



CLARKSON
Centre for Board Effectiveness



**The Impact of Family Control on the Share
Price Performance of Large Canadian
Publicly-Listed Firms (1998-2012)**

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1. Executive Summary

Over the past 15 years, corporations have faced unprecedented scrutiny of their governance models and practices. Many high-profile organizations, including the Clarkson Centre for Board Effectiveness (CCBE), consider director independence and shareholder democracy to be among the most important components of good governance. Family-controlled public issuers often do not conform to typical governance expectations, and as such tend to be discounted from discussions about the best-governed firms. Nonetheless, family-control continues to be a common corporate structure in Canada, and perhaps one with very different realities from the widely-held norm.

Our goal for this study was to observe the performance of Canada's largest family-controlled issuers over the past 20 years compared to their non-family counterparts. Our analysis also took into consideration the governance structures adopted by family-controlled firms in order to examine which, if any, practices may be associated with better performance over time. What we found was that Canadian family-controlled issuers have outperformed their peers between 1998 and 2012. Moreover, family firms often appear best able to create value for their shareholders when they choose not to adhere to typical best practices in share structure and independence.

2. Methodology

The Clarkson Centre for Board Effectiveness (CCBE) measured the performance of large Canadian publicly traded family-controlled issuers from 1998-2012. We captured share price performance 435 firms that were listed on the S&P/TSX Composite Index (TSX Index) for all or part of the period between 2002 and 2012.

The CCBE defines a controlled firm as one where an individual or organization holds 30% or greater voting power. We deemed an issuer to be *family* controlled if at least 30% voting control was held by a family member or group that has either: a) experienced one or more events of generational turnover or; b) family member(s) are in a clear position to succeed to the next family generation. Throughout this report, we will refer to these family-controlled issuers as Family Firms. Public issuers under the corporate umbrella of a Family Firm (i.e. publicly-traded subsidiaries) were not included in the Family Index. For instance, George Weston Limited is included and Loblaw Companies Limited is not. Using these criteria, we classified 23 of the 435 corporations in our sample as family-controlled. Throughout this report, we will refer to these 23 issuers collectively as The Clarkson Family Firm Index (CFFI).

Share price performance was measured by calculating compound annual growth rate (CAGR). CAGR expresses the annual return to investors over a given period of time. Dividends were

included in the calculation by calculating the average dividend yield over the observation period and adding it to CAGR.

The primary focus of this report is on Family Index share price growth over the last 15 years (1998-2012). This is the longest time period where all 23 Family Index can be observed and compared with Non-Family firms. 15 years is also a sufficiently long observation period to meaningfully analyze performance trends in short- and long-term periods. In Section 7.2 below we have also observed performance over 20 years (1993 to 2012), including only 21 CFFI constituents.

Compound Annual Growth Rate (CAGR) Calculation:

$$\left\{ \frac{\text{End 30 - day average share price (s)}}{\text{Start 30 - day average share price (s)}} \right\}^{1/\# \text{ of Years}} - 1 + \left\{ \frac{\text{Sum Annual Dividend Yields}}{\# \text{ of Years}} \right\} \\ = \text{CAGR}$$

3. Benefits and Disadvantages of Family Firms

In our review of academic and management literature we found three important characteristics, common among Family Firms, that are beneficial to long-term shareholders:

- **Commitment to Principles** – Family members are typically committed to the principles under which the firm operates. It is often as if they are taking on an identity which embodies the values of the founding family. This helps to create a unified and productive culture.
- **Long-Term View** – Minority shareholders of family firms are well aware of the risks associated with the family’s concentration of voting control. The controlling family could make business decisions (e.g. with respect to M&A) that may not be in the best interests of minority shareholders if they are the best way to preserve and grow family wealth. However, Family Firms with a plan for family succession tend to focus on the sustainability of the firm for future generations and choose long-term strategy over short-term gains.
- **Ability to Change** – Family Firms are more willing to adopt new strategies quickly compared to widely-held firms. This agility allows Family Firms to take advantage of new opportunities for long-term success, and to mitigate possible risks from changing markets in order to maintain long-term firm viability.

70% of issuers in the CFFI are family managed (i.e. a family member is the CEO). Family member CEO tenure at Family Firms tends to be significantly longer (15.6 years) than that of non-family member CEOs (8.1 years) (Westhead, Cowling & Howorth 2001). According to Kets Devries (1993), family management enables family firms to take a longer-term perspective on strategy.

4. Literature review

Family firms are the most prevalent business and ownership structure in the world (La Porta, et al., 1999). The owners of many Family Firms are also the managers, thus eliminating a gap that presents exists for many widely-held firms and creating important efficiencies (Morck et al., 1988). These efficiencies are not measured in most governance ratings. Governance ranking systems are typically designed in such a way that all firms are held to the same governance best practice standards, and are often very harsh on dual-class share structures where a voting imbalance exists – a common feature of the CFFI.

Empirical evidence has shown that Family Firms outperform their widely held counterparts globally. Family Firms achieve performance advantages whether performance is measured financially or through perceived measures of performance (Daily, Dollinger 1993). S&P 500 Family Firms outperformed non-family firms according to Anderson and Reeb (2003).

We found conflicting evidence that concluded that Family Firms were inherently inefficient (Dyer, 2006). Levinson (1971) found that Family Firms tend to make ineffective recruitment decisions, and concluded that the best course of action was to replace family members in leadership positions with external managers with greater skills and objectivity.

In Sweden (Bjuggren, Palmberg, 2010) and more recently in the U.S. (ISS, 2012), research has shown that Family Firms with aligned ownership and control are significantly more profitable or have higher share price performance than Family Firms with misaligned ownership and control.¹ This suggests that family control has no significant positive effect on investment performance if it is not aligned with equity ownership. Multi-class share structures can enable a family or group to have voting control over a corporation without the need to own the equivalent level of equity in the firm. For instance, The Keevil family owns 2% of the Teck Corporation equity, but controls 29% of the votes.

Multi-class share structures are prevalent in the U.S. (ISS, 2012), as founders look to retain control of their firm when they go public. Similarly, the CCBE found that 18 firms in the CFFI have a multi-class share structure, often allowing for an imbalance between shares and votes. Multi-class share structures with imbalanced voting allow the controlling family to control the firm with relatively small economic risk. Nonetheless, minority shareholders have historically been willing to forego voting control for the opportunity to invest in a firm that otherwise would not have been available to outsiders. Leslie E. Shaw, ShawCor founding family member, believes dual class structures have also protected Canadian public firms from foreign control (Pitts, 2002).²

¹ Control is defined as the voting power carried by the equity the family holds in the firm. Aligned ownership and control exists when voting power and equity owned are the same, or similar.

Singal and Singal (2011) found that concentrated ownership has a positive impact on financial performance, whether controlled by a family or not. In other words, it is the concentration of control, regardless of family involvement, that makes the difference. However, not all family firms outperform to the same degree, Bjuggren and Palmberg (2010) found firm performance in to be higher when there is a close alignment between control and economic risk (i.e. when there is closer alignment between votes and shares).

Psychological effects that are unique to family firms can impact firm performance. For example, family members' identities are often associated with their firm's products/services. (Kets De Vries, 1993). Defective or inferior products/services can be a negative reflection of the family identity. Therefore, compared to outside managers, family members are more sensitive to risks that might affect their personal reputation. Conversely, the long-term commitment and desire to carry on a legacy by the controlling family can positively impact long-term firm performance. In order to optimize the effectiveness of this long-view, Kets De Vries (1993) argues that an independent-minded board is needed, as well as the employment of professional advisors, due to the need for the family to maintain a separation between business and personal lives when guiding a publicly-traded issuer.

CCBE found no academic research that has specifically looked at long-term large public Canadian family controlled firm performance within the last 10 to 15-years. North American research has been largely focused on family firms in the U.S. on the S&P 500 firms (ISS, 2012, Anderson & Reeb, 2006). In this report, CCBE's insights are focused on the performance trends of the Family Index.

5. Family Firm Governance

By investing in controlled corporations, minority shareholders concede control to the controlling shareholder, whose experience, knowledge and drive to succeed have been integral to the success of the firm. Shareholders benefit from the controlling shareholder's long-term perspective on strategy (Kets De Vries, 1993). Among the CFFI, the controlling shareholder is typically the founder of the company, and they are relied on for their passion, knowledge and expertise. Because of their significant equity stake in the corporation, the controlling shareholder's personal wealth is closely tied to the corporation's share performance.

Family firm governance structures are often different from Non-Family firms, generally in ways that assist the Family to maintain control and direction of the firm. In many cases, this involves an imbalance of voting rights and a lower proportion of independence on the board of directors; two factors that are heavily scrutinized and criticized in Canada by governing bodies (e.g. TSX, OSC) and ratings systems (e.g. CCBE's *Board Shareholder Confidence Index* and Globe & Mail's *Board Games*). The CCBE has annually published the *Board Shareholder Confidence Index* (BSCI) since 2002, which measures the adoption of best practices in corporate governance by firms listed on the TSX Index. BSCI criteria are developed with input from Canadian institutional investors, and reflect their governance values. In 2012, the average BSCI score for the Family

Index was 42/100 compared to 60/100 for Non-Family firms, a difference that was primarily a result of differences in share structure and director independence.

In 2010, the Canadian Coalition for Good Governance (CCGG) developed a set of guidelines to help ensure that the board of a public company is knowledgeable, experienced, engaged with shareholders, and accountable and independent. This was later followed by a CCGG policy published in 2011 on the governance differences of controlled corporations. In this document the CCGG acknowledges that controlling shareholders should have substantial influence over strategy, director elections, executive appointments and compensation. This influence can be highly valuable to firm performance. CCGG also recommends, however, that board representation by the controlling shareholder should be proportional to equity holdings. These guidelines also cover shareholder democracy, board composition, succession planning and CEO/Chair duality (Canadian Coalition for Good Governance, 2011). While Family Firm governance may not measure up in to Non-Family firms in typical governance ratings, CCGG's guidelines are an important indication that Canadian institutions are beginning to understand the governance realities facing Family Firms.

5.1 Shareholder Democracy at Family Firms

Most minority shareholders of Family Firms rely on the controlling family to make strategic decisions that will increase the value of their ownership. CCBE has observed trends among the CFFI that enable the controlling family to maintain control of voting decisions such as director elections. For example, 67% of Non-Family firms had a majority voting policy compared to 43% of the Family Index. In addition, 34% of Family Index firms used a slate voting policy compared to 5% of Non-Family firms.³ These discrepancies can at least in part be attributed to the fact that 18 of the 23 CFFI firms have dual class share structures with imbalanced voting, rendering majority voting policies essentially moot.

5.2 Board Independence

Board independence is typically lower for Family Firms than Non-Family firms. According to the CCBE's 2012 *Board Shareholder Confidence Index* (BSCI), 71% of Non-Family firms on the TSX Index in 2012 had a board composed of two-thirds or greater of independent directors compared to 39% of the CFFI. However, most CFFI boards still comprise a majority of independent directors; only one had less than 50% board independence.

Family Firms generally have lower committee independence as well. According to the 2012 BSCI scores, for Audit, Compensation/HR, and Nominating committee independence, 87%, 70% and 87% of Family Firms, respectively had best practice level independence compared to 90%, 81% and 96% respectively for Non-Family firms. Audit committees must abide by more strict regulatory requirements regarding independence than the other key board committees, and it is with these other committees that we see a larger gap between the CFFI and the rest of the TSX Index.

³ As of 2013, slate voting is prohibited by the TSX

5.3 CEO/Chair Split

Most Non-Family firms listed on the TSX Index have split the CEO and Board Chair roles while most CFFI firms have not. This is an important distinction because publicly-traded issuers tend to adopt more governance best practices when there is an independent Chair of the board (Clare, 2009). According to the 2012 BSCI, 56% of Non-Family firms have an independent Chair, compared to 17% of the CFFI. However, 28% of CFFI boards have appointed a Lead Independent Director to assist with making decisions independently from management influence in cases where the Chair is non-independent. If the CEO and Chair roles are not split, there is a risk that the lines between management and the board will blur, making it challenging to provide effective oversight of the firm without management influence.

5.4 Succession Planning

Management succession planning can be somewhat simpler for family-managed firms than their Non-Family counterparts. If a family member has been chosen as a successor, she/he can be groomed through increasingly senior positions in order to be fully prepared to assume her/his leadership role. A Family member that is being groomed for succession may also sit on the board, sometimes at a much younger age than other board members, as they are groomed for succession. Lino Saputo Jr., for instance, began as an Administrative Assistant at Saputo Inc. 11 years prior to becoming the President and CEO. There are other similar examples on the CFFI. According to the 2012 BSCI, however, only 43% of Family Firms and 42% Non-Family firms disclosed a formal succession plan to shareholders in their 2012 Management Information Circular. Succession planning is a challenge at all types of firms and if there is no formal succession process the board may not be adequately prepared for a succession event, even if an ideal successor has been identified.

6. Unusual Market Conditions

CCBE studied the performance of Family Firms during the period from 1998 to 2012. Within this timeframe, there were several important economic events, including 5 that had significant negative impacts on the market performance of the TSX Index as a whole:

- Dot-Com bubble burst 2000
- U.S. Recession 2001; recessionary periods in Canada
- 9/11 Terrorist Attacks on the World Trade Center Towers in 2001
- Financial Crisis 2008
- Global Recession 2008-2009

Out of these events, the Financial Crisis of 2007-2008 had the most dramatic impact on financial markets. The Toronto Stock Exchange (TSX) rebounded quickly in 2009 with 31% gains (CBC News, 2009), but the 35% loss (The Canadian Press, 2009) in the previous year was one of the worst years on record.

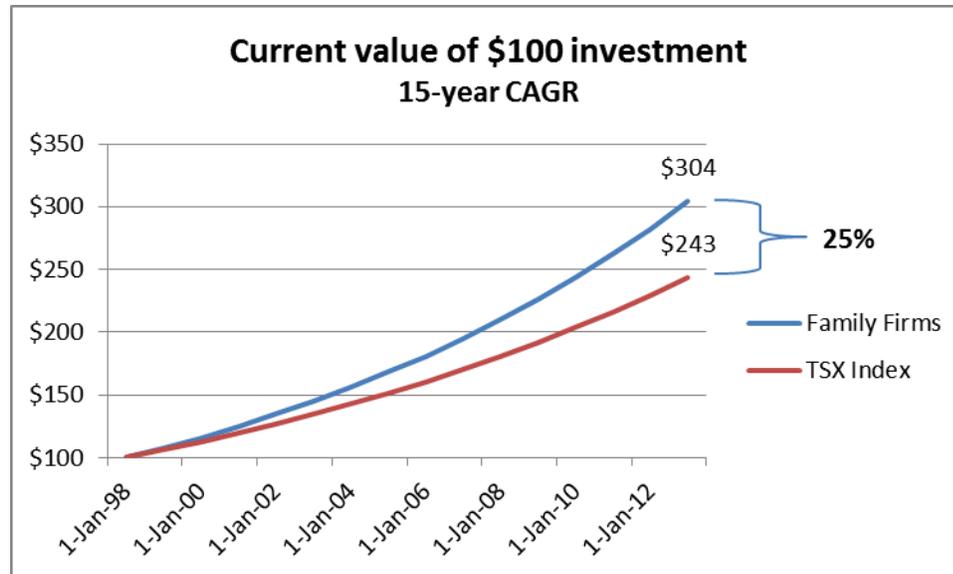
The Financial Crisis, followed by the Global Recession, significantly impacted share prices in 2008-2009. The 435 issuers in our sample lost, on average, about one-third of their share value.

7. Family Index Performance

As described above under *Benefits and Disadvantages of Family Firms*, most Family Firms have longer-term strategic outlooks and longer CEO tenure than their widely-held Non-Family counterparts. This tendency is driven, in part, by the need to protect family wealth for future generations. However this long-term focus does not preclude the ability to exploit short-term opportunities. Some studies have suggested that Family firms are more resilient than widely-held firms and have greater flexibility to respond rapidly to market uncertainty or take advantage of new opportunities more quickly (Allaire, 2010).

Financial markets have been highly volatile since 2000 as the markets have experienced two significant downturns in a relatively short time span. This is a sharp contrast to the 1990s, when many issuers on the TSX Index experienced reliable growth. While share performance during 2008-2012 indicates how well share prices have performed during these adverse market conditions, they may not be characteristic of the publicly-listed firms' longer term performance. The 15-year long-term period beginning 1998 gives us a clearer indication of how TSX Index share price growth has been affected by market conditions in the 2000s while 'smoothing out' their short-term effects on share price.

From 1998 to 2012, the CFFI outperformed its Non-Family counterparts. Over 15 years, The Family Index posted 7.7% CAGR compared to 6.1% for the rest of the TSX Index, resulting in a 25% difference in returns over 15 years. This strong performance is particularly striking in the wake of the Financial Crisis. Since 2010, CAGR for the CFFI was 10.4% compared to 7.8% for Non-Family issuers. Investors in Canadian Family Firms have achieved significant gains despite significant market turmoil in the wake of the Financial Crisis.



Although the gaps in CAGR between two groups may appear small, even minor variance can make large differences in realized investment over time. For instance, the small difference between Family and Non-Family firm average CAGR in the 10-year period from 2003 to 2012 (7.63% and 7.13% respectively), yielded significantly different investment results. An investment of \$100 in the CFFI in 2003 would have been worth \$208.61 at the end of 2012, compared to \$199.12 for the same investment in Non-Family firms, a difference of nearly 5%.

Academic and practical research has shown that controlled firms in Sweden and the U.S. with aligned control and ownership significantly outperform those with a voting imbalance.⁴ In other words, family control did not, on its own, drive strong performance; a balance of voting and equity was also necessary. CCBE's data, however, suggests a different trend among large Canadian issuers.

Looking at the CFFI, firms with a voting imbalance outperformed Non-Family firms over 15 years with 8.8% CAGR and 6.1% CAGR respectively. Furthermore, we found that CFFI firms with a voting imbalance also outperform CFFI firms with balanced voting control, which had an average 15-year CAGR of 5.1%.⁵ We have provided a breakdown of CFFI performance broken down by voting control and management type below in Table 1. Clearly, CCBE's findings for the CFFI show that the performance of Family Firms is notably better than their Non-Family counterparts, contrary to similar studies that have focused on U.S. and other issuers.

⁴ A voting imbalance exists, typically through a multi-class capital structure, when the Family controls more votes than shares owned in the firm. This can be achieved through enhanced voting rights with a super-voting share class or when the widely-held share class is non-voting.

⁵ There are 5 issuers on the CFFI with no voting imbalance.

Table 1

Control Type	CAGR - 15 Years (1998-2012)	CAGR - Post Financial Crisis (2010-2012)
Family Index – All	7.70%	10.37%
All Non-Family Firms	6.11%	8.24%
Family Index – Externally Managed	7.14%	7.25%
Family Index - Family Managed	8.02%	12.20%
Family Index – Voting Imbalance	8.82%	10.08%
Family Index – No Voting Imbalance	5.08%	11.20%
Widely-Held Non-Family Firms	6.60%	8.79%
Controlled, Non-Family Firms ⁶	4.71%	4.25%

Bjuggren and Palmberg (2010) found that family ownership and control alignment had a significant and positive effect on firm performance compared to family control alone. Similarly, a report by ISS published in 2012 showed that U.S. firms Family Firms with a single class share structure materially outperformed widely-held firms over 10 years ended 2012 while multi-class underperformed. Our findings on the CFFI clearly run counter to U.S. research. CFFI share prices have outperformed widely-held firms over 15 years and have also rebounded robustly following the Financial Crisis.

Singal and Singal (2011) found no significant performance difference between Family Firms and other controlled corporations. They found that Firms controlled by a family, group of unrelated individuals, or an organization outperform widely held firms. We found a significant gap between the CFFI and controlled, non-family firms, as per Table 1 above. This suggests that the type of control matters and that *family* control may be a key driver of performance in Canada.

Since 1998, family managed CFFI issuers have outperformed externally managed Family Firms, as well as widely-held issuers. Since the Financial Crisis, the discrepancy has been much larger. In fact, since 2008 externally managed Family Firms underperformed not only compared to the average CFFI firm, but also compared to Non-Family firms. The combination of family control and family management has been the most successful control structure on the TSX Index over the past 15 years. This suggests that, far from being a barrier to performance, family control may be a highly successful model for creating and protecting shareholder value.

⁶ Fairfax Financial (FFH) has a disproportionate impact on the figures for the Controlled, Non-Family sample due to its very high share price. If we exclude FFH from the bottom row of Table 1, the figures for Controlled, Non-Family are as follows – 15-year: 7.81%, Post Financial Crisis: 4.07%.

7.2 20-year performance

CCBE observed performance of the CFFI for 20 years, and found that the performance gap between the CFFI and non-families was even greater than during our 15-year observation (see Table 2).

Table 2

Control Type	CAGR - 20 Years (1993-2012)	CAGR - 15 Years (1998-2012)
Family Index – All	10.58% (n=21)	7.70% (n=23)
All Non-Family Firms	8.47% (n=122)	6.11% (n=194)

During this longer observation, the CFFI shrinks from 23 to 21 issuers, because Maple Leaf Foods and Saputo Inc. were not yet publicly traded at the beginning of the 20-year period starting 1993. The size of the non-family sample also decreased from 194 issuers to 122 issuers due to a lack of historical data for 72 firms. We acknowledge these differences because, as a result, the 20-year observation is not directly comparable to the larger 15-year observation discussed above.

8. Conclusion

Between governance ratings and academic literature, family-controlled issuers often get very little credit for the unique value they provide to Canadian markets. The CCBE's own *Board Shareholder Confidence Index* (BSCI) strongly penalizes most Family Firms for having multiple share classes and a voting imbalance because of the possibility for significant control without significant risk. We undertook this study in an effort to look beyond these perceptions and compare the actual performance of the CFFI compared to its Non-Family counterparts, and found that Canada's Family Firms have, in fact, created tremendous value to their shareholders.

The study above shows that Canadian family-controlled issuers have performed better than their peers over the past 15 years, greatly benefitting minority shareholders. This trend runs counter to academic findings in other countries, where an aligned ownership and control structure has been linked to positive and significant performance compared to Non-Family firms.

We also found that the CFFI outperformed other, Non-Family, controlled issuers. This is contrary to academic literature, which has found no significant performance difference between Family Firms and other controlled firms in the United States. Family management also appears to have a positive impact on performance, as issuers under family control *and* management were the best performers of all.

These findings may not be sufficient to change common opinions about the governance of Family Firms. However, the performance gap between the CFFI and the TSX Index suggests that family-controlled issuers are benefitting from their longer-term outlook, and perhaps also from their unique governance structure. By striving to create and protect value for their families, the CFFI has also created significant value for its minority shareholders.

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