

# **Can Independent Directors Facilitate Strategic Change in Family Firms? Former Family CEO Director vs. Agent CEO**

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## **Abstract**

As family CEOs approach retirement, they may emphasize legacy preservation, and this behavior may persist even after they retain seats on their boards. When new agent CEOs are appointed to lead strategic changes in family firms, former family CEO directors may resist the changes initiated by the agent CEOs. Independent directors, motivated by a desire to build their reputations as experts in decision-making and governance within the director market, may prioritize protecting shareholder interests. This study explores whether and how independent directors influence strategic change in family firms when the former CEO director is a family member and the new CEO is an agent CEO. Empirical results, based on a sample of electronics firms listed on the Taiwan Stock Exchange, support the proposed hypotheses. This study contributes to the literature on family business and corporate governance.

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## Extended Abstract

To survive and sustain competitive advantages in today's highly dynamic environment, firms must be able to identify changes in the external environment and quickly adjust by either committing or halting resource investments in response to these changes (Bednar & Brown, 2024). Family firms, which contribute significantly to the majority of global GDP, are no exception. However, only about 30% of family firms survive to the second generation, and fewer than 15% survive to the third generation or beyond. Researchers suggest that the low survival rates are partly due to the intention of family chief executive officers (CEOs) to preserve past legacies, which can hinder necessary change (Sievinen, Ikäheimonen, & Pihkala, 2020).

Choosing an outsider as CEO (i.e., agent CEO) can be an effective strategy to help family firms overcome inertia, as the agent CEO can bring in new knowledge, build connections, and gain access to external resources (Sun, Huang, & Su, 2023). Nevertheless, in many family firms, family members often serve as CEOs and may remain on the board after stepping down as CEOs (Querbach, Bird, Kraft, & Kammerlander, 2020). The differing motivations and cognitive frames between former family CEO directors and agent CEOs can lead to strategic tension, complicating the strategic decision-making process and limiting the agent CEOs' discretion to implement changes (Cummings, Eggers, & Wang, 2022).

Independent directors, who have no affiliation with the family firm other than their directorships and have a desire to build their reputations as experts in decision-making and governance within the director market, may counter the legacy-preservation motives of former family CEO directors when it comes to strategic change initiated by agent CEOs. A higher proportion of independent directors can provide the psychological safety necessary for them to rely on the support of their peers (Frazier, Fainshmidt, Klinger, Pezeshkan, & Vracheva, 2017). This psychological safety and support from other independent directors encourage independent directors to express their opinions, either individually or collectively, on the strategic direction of the family firm (Cummings, Eggers, & Wang, 2022). Additionally, independent directors' industry-specific experience can help them acquire timely information and relevant skills (Piaskowska, Trojanowski, Tharyan, & Ray, 2022), thus enhancing their ability to counterbalance the legacy-preservation efforts of former family CEO directors. The resistance to legacy-preservation is most significant when the former CEO director is a family member, and the new CEO is an agent CEO. Taken all together, this study explores whether independent director ratio and independent directors' industry-specific experience influence strategic change in family firms when the former CEO director is a family member and the new CEO is an agent CEO.

This study uses a dataset of electronics firms listed on the Taiwan Stock Exchange and focuses specifically on family firms. Family firms are defined as those with more than 5% family shareholdings and at least one family member serving as a board member (Patel & Cooper, 2014). To conduct the regression analysis, several control variables are included in addition to the dependent variable (i.e., strategic change) and the independent variable (i.e., the presence of a former family CEO serving as a director). Consistent with prior research, the control variables include firm size, firm performance, firm age, ownership, TMT size, and

board size (Zhang & Rajagopalan, 2010; Zhao, Carney, Zhang, & Zhu, 2020; Cummings, Eggers, & Wang, 2022). A pooled regression is employed with a one-year lag between the dependent and independent variables to mitigate potential endogeneity (Lee & O'Neill, 2003) and to account for the time required for strategic change efforts to materialize. The regression results suggest that independent directors can help mitigate the legacy-preservation resistance of former family CEO directors to strategic change initiated by agent CEOs.

This study provides some research contributions to the literature on family firms and corporate governance. First, the central argument of this study is that independent directors may soften the former family CEO director's personal legacy-preservation efforts, enabling the agent CEO to initiate necessary change for family firms. Using family firms to test this argument enriches our understanding of the interactions among new CEOs, former CEO directors, and independent directors within family firms. Second, by considering both motivation and ability, this study examines the effects of independent director ratio and independent directors' industry-specific experience on strategic change when the former CEO director is a family member and the new CEO is an agent CEO. Therefore, this study provides a holistic picture of why and how independent directors can monitor and facilitate strategic change.

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