ranking among the top 1,000 UK companies by turnover.

Table 4. Summary of Top 1,000 UK firms by turnover

	2015 (Repgraph, 2016)	2018
Panel A: All firms		
Number of firms	1000	1000
Cumulative turnover (m£)	3,730,284	4,487,188
Mean turnover (m£)	3,730	4,487
Min turnover (m£)	626	919
Max turnover (m£)	277,485	230,639
Total number (%) of family firms, including FGEs	223 (22.3%)	201 (20.1%)
Total number (%) of firms owned by UK families, including FGEs	130 (13.0%)	111 (11.1%)
Panel B: Family firms excluding FGEs		
Number of firms	203	179
Cumulative turnover (m£)	432,588	500,774
Mean turnover (m£)	2,131	2,797
Min turnover (m£)	628	923
Max turnover (m£)	23,325	22,220
Panel C: Family firms owned by UK families, excluding FGEs		
Number of firms	110	91
Cumulative turnover (m£)	176,067	203,615
Mean turnover (m£)	1,761	2,237
Min turnover (m£)	628	923
Max turnover (m£)	13,417	15,526
Panel D: FGEs		
Number of firms	20	22
Cumulative turnover (m£)	34,157	49,282
Mean turnover (m£)	1,708	2,240
Min turnover (m£)	643	1052
Max turnover (m£)	3,595	4,593

4. RESULTS: CORPORATE GOVERNANCE IN LARGE UK FAMILY FIRMS

4.1 Board Size

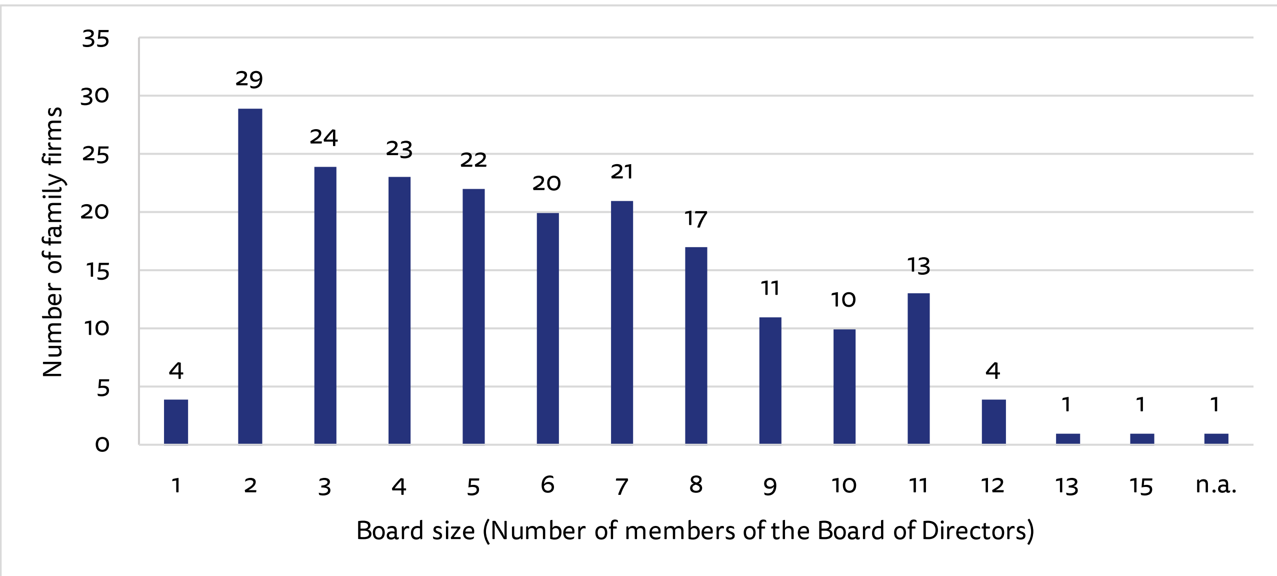
Board size refers to the number of members of the board of directors and is an important dimension of corporate governance in family firms. It is a proxy for board capital,[24] including human capital (directors' experience, expertise, knowledge, skills, and reputation) and social capital (resources embedded within, available through, and derived from the network of relationships possessed by board directors). Prior studies have shown the positive effects of board size on family firms' financial performance,[25] as well as on non-financial outcomes such as corporate social responsibility.[26]

The results of our analysis are summarised in Figure 3. The average board size among the largest UK family firms is 5.8 members,[27] a larger figure compared to previous studies considering the whole population of private firms in the UK.[28] Thus, our results suggest that family firms have, on average, larger boards of directors compared to smaller private family and non-family firms.

More specifically, our analysis shows that only four family firms have a single board member (i.e., sole directorship). Moreover, 14.4% of the large UK family firms have only two board members. Nonetheless, the median size of the board of directors is five, meaning that 98 out of the largest 201 family firms in the UK (48.8%) have six or more board members. These companies are near equally distributed between six and eleven board members, with only six companies having twelve or more.

Finally, a comparison of family firms controlled by UK-national families vs. foreign-national families indicates that family firms controlled by UK-national families have a slightly higher average board size (6.0) compared to foreign national-owned family firms (5.5).

Figure 3. Board size distribution in large UK family firms



4.2 Board Diversity

The size of the board is a strong indicator of board capital, but the ability of the board of directors to provide access to valuable resources critically depends on the diversity of board members. Our analysis provides important insights on these issues by examining four dimensions of board diversity:

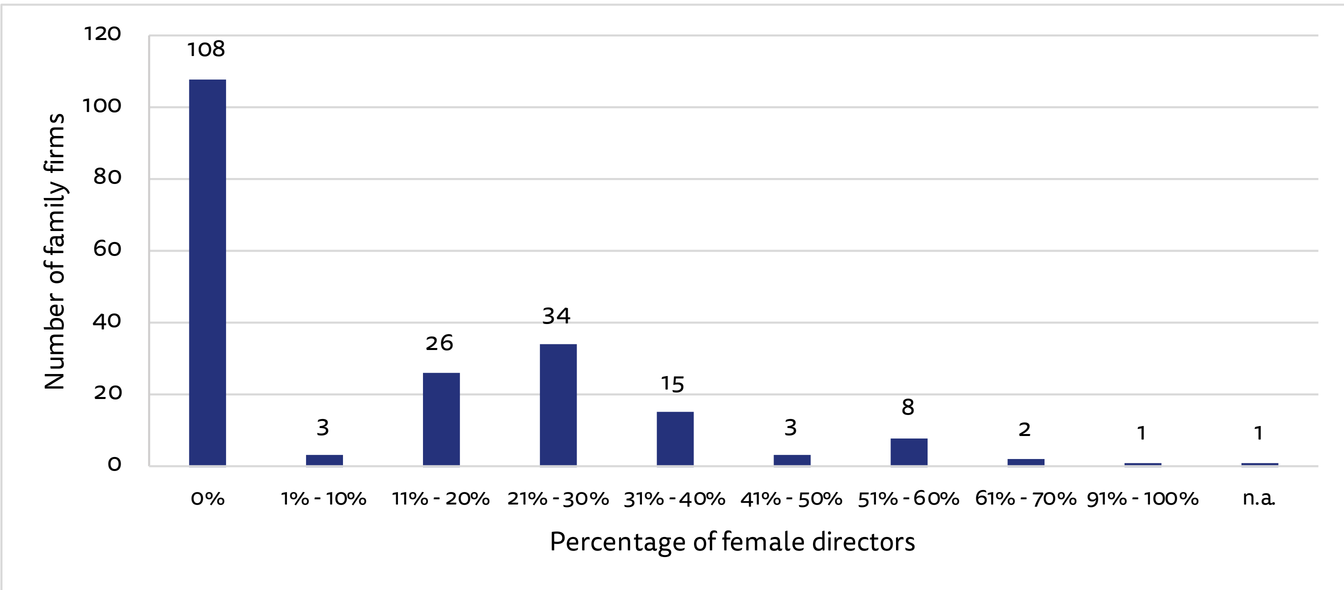
- Gender diversity
- Age diversity
- Tenure diversity
- National diversity

First, gender is a key dimension of board diversity and is one that continues to attract much attention in the UK business world. Existing studies indicate that gender diversity has a positive effect on organizational outcomes,[29] including, for example, boosting family firms' entrepreneurial orientation[30] or reducing their bankruptcy risk.[31]

Clearly, our results show that large family firms in the UK have low levels of gender diversity in their boards of directors. Increasing gender diversity should be an important priority for large family firms in the UK, and the topic deserves further research attention as well.

In particular, our analysis (Figure 4) reveals that the average female representation on the board is as low as 12.5%, much lower compared to all FTSE 100 companies (23.5%).[32] Moreover, the majority of family firms (108) have no female directors at all. Among the remaining family firms, just 11 have boards that are more than 50% female.

Figure 4. Percentage of female directors in large UK family firms



Another important dimension of board diversity relates to the age profile of the board of directors. The analysis in Figure 5 shows that the average age of board members in the largest 201 family firms in the UK is about 54 years. This is higher than that reported for all private family and non-family firms in the UK.[33] Only six family firms were found to have an average board members' age below 45 years, whereas the average age is greater than 60 years in 31 family firms (15.4%).

Figure 5. Average board members' age in large UK family firms

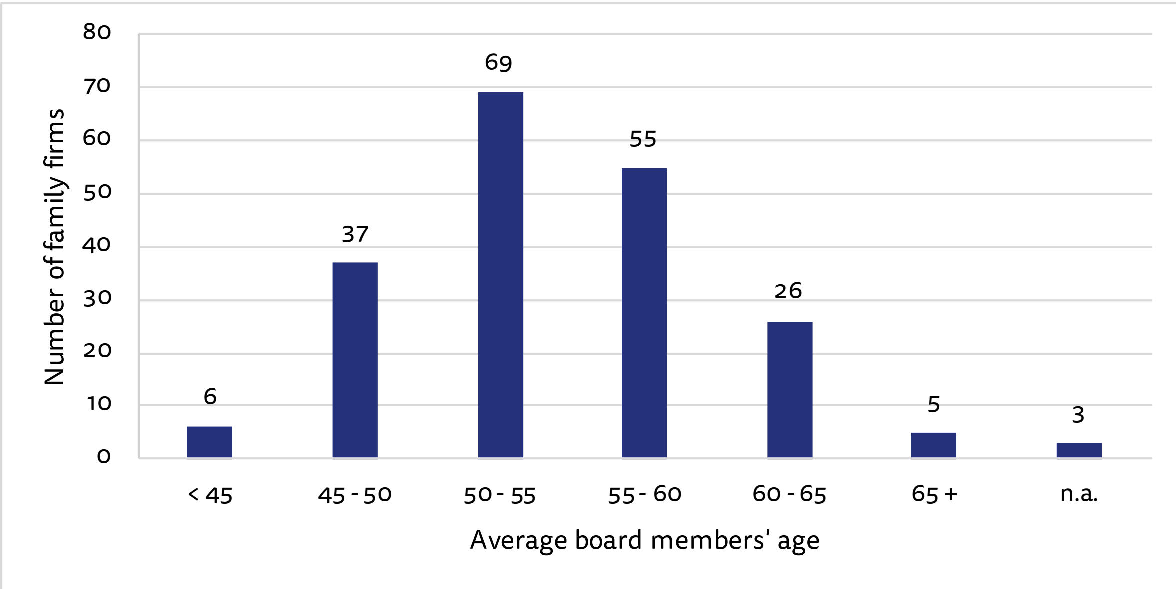
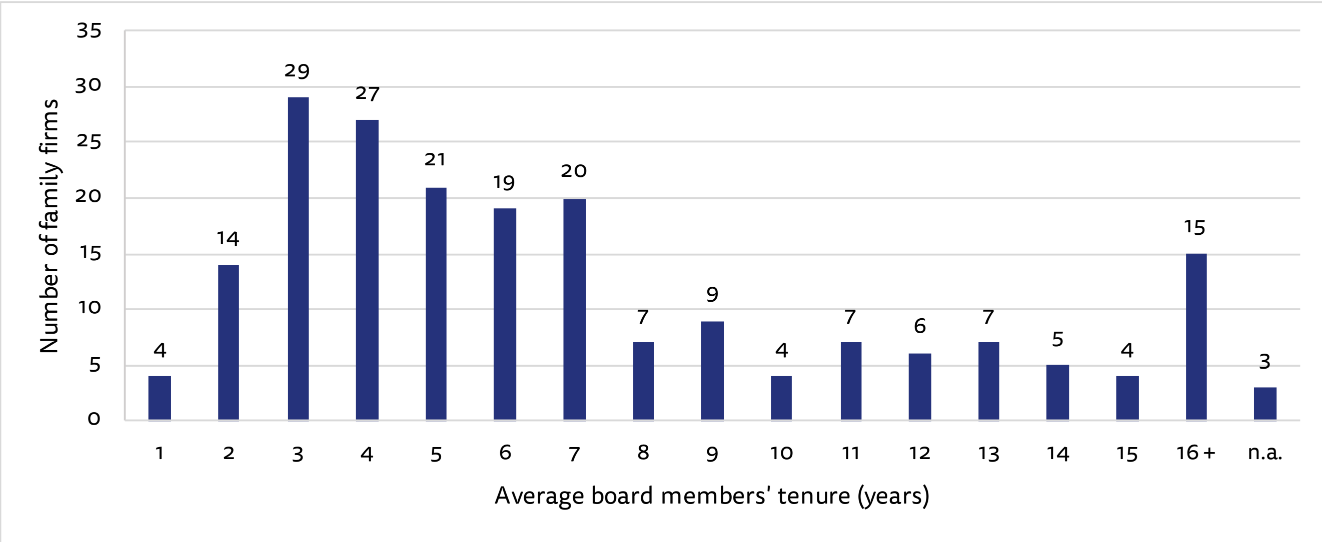


Figure 6 shows the distribution of family firms by the average tenure of their board members. The rate of turnover among board members indicates the extent to which board membership changes over time, thereby bringing in new knowledge, skills and perspectives. The rate of board members' turnover among all family firms is eighty months (6.7 years). Moreover, 116 family firms (57.7%) have a rate of turnover between three and seven years, and 48 family firms (23.9%) between eight and fifteen years. Finally, in 15 family firms, the rate of turnover is greater than or equal to sixteen years.

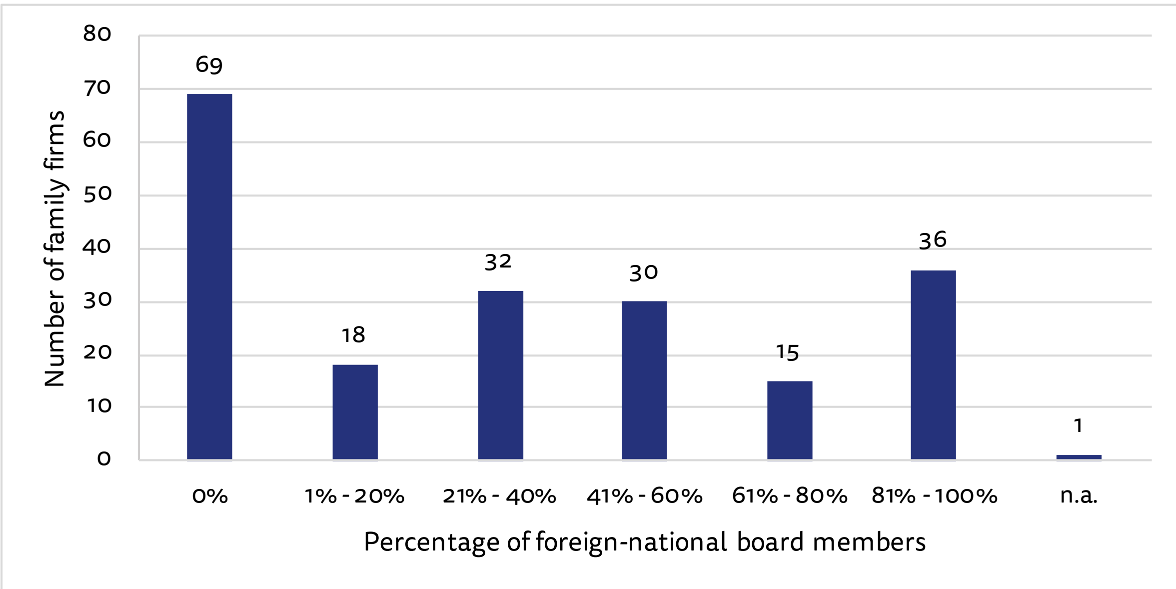
Overall, the analysis shows that the largest family firms vary in their choices concerning board members' tenure: the majority change board members less than every seven years, but a proportion of them appears to keep the same directors for very long periods of time.

Figure 6. Average board members' tenure in large UK family firms



Finally, our analysis of board members' nationalities (Figure 7) shows that 69 family firms (34.3%) have no foreign-national board members at all, and 87 (43.3%) have less than 20% foreign nationals on their boards. Nonetheless, 17 family firms (8.5%) have an equal representation of UK and foreign nationals on the board of directors, and 58 family firms (28.9%) have a board of directors where foreign directors are in a majority. Among the latter, most (44 family firms) are represented by family firms owned by foreign-national families.

Figure 7. Ratio of directors with foreign nationality



Note: Directors with foreign nationality include directors with double nationality (UK & foreign nationality).

4.3 Board Independence

Board independence is regarded as an important attribute of the board of directors,[34] yet it is difficult to measure board independence using publicly available data, especially for non-listed firms. Moreover, the potential involvement in the firm of "outside" family members who may not be owners of the firm complicates the interpretation of board independence data.[35]

Notwithstanding these challenges, we explore the level of board independence in large family firms in the UK based on five conditions:[36]

- Are members of the owning family directly involved in the board of directors?
- Do shareholders have a direct involvement in the board of directors?
- Is the CEO a family member?
- Is the CEO also the Chairman of the Board of Directors (i.e., CEO duality)?
- Are the majority of board members independent from the main shareholders?[37]

The analysis of family involvement in the board of directors (Figure 8 and Table 5) shows that the average level of family involvement in the board of directors is 20.5%. A closer look at the distribution of family firms according to the level of family involvement in the board of directors shows that almost half of family firms (45.8%) have no family members on the board of directors. Just 34 family firms (16.9%) have family members representing the majority of the board of directors. Finally, family members on the board are more frequent in UK owned firms compared with family firms owned by foreign-nationality families.

Figure 8. Share of family members on the board in large UK family firms

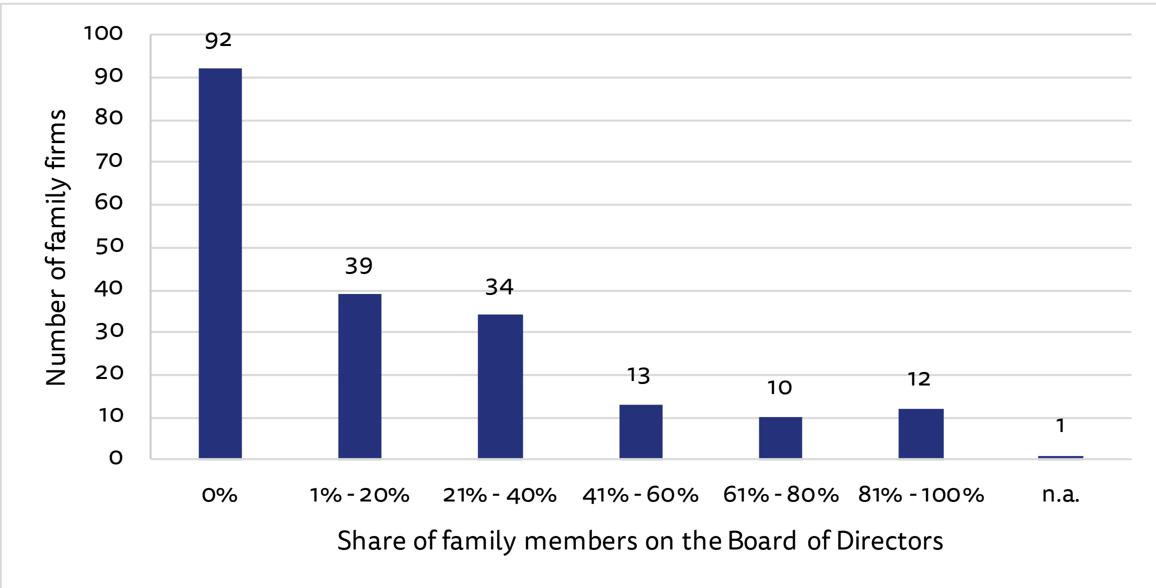


Table 5. Share of family members on the board in large UK family firms

% family members	UK-national **owned** family firms	**Foreign**-national **owned** family firms	**All large UK family firms**
0%	26.1	70.0	45.8
1-20%	25.2	12.2	19.4
21-40%	22.5	10.0	16.9
41-60%	10.8	1.1	6.5
61-80%	6.3	3.3	5.0
81-100%	9.0	2.2	6.0
n.a.	0.0	1.1	0.5
N	**111**	**90**	**201**

On the other hand, the average proportion of board members who are also shareholders is 13.7%. As shown in Figure 9, most family firms (70.6%) have no shareholders as board members, and shareholders make up the majority of board members in only 27 family firms (13.4%).

Overall, the level of family members' and shareholders' direct involvement in the boards of large family firms is relatively low compared to the whole population of family firms in the UK,[38] suggesting a relatively high level of board independence in the largest family firms.[39]

Our analysis identifies two further indicators of board independence, namely the choice of the CEO[40] and CEO duality (that is, whether the CEO is also Chair of the Board of Directors).[41]

A breakdown of family firms by CEO characteristics (Table 6) indicates that 47 family firms (23.3%) have a family member as CEO, whereas 134 family firms (66.8%) are led by a non-family CEO. This information was unavailable in the other 20 cases. The data also indicate that only 17 family firms have a dual CEO-Board chair (8.4%). In nine of these cases, the CEO-Board chair is a family member. In 52.7% of cases (106 family firms), the CEO is neither the chairman nor a family member.

Figure 9. Share of board members who are also shareholders in large UK family firms

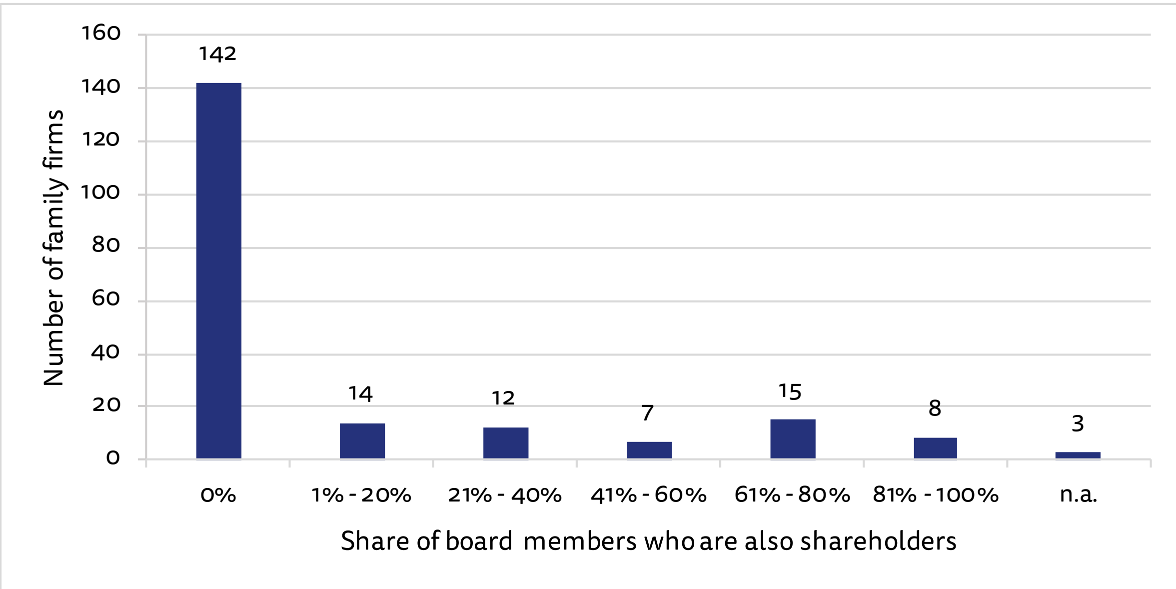


Table 6. CEOs in large UK family firms

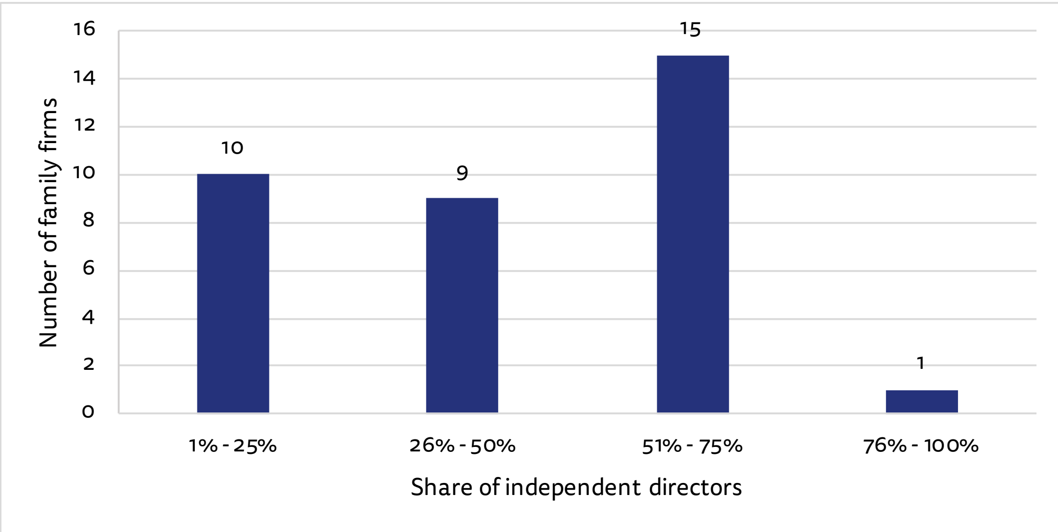
	CEO duality			All
Family CEO	Yes	No	Missing data	
Yes	9 (4.5%)	28 (13.9%)	10	47 (23.3%)
No	8 (3.9%)	106 (52.7%)	20	134 (66.8%)
Missing data	0	2 (1.0%)	18	20 (9.9%)
Total	17 (8.4%)	136 (67.6%)	48	201 (100.0%)

Note: CEO family member status is not available for 20 companies. CEO duality is not available for 48 companies. Percentages have been calculated based on the full sample of 201 family firms.

Overall, these findings suggest that family leadership is relatively rare in large family firms in the UK, as these firms appear to be most commonly led by non-family leaders.[42]

Finally, we find that only 35 out of 201 family firms disclose information on board independence. By analysing the information on board independence among the 35 family firms that report these data,[43] we find that the average level of board independence among these firms is 42.7%, which is higher than private family and non-family firms in the UK,[44] but similar to the level observed in listed family firms in the US.[45] Clearly, the lack of data in this area is a critical issue that calls for more consistent guidance for reporting board independence.

Figure 10. Proportion of independent directors on the board in large UK family firms



Note: Information available only for 35 out of 201 family firms in the UK.

4.4 Adoption of Corporate Governance Codes

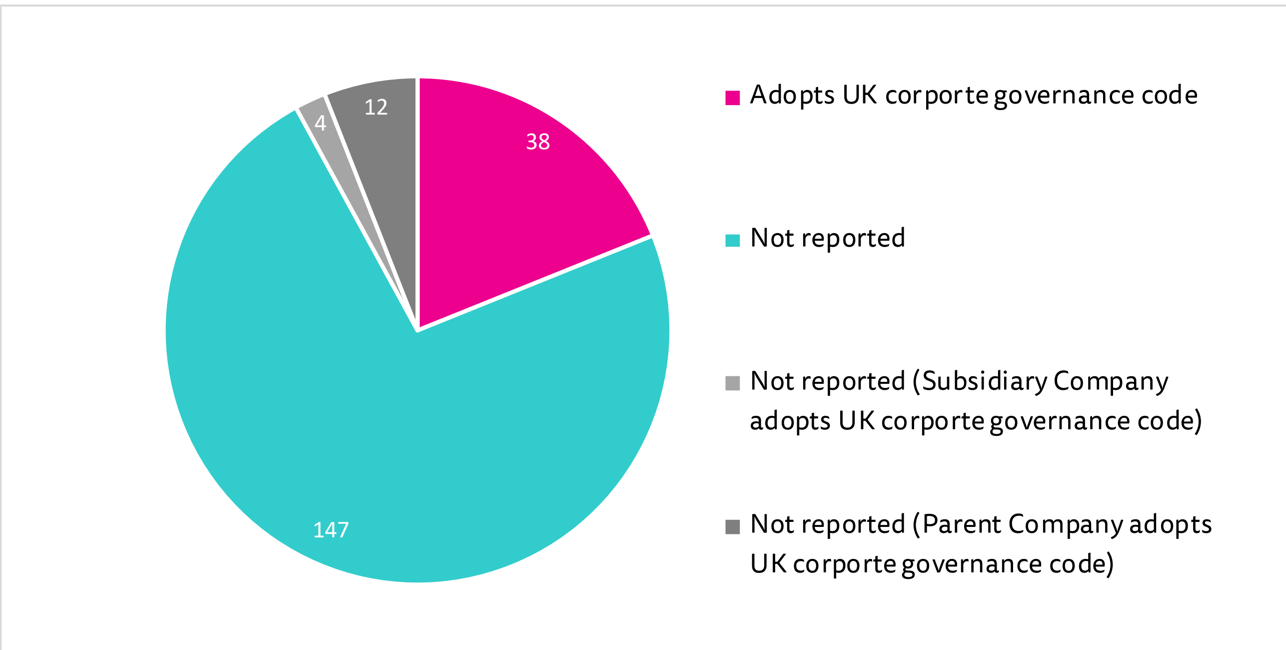
National and international corporate governance codes are self-regulatory codes, usually based on the "comply or explain" principle. They are commonly issued for listed companies, although there are also codes designed for non-listed companies,[46] or even for both listed and non-listed companies. More recently, there has also been the issuance of codes designed for companies with a specific ownership structure, for different types of financial institutions, or for voluntary and charitable organizations. Since the issuance of the Cadbury code in 1992, the UK has led the development and diffusion of these codes around the world, with the exception of codes aimed to improve the governance of private companies or family firms. In addition, corporate governance codes can be designed at individual firm level.[47]

Regarding the issuance of codes aimed to improve the governance of private companies or family firms in the UK, this is an area currently undergoing legislative change in the UK, with the issuance of standardised guidelines also for large private firms[48] - such as the "Wates Corporate Governance Principles for Large Private Companies" issued in December 2018 (FRC, 2018).[49] Companies that are not required to adhere to particular governance codes, such as large private companies before December 2018, can do so and report such information on a voluntary basis.[50] Previous studies show that several factors can influence the rate of compliance with codes' recommendations,[51] including firm's size and family ownership structure.[52]

The breakdown of large UK family firms by adoption of the UK Corporate Governance Code (i.e., the UK Code) and other governance codes is shown in Figure 11. In particular, 38 of the 201 largest family firms in the UK explicitly report the adoption of the UK Code, whereas the remaining 163 family firms (81.1%) do not disclose any information about their reporting practices. Because not all firms are required to report adoption of the UK Code, this could mean either that the majority of family firms have not adopted the UK Code, or that they have adopted the UK Code but have not reported this explicitly in their corporate reports and websites.

A closer look at the corporate websites of those 163 family firms that do not report the adoption of the UK Corporate Governance code shows a more nuanced picture. Specifically, we found a wide variety of practices, including 12 family firms (5.9%) that are subsidiaries of parent companies adopting the UK Corporate Governance code, and four family firms (1.9%) that have at least one subsidiary adopting the UK Corporate Governance code. In two family firms, no information about governance code adoption could be found at all.

Figure 11. Adoption of the UK Corporate Governance code in large UK family firms (number of firms)



Moreover, 41 companies report the adoption of other governance codes, including six other country/region specific codes (Hong Kong, German, Swedish, French, Dutch, and Swiss), five stock exchange specific codes (UK, Hong Kong, Swiss, NASDAQ, and NYSE), 16 general other governance codes, and two UK other codes (Financial Conduct Authority DTR and MAR). This information is summarized in Table 7.

Table 7. Adoption of other governance codes

Other Reported Governance Codes		
Country (Region) Specific	Hong Kong's Guide on Environment, Society and Governance	
	German Corporate Governance Code	
	Swedish Corporate Governance code	
	AFEP-MEDEF Code (France)	
	Dutch Corporate Governance Code	
	Swiss Code of Best Practice for Corporate Governance	
Stock Exchange Specific	Admission and Disclosure Standards of the Main Market of the London Stock Exchange and the UK Listing Rules	
	Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited	
	Swiss Stock Exchange Directives	
	NASDAQ Stock Exchange Corporate Governance Rules	
	NYSE Corporate Governance Rules and NYSE Criteria for Directors' Independence	
Others	**Country specific**	UK Financial Conduct Authority DTR (Disclosure and Transparency Rules) and MAR (Market Abuse Regulation)
		UK Stewardship Code
	General	(Internal) Corporate Governance Code/Guidelines/Principles Charter of the Audit Committee Charter of the Compensation Committee Charter of the Finance Committee Charter of the Nominating and Governance Committee Charter of the Sustainability and Innovation Committee Code of Business Ethics Code of Ethics for Senior Financial Personnel Code of Ethics for the Board of Directors Code of Conduct Global Code of Conduct Anti-Money Laundering Anti-Bribery Anti-Slavery Tax Strategy Statement Modern Slavery Act

5. LIMITATIONS AND FUTURE RESEARCH DIRECTIONS

This report has examined the corporate governance arrangements of large family firms registered in the UK. As part of the project, an up-to-date database of large UK family firms among the largest 1,000 UK companies (as measured by turnover) was created. This includes key information about firm ownership, corporate governance arrangements, and further data concerning strategy and performance.

The report has provided an overview of the population of large UK family firms and evidence concerning two broad areas of inquiry, namely family firms' representation among the top 1,000 UK companies (by turnover), and the corporate governance arrangements of the largest UK family firms.

The investigation has a number of limitations that point to opportunities for future research.

First, board independence from family owners and shareholders was examined according to several relevant dimensions. However, most family firms do not state the independence of their directors explicitly in public records or websites. If the lack of reporting continues in the future, we suggest collecting further data about board independence, not only through secondary research. In particular, given the complexity of addressing board independence beyond directly observable board members' characteristics (e.g., family members, shareholders, etc.), collecting further data about board independence through primary research offers a promising focus for future research.

Second, around six out of ten UK large family firms do not report the adoption of any governance codes. This suggests that the lack of standards and guidance from the UK legislative body in this regard might be a major issue. For companies, the lack of standardised guidelines creates difficulties in reporting information about compliance with governance codes. For researchers, this means that there is a lack of useful information that might help understanding of family firms' compliance and reporting behaviour. In fact, the current lack of standards and guidelines makes it virtually impossible to distinguish between lack of compliance versus lack of reporting.

Our results confirm that, without standards and guidance from the UK legislative body in this regard, obtaining accurate data on compliance with corporate governance codes may only be possible through further primary research, that is through the use of surveys. The lack of reporting is something which should change after the introduction of a statutory requirement for large companies to report on their corporate governance arrangements (The Companies (Miscellaneous Reporting) Regulations 2018). This is accompanied by the publication of standardised guidelines for large private firms – the recently launched Wates Corporate Governance Principles for Large Private Companies in December 2018 (FRC, 2018). This offers a promising focus for future research that could study the determinants and the extensiveness of the adoption of governance codes and frameworks, and their effects on firms' governance practices and disclosure (including the reasons for non-compliance and independence of the Board members) to contribute to the extensive literature on this topic (for a recent review see Cuomo, Mallin and Zattoni, 2016).

Third, our results show a considerable amount of change in family firms' rankings among the top 1,000 UK companies (by turnover). The systematic study of the causes driving these changes offers a promising focus for future research.

Fourth, this study has some limitations. In line with the approach taken in Repgraph (2016), this study takes a firm-level unit of analysis, thereby providing separate information about individual companies even when those companies are related by cross-shareholding structures (i.e., business groups). Due to the initial research design we adopted, analysis at the business group level was not possible, as those business groups often extend well beyond the top 1,000 companies by turnover considered in this study. However, the database created as part of this project provides detailed information about such relationships, which makes it possible to track the links between individual companies and their common ultimate owner, and whether each company is a subsidiary, parent, or parent and ultimate owner.

In addition, in line with the approach taken in Repgraph (2016), this study used consolidated or unconsolidated data. Future studies could further investigate governance issues by using a different research design, with the aim to shift the attention from firm-level to business group level. For example, exploring potential differences in corporate governance arrangements and practices between parent companies and subsidiaries within a family business group is a promising avenue for future research.

Finally, we believe that it is important to extend the analysis reported here to the top 2,000 companies and recommend updating the database of large UK family firms among the largest UK companies annually.

ENDNOTES

[1] Edelman Trust Barometer: Special Report on Family Business. 2017. https://www.edelman.com/research/family-business-trust
[2] FRC (2018) The Wates Corporate Governance Principles for Large Private Companies. Available at: www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf
[3] See the full list of variables in the Methodology section.
[4] Institute for Family Business (IFB) 2016 UK Large Family Business Report (https://www.ifb.org.uk/media/1963/uk-large-family-business-report-2016-website-final.pdf)
[5] See the methods section for further details concerning the identification of family ties.
[6] The UK Corporate Governance Code is published by the Financial Reporting Council. The latest version of the Code is available at: https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code. For recent developments, see also: https://uk.reuters.com/article/uk-britain-accounts/private-firms-in-britain-to-comply-with-first-governance-code-idUKKBN1O900C
[7] See https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8143#fullreport
[8] Oxford Economics (2018).
[9] Kotlar, Signori, De Massis, and Vismara (2018).
[10] See, for example, Carney (2005), and Zattoni, Gnan, and Huse (2015).
[11] Please note that we define "UK companies" as all companies registered and based in the UK, regardless of the nationality of their ultimate owner.
[12] https://ec.europa.eu/growth/smes/promoting-entrepreneurship/we-work-for/family-business_en
[13] For example, see Cannella Jones, and Withers (2015) and Kotlar, Signori, De Massis, and Vismara (2018).
[14] Cannella, Jones, and Withers (2015).
[15] First, ownership data were retrieved from the online version of the FAME database on 20 June 2018. Turnover and other financial data are based on the latest available data in 2017 or 2016. Companies with no turnover data available in 2017 or 2016 were excluded from the study. Then, ownership and governance data on 20 June 2018 not available in FAME were collected between 15th July 2018 and 15th August 2018 from several other sources (see the Methodology section for more details about these sources).
[16] For the purpose of the present study, we consider only companies with turnover data available for the year 2017 or 2016. In order to develop the ranking of large UK family firms, we used the latest data available, whereas family firms with no turnover reported in 2016 or 2017 were excluded from the list. Further information about companies excluded from the 2018 ranking is available from the authors upon request.
[17] Available from IFB Research Foundation upon request.
[18] Data were also collected for these other key variables: asset turnover, industry, number of companies in corporate, firm age and number of employees, financial ratios (ROA, ROI, RO shareholder funds, Tobin's Q, profit margin, EBIT), interest cover, stock turnover, ratio between cost of goods sold and average inventory, debtors' turnover and collection, creditors' collection, liquidity ratios and R&D expenses.
[19] This study focuses on individual firms; hence, the list includes companies as separate entities even if they are linked by cross-shareholdings or pyramidal ownership structures (i.e., business groups).
[20] Three companies were not included in the study because they did not disclose turnover data in 2017 or 2016, as they disclosed their accounting data after the data collection in July 2018. By including them, the turnover threshold defining the top 1,000 UK firms would be £921m.
[21] Available from IFBRF upon request.
[22] Among the 22 FGEs identified in our list, four belong to the same business group.
[23] A detailed summary of these changes is available from the authors upon request.
[24] Hillman and Dalziel (2003).
[25] For example, see Gersick and Feliu (2014).
[26] Cuadrado-Ballesteros, Rodríguez-Ariza, and García-Sánchez (2015).
[27] Information about board size was not available for one company, which was excluded from this analysis.

[28] Wilson, Wright, and Scholes (2013).
[29] For a review on gender issues in family firm governance, see Martinez Jimenez (2009) and Campopiano, De Massis, Rinaldi, and Sciascia (2017).
[30] Arzubiaga, Iturralde, Maseda, and Kotlar (2018).
[31] Wilson, Wright, and Scholes (2013).
[32] Vinnicombe, Doldor, Sealy, Pryce, and Turner (2018).
[33] Wilson, Wright, and Scholes (2013).
[34] Zattoni and Cuomo (2010).
[35] Ryan Jr and Wiggins III (2004).
[36] Ryan Jr and Wiggins III (2004).
[37] This information was available only for 35 family firms, including all the 28 family firms that are currently listed on stock markets, two family firms that were previously listed but are not anymore, and five private family firms.
[38] Wilson, Wright, and Scholes (2013).
[39] As indicated in the methods section, our data may underestimate the level of family involvement due to the identification of family ties based on individuals sharing the same family name. However, the comparison with Wilson, Wright, and Scholes (2013) is appropriate as the two studies adopt the same definition and operationalization approach.
[40] See Krause, Semadeni, and Cannella Jr (2014).
[41] See Voordeckers, Van Gils, and Van den Heuvel (2007).
[42] Bammens, Voordeckers, and Van Gils (2011).
[43] Due to the limited number of observations, this information should be interpreted with caution.
[44] Wilson, Wright, and Scholes (2013).
[45] Anderson and Reeb (2004).
[46] Such as the Code Buysse (2009).
[47] For updated national and international codes, guidance, and legislation that takes into account the latest legal and policy changes, see Mallin (2018).
[48] A summary of the UK's recent Corporate Governance Reforms can be found here: https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8143#fullreport/
[49] The Wates Corporate Governance Principles for Large Private Companies is a new corporate governance code for all companies that do not have an existing corporate governance reporting requirement and satisfy either or both of the following conditions: (1) they have more than 2000 employees; (2) they have a turnover of more than £200 million and a balance sheet of more than £2 billion. This new reporting requirement will apply to the financial years beginning 1 January 2019 with reporting to start in 2020. Available at: https://www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf. See also https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8143#fullreport
[50] Except publicly listed companies that must adopt specific governance codes, if required by the stock exchange market.
[51] For a recent review of these studies, see Cuomo, Zattoni and Mallin (2016).
[52] On the one hand, several studies find that family-owned firms are less likely to comply with voluntary recommendations than non-family firms (e.g., see Arcot, Bruno, and Faure-Grimaud, 2010 for the UK; Zeidan, 2014 for Brazil). On the other hand, the results of a recent study by Kabbach de Castro, Aguilera, and Crespí-Cladera (2017) show an inverted U-shaped effect of family ownership on non-compliance of the largest firms by market capitalization listed in the United Kingdom, Germany, and Spain. In particular, this study finds that while the family influence and control dimensions lead to high levels of non-compliance, image and reputation dimensions lessen the level of non-compliance.

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