THE POWER OF DYNASTIC COMMITMENT

Laurent Bach
Nicolas Serrano-Velarde

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Laurent Bach[*]   Nicolas Serrano-Velarde[†]

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Abstract

We study how, at times of CEO transitions, the identity of the CEO successor shapes labor contracts within family firms. We propose an alternate view of how family management might underperform relative to external management in family firms. The idea developed in this paper is that, in contrast to external professionals, CEOs promoted from within the family not only inherit control of the firm but also inherit a set of implicit contracts that affects their ability to restructure the firm. Consistent with our dynastic commitment hypothesis, we find that family-promoted CEOs are associated with lower turnover of the workforce, lower wage renegotiation, and greater loyalty for the incumbent workforce.

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[*]Paris School of Economics and CREST
[†]Center for Business Taxation, Saïd Business School

1 Introduction

Recent empirical work has highlighted that inherited control in family firms is associated with lower firm performance, as compared to management by external professionals (Bennedsen, Nielsen, Perez-Gonzalez and Wolfenzon (2007); Perez-Gonzalez (2002); Villalonga and Amit (2002)). The underperformance of family-promoted CEOs with respect to external professionals is typically interpreted as "wasteful nepotism" (Bertrand and Schoar, 2006) and "a failure of meritocracy"(Caselli and Gennaioli, 2003).

The literature attributes the gap in firm performance to a lack of talented management in the family. Selecting managers solely among family members not only limits the pool of potential talent to run the firm, but it might also imply a lower quality pool of managers. This may be because family members might invest less in education because they know they will end up running the firm (Bloom and Van Reenen, 2007). Alternatively, unless managerial talent is perfectly correlated across generations, the firm will ultimately end up "in the wrong hands"(Caselli and Gennaioli, 2003).

We propose an alternate view of how family-promoted CEOs might underperform compared to external CEOs. We study how, at times of CEO transitions, the identity of the CEO successor shapes labor contracts within family firms. The basic idea developed in this paper is that, in contrast to external professionals, CEOs promoted from within the family not only inherit control of the firm, but also inherit a set of implicit contracts that affects their ability to restructure the firm. Such constraints are likely to be most acute immediately after a CEO transition takes place.

Why should family-promoted CEOs be bound by their predecessors' promises? First, because dynastic managers have a longer time horizon (Morck and Yeung, 2003). Second, because family-promoted successors are endowed with preferences similar to the incumbent CEO's, as argued by Shleifer and Summers (1987):

> "It is probably most likely that prospective managers are trained/or brought up to be commited to stakeholders. For example, in a family enterprise, offspring could be raised to believe in the company's paternalism towards all the parties involved in its operation."

Using a unique dataset of French CEO successions together with matched

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employer-employee information, we test whether management practices of family promoted CEOs are consistent with the persistence of implicit contracts across generations of family CEOs. We first investigate the dynastic commitment hypothesis using a differences in differences approach, and we show that the simple differences in differences estimates obtained are robust to a variety of potential confounding factors. We then take into account the potential endogeneity of the transition decision by instrumenting for dynastic preferences.

Contrary to Perez-Gonzalez (2005), we find that external CEOs are associated with a higher turnover of the workforce, as compared to family-promoted CEOs. However, consistent with our dynastic commitment hypothesis, the higher turnover in non-dynastic firms is also associated with greater wage renegotiation for both the incumbent and the arriving workforce. Indeed, since the firm offers a joint product relative to employment and financial intermediation, it will need to compensate workers for the greater termination risk faced after renegotiation by external CEOs (Bailly, 1974). Finally, we show that family management is also associated with greater loyalty towards the incumbent workforce: family promoted CEOs rely more on internal promotion of the management workforce and less on the hiring of external managers.

This paper contributes to the literature on the performance of heir-managed firms. We highlight an alternate view of how dynastic transitions might underperform non-dynastic ones. Contrary to Perez-Gonzalez (2005), Bennedsen et al.(2007) and Caselli and Gennaioli (2003), we show that commitment rather than talent might have an impact on family firm performance following a CEO transition. Our paper also contributes to the emerging literature on the distinct features of family management. Our results are consistent with the argument of Sraer and Thesmar (2007) that heir-managed firms are more credible in building long-term relationships with their workforce, in particular by means of less turnover in exchange for lower wages. In the same line of argument, Mueller and Philippon (2008) find that dynastic firms are more numerous where labor relations are more conflictual, thus giving weight to the idea that those firms have some natural long-term credibility vis-à-vis the workforce.

2 Implicit Contracts With the Family

The idea that implicit contracts pervade between shareholders and stakeholders within the firm is well known (Shleifer and Summers, 1988; Kreps, 1990). Implicit contracts can serve to promote relationship-specific capital investment by stakeholders (Williamson, 1985), as an effort elicitation device (Lazear, 1979) or as a a risk sharing device (Harris and Holmstrom, 1982; Guiso et al., 2005). Generally, the ability to use such contracts depends on the stakeholders' ability to credibly commit to no ex-post renegotiation.

The identity of the CEO is likely to play an important role in whether or not implicit contracts are upheld (Shleifer and Summers, 1988; Akerlof, 1983). This is particularly true during times of CEO transitions in family firms, as the family has the choice between promoting a family member or an external manager to the position of CEO. The basic idea developed in this paper is that, in contrast to external professionals, CEOs promoted from within the family are committed to upholding contracts signed under the previous family management.

Why should family-promoted CEOs be bound by their predecessors' promises? First, because dynastic managers have a longer time horizon. Morck and Yeung (2003) for instance argue that "professional CEO's careers are relatively brief. In contrast, family control endures, with patriarchs grooming scions, sometimes for decades." Second, because family-promoted successors are endowed with preferences similar to the incumbents CEO's. An example is given by Bertrand and Schoar (2003):

> In an interview with Wharton Alumni Magazine (Moffitt, 2000), Brian L. Roberts, current CEO of Comcast and son of Ralph J. Roberts, the founder of Comcast, reports going to work with his father as a teen and "learning the nuts and bolts of the cable business." His father had "his teenage son sit in on some of the significant deals in the making, positioning Brian at the back of the room and instructing him to quietly listen."

Finally, the idea that family promoted CEOs also inherit a set of contracts is consistent with evidence on persisting welfare paternalism in Europe and the US (Sraer and Thesmar, 2004; Mueller and Phillipon, 2009).

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However, such long-term contracts may also entail significant opportunity costs for the family promoted CEO. They deprive family management of the possibility of restructuring the firm according to changing economic environments (Shleifer and Summers, 1988). External CEOs, on the other hand, are less likely to be constrained by the previous management's promises. This leads to our first prediction:

Prediction 1: The transition from family management to external management will be associated with higher workforce turnover. The higher turnover will mainly affect long-tenured employees.

Breaking implicit contracts also entails costs for the external CEO. As argued by Bailly (1974), the firm offers a joint product relative to employment and financial intermediation. Consequently, the firm will have to compensate workers for the greater termination risk faced. This leads to our second prediction:

Prediction 2: The transition from family management to external management will be associated with an increase in wages for both the incumbent workforce and the newly hired workforce.

Family-promoted management, on the other hand, will be associated with a greater reliance on the internal workforce as opposed to external hirings. This is the case when family firms enjoy private benefits associated with employment relationships (Lippi and Schivardi, 2009).

Prediction 3: Family-promoted management will rely more on the internal promotion of the workforce and less on external hirings.

Our analysis focuses on higher layers of the firm. Managers are by definition the primary implementers of a CEO's "vision" (for a theoretical discussion of the relationship between CEOs and managers, see Landier et al. (2009)). Managers are therefore most likely to make firm-specific investments and are therefore those employees for which a change at the very top has potentially the biggest consequences (Bhagat et al., 1990).

3   Data Description

3.1   Data Sources and Variables

Our empirical analysis combines a unique dataset on French CEO transitions
and matched employer-employee datasets for the period from 1997 to 2002. As
in Bach (2008), we identify CEO transitions on the basis of CEO names available
in the DIANE dataset. For the period under study, we compare monthly issues of
DIANE in order to track the timing and the dynastic character of a succession.
DIANE covers 90% of French firms with more than 100 employees and 76%
of firms with 20 to 49 employees. Unfortunately, the data do not allow us to
distinguish between professional managers and sons-in-law.[1] Focusing on firms
which experienced a single CEO succession between 1997 and 2002, we obtain a
dataset of more than 20,000 observed successions, 20% of which could be identified
as dynastic transitions.

Firm characteristics are extracted from firm balance sheets compiled by the
French National Institute of Statistics. The accounting information available cov-
ers all French firms, regardless of ownership, whose annual sales exceed 100,000
Euros in the service sector and 200,000 Euros in other sectors. Above these
thresholds, firms are required to fill out a detailed balance sheet and profit state-
ment. Instead, smaller firms are subject to a simplified tax regime. The tax files
also include four-digit industry classification codes similar to the US SIC coding
system and unique firm identifiers that allow us to track firms over time.

Finally, we construct variables on the workforce of a firm based on employee
tax files also collected by the French National Institute of Statistics. This dataset
consists of mandatory employer reports of the gross earnings of each employee
subject to French payroll taxes, and is similar to the one used by Abowd, Kramarz
and Margolis (1999). It essentially covers all employed persons in the economy
and provides information about an individual's age, gender, occupation, total
net nominal earnings during the year, and hours worked. In addition, it contains
information about whether or not the individual began or left his employment at

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[1]For an in-depth discussion of the data and the problem posed by sons-in-law, refer to Bach
(2008).

the plant during the year. We aggregate data at the firm level so as to construct measures of management turnover, management promotions, wage raises, and skill and age composition.

We delete as outliers firm succession observations whose average OROA during the two years prior to the transition fall outside a multiple of five of the interquartile range. We also delete as outliers firm succession observations in terms of layoff, arrival, and wage raise ratios using the same procedure.

3.2 Descriptive Statistics

Table 1 provides descriptive statistics on firm balance sheet characteristics. On average, we find that firms experiencing dynastic successions are significantly smaller, both in terms of employment and sales, than firms experiencing transitions to external professionals. Dynastic successions occur in firms with a workforce half the size of non-dynastic ones, on average. This is in line with previous findings by Bennedsen et al. (2007) that indicate that dynastic firms in Denmark are four times smaller in terms of assets than non-dynastic ones.

Family firms experiencing a dynastic transition also do significantly better in terms of profitability. The average profitability of dynastic firms during the two years preceding the transition is 1.3 percentage points higher than the average profitability of non-dynastic firms. Such evidence is consistent with several explanations. It might hint at the endogeneity of the timing of the transmission decision (Bennedsen et al., 2007) or possibly at the existence of significant founder effects (Adams, Almeida and Ferreira, 2003). Finally, it could also be consistent with the more prudent growth path of family firms (Morck et al., 2000), since dynastic firms are also on average significantly older and less indebted than non-dynastic ones. In the presence of decreasing returns to scale, such behavior could lead to higher apparent profitability.

Panels A and B in table 2 provide descriptive evidence on the organizational structure of firms. Consistent with previous evidence on family firms by Sraer and Thesmar (2007), we find that dynastic firms employ a lower fraction of managers with respect to the total size of the workforce. Differences in organizational structures are particularly strong when comparing the relative share of high managers in the firm, which is twice as high in non-dynastic firms. This is consistent

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either with dynastic firms being relatively more labor intensive or with a clustering of these firms in labor intensive activities. Mueller and Philippon (2008) find, in cross-country data, that family firms have more weight in labor intensive industries, especially when overall labor relations are poor enough, which is the case of France according to their study. Interestingly, we find that the managerial workforce in dynastic firms is also older on average than that of non-dynastic firms.

Table 3 provides descriptive evidence on tenure patterns of the workforce. To compute tenure we have to use a random extract of our initial data consisting of employees who were born in October of even-numbered years. As this considerably reduces the size of our sample, we will use the resulting subsample only to provide complementary evidence. We find that the workforce in dynastic firms has, on average, one more year of tenure as compared to non-dynastic firms. Interestingly, the difference is greatest for the high management category. This is consistent with our idea that dynastic firms have more credibility in long-term relationships, and that such credibility is most valuable for higher management categories.

4 Empirical Analysis

4.1 Conceptual Issues

The main conceptual and empirical challenge is that neither firms experiencing dynastic transitions, nor firms experiencing transitions to external professionals can be considered random draws. Shareholders decide on the nature of the CEO transition precisely by anticipating gains and losses from maintaining or not implicit contracts with stakeholders.

Thus, dynastic successions are in many ways brought about by the prospects of the firms, even though we do not know a priori the sign of that causation (Bennedsen et al., 2007). One aspect of the endogeneity bias is more specific to restructuring itself: if restructuring has to be undertaken, the incumbent owner may choose to leave his son in control because he will have more legitimacy in employees' minds. On the other hand, the incumbent family may not want to involve itself in painful restructuring and therefore leaves the firm in the hands

of an external manager. Again, the sign of the endogeneity bias is not obvious.

To tackle these endogeneity problems we must first adopt a differences in differences strategy. We compare the average intensity of a firm's restructuring activity during the two years following a transition, with the average intensity of a firm's restructuring activity during the two years preceding a transition. Provided time differences in the outcome are identical across firms in the absence of treatment, the difference between dynastic and external transitions will indicate how committment to existing contracts affects firm restructuring (Angrist and Pischke, 2008). The identification strategy therefore requires that any structural trend in the outcome not evolve over time for reasons other than the succession. It is important that the trend be of the same magnitude for both groups of firms, especially before the transition.

4.2   Graphical Analysis

Figure 1 provides an initial insight into the main tradeoff analysed. It plots layoff rates (left-hand side) and wage raises (right-hand side) for the management workforce of dynastic and non-dynastic firms for each of the two years before and after the control transition.[2]

Firms where dynastic successions occur structurally differ with respect to firms experiencing non-dynastic transitions. Both layoff rates and wage raises are significantly lower before control transitions for dynastic firms than for non-dynastic ones. Layoff rates in dynastic firms are about 3 percentage points lower than layoff rates in non-dynastic firms in both years prior to the transition. The difference in layoff rates is highest for the high management category (4 percentage points) as compared to middle management (2 percentage points). A similar pattern applies to the differences in wage raises of the management workforce in both types of firms.

Note as well the existence of a structural increasing trend in layoff rates and wage raises around the time of succession. Our identification strategy, however, only requires the increasing trend to be of the same magnitude for both groups of firms before the transition. Figure 1 seems to confirm this hypothesis since the trajectories for both groups are parallel before a succession occurs. Another test is to check whether or not the trajectories diverge after a succession occurs.

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[2]Excluding the transition year itself.

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However, since the effect of a succession may develop over more than one year, it is possible that these trajectories do diverge after a succession. In nearly all the figures we see no divergence in the trajectories of layoff rates between the two groups. Only in the case of average wage raises after the transition do we observe a divergent slope for the dynastic firms. However, the wage raise slopes of the subcategories are parallel for both groups.

Thus, differences in the structural difference between the two groups that arise after the succession can reasonably be interpreted as caused by the succession.[3] Differences in average layoff rates jump from 3 percentage points before the transition to over 5 percentage points after the transition. We interpret these figures as indicative that family successions do reduce layoff rates following a change of CEO by about 2 percentage points. The constant difference following the succession suggests that the change in layoff behavior occurs right after the succession and is persistent (up to two years after the succession). These differences also appear across management categories. Average wage raises of the management workforce also display a jump after the control transition. The difference between the two groups increases from 1.5 percentage points to over 2.5 percentage points for the high management category. Except for the overall average wage raise, differences in slopes are constant for both high and middle management.

Thus, graphical analysis of differences in differences seems to support our central hypothesis: when a family member replaces the incumbent CEO, the management workforce suffers less from layoffs, but at the expense of a less dynamic wage profile. These results suggest that family-promoted CEOs not only inherit control of the firm, but also inherit a set of implicit contracts that affects the scope of firm restructuring.

4.3 Multivariate Analysis

Specification
We now turn to multivariate evidence on the impact of dynastic transitions in terms of a firm's organizational structure. We estimate the following model by

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[3]Note that this interpretation also relies on the assumption that successions have a rapid effect on layoffs. If this were not the case, then the change in layoff trajectories happening just one year after the succession would be a sign that the two groups can be differentially impacted through channels other than succession.

OLS:

$$\left[\overline{Y}_{t+1}^{t+2} - \overline{Y}_{t-1}^{t-2}\right]_i = \alpha Dynastic_i + \beta X_{it-1} + \epsilon_{it} \tag{1}$$

where we compare the average intensity of a firm's restructuring activity during the two years following a transition, $\overline{Y}_{t+1}^{t+2}$, with the average intensity of a firm's restructuring activity during the two years preceding a transition $\overline{Y}_{t-1}^{t-2}$. $Dynastic_i$ is a binary indicator of whether or not the transition was dynastic, and X_{it-1} are controls measured one year prior to the succession.

All specifications include controls for the size and age of the firm, industry, business groups, and year fixed effects. Analysis of the data reveals that there is a high degree of mean reversion in the level of restructuring: firms that undergo few episodes of restructuring before the succession are more likely to have greater restructuring after the succession. This is why we control in our regressions for the level of restructuring pre-succession. All specifications are estimated using heteroskedasticity robust estimation techniques.

Prediction 1: Turnover Rates

Table 4 presents results related to layoff rates of the overall management, as well as the specific results for the high management and middle management categories. Provided external CEOs are less constrained by contracts signed under the previous family management, they should be more likely to engage in restructuring the firm. Consequently, the intensity of workforce turnover should be higher under non-dynastic transitions as compared to dynastic ones.

Table 4 confirms visual inspection of the differences in differences plots. The estimate for the constant, 0.15, means that the effect of a transition per se is to increase conditional layoff rates by about 15 percentage points. However, as confirmed by graphical inspection, layoff rates increase less in the case of dynastic transitions. Column (1) indicates that transitions from one family member to another decrease layoff rates of management by 3.4 percentage points on average compared to transitions to external professionals. Columns (2) and (3) suggest that the less volatile employment relationship related to dynastic transitions extends to the different managerial levels in the firm.

Note however that graphical analysis suggests a lower layoff rate of around 2 percentage points, as compared to 3.4 percentage points in our multivariate anal-

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ysis. This difference may not be statistically significant. Yet, if it were significant, it would point to the existence of confounding factors driving the difference in evolution of the two groups towards zero, thus leading to an underestimation of the effect of family successions.

Finally, column (4) presents complementary evidence on the evolution of tenure patterns in family firms experiencing a CEO transition. Since benefits from reneging on implicit contracts should be greatest when contracts are back-loaded (Guiso et al., 2005; Guiso et al., 2009), higher layoff rates should mainly affect long-tenured workers. We find evidence that the higher layoff rates in non-dynastic transitions concern mainly the more tenured workforce of the firm. The average tenure of the overall workforce increases by .2 years in dynastic firms as compared to non-dynastic ones.[4]

Prediction 2: Wage Dynamics

Our argument is that the main difference in management styles lies in the greater commitment to existing implicit contracts of family-promoted CEOs. Given that the firm offers a joint product relative to employment and financial intermediation, it will need to compensate workers for the greater termination risk faced after a non-dynastic transition (Bailly, 1974). If this is the case, the higher turnover in non-dynastic firms should also be associated with greater wage renegotiation.

Table 5 investigates wage raise patterns of the incumbent workforce. Control transitions are associated with a significant increase of wage raises in the order of 7.2 percentage points. However, this increase in wages is less pronounced in the case of dynastic transitions. Dynastic transitions reduce wages raises associated with control transitions by 1.9 percentage points. This difference is highest for the high management category where dynastic transitions lower wage raises by 2.1 percentage points. These differences are statisically significant and valid across management categories.

Table 6, on the other hand, investigates how wages of the newly hired work-force evolve at times of control transitions. Contrary to the incumbent workforce, which is locked into existing contracts, wages of the newly hired workforce should more directly reflect the reputation costs associated with reneging on past implicit

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[4]One would like to cast this test in its ideal setting: only testing for the tenure of the laid-off workforce. However, the sample shrinks considerably and we therefore prefer to present evidence on average tenure patterns.

contracts. This is confirmed by column (1) of table 6, since firms experiencing a non-dynastic transitions have to pay, on average, a 3.5% premium on wages to newly hired managers. These differences are in all cases greater than the differences in wage raises of the incumbent workforce.

Such a pattern could, however, also be consistent with external CEOs hiring more competent or less risk averse managers (Bandiera et al., 2009). Although this would explain the differences in wages of arriving managers, it is not necessarily compatible with an increase in wages for the incumbent workforce. Taken together, our results therefore point to differences in management styles consistent with our commitment hypothesis.

Prediction 3: Hiring and Promotions Rates

We will now investigate whether implicit contracts with the dynasty might extend to other dimensions of the firm's management and organization. Table 7 analyses whether family promoted CEOs rely more on the incumbent management workforce compared to external CEOs. This is the case, for instance, if family firms enjoy private benefits from an employment relationship. We therefore expect family promoted CEOs to rely more on internal promotion of the management workforce and less on the hiring of external managers.

Left columns (1) and (2) of table 7 show promotions of high management categories into executive positions and promotions from middle management categories into high management categories. Results indicate that control transitions are associated with an increase in the promotion rate of both management categories into higher positions. However, the impact of dynastic management differs according to the considered management category. In the case of dynastic transitions, high management is promoted at a faster rate into executives positions. Family-promoted CEOs have no statistically significant impact on the promotion rate of the middle management categories.

Columns (1) to (3) on the right-hand side of table 7 show change in management hirings at the time of a control transition. Results suggest that family promoted CEO's rely less on the hiring of external management. CEO transitions are associated with an increase in the hirings rate of new managers by 15.6 percentage points. However, family promoted CEOs reduce, ceteris paribus, the rate at which the firm hires external management by 3.2 percentage points. This

impact is statistically significant and constant across management categories. However, one must highlight that, unlike our previous measures of firm management and organization, information on the hiring of new management is likely to be a relatively noisy measure.[5]

5 Robustness Checks

5.1 Confounding Factors

Our results suggest that family promoted CEOs are constrained by the promises of the previous management when restructuring the firm. However, other determinants could potentially account for differences between the two types of CEO successions. In this section we run a horse race between potential confounding factors and the dynastic commitment hypothesis.

Age and Skill Structure of the Firm
An invalidation of our dynastic commitment hypothesis could result from the influence of the age and skill structure of firms. Descriptive evidence suggests that the management workforce within dynastic firms is on average older than the management workforce in non-dynastic firms. The age structure at the same time partly creates via legal obligations, the possibility for newly arrived CEOs to restructure the firm.[6] In addition, baseline differences in the skill structure of the dynastic firms could impact the scope of internal restructuring.

Table 8 controls for such potential confounding factors. Consistent with age-related labor law restrictions, we find that the average age of the management workforce negatively impacts both layoffs and hirings at times of CEO transitions. Although dynastic transition firms have a significantly, older workforce as compared to non-dynastic ones , the results are unchanged. Neither the magnitude nor the precision of previous estimates changes significantly, and therefore

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[5]The main problem of the matched employer-employee dataset is that it is computed at the plant level. Consequently, a potentially non-negligible fraction of new managers could in fact be simple transfers from one plant to another. Layoffs, wage raises and promotion measures are however largely unaffected by this problem.

[6]During the analysed period the "Contribution Delalande", for instance, penalized firms who laid off workers over the age of 50.

our primary hypothesis is reinforced.

Firm Profitability

Having shown that our results are robust to the inclusion of workforce specific characteristics we now turn to the timing of successions. As shown in Bennedsen et al. (2007), and confirmed in our descriptive evidence, dynastic transitions usually occur in good economic environments. This naturally implies that the need for hard restructuring of the workforce is rather limited. The negative relation between dynastic successions and management turnover rates would thus be primarily driven by the performance of the firm prior to the transition.

Table 9 controls for operating return on assets prior to the transition. As expected, a higher pre-transition profitability lowers layoff rates after the transition and increases the hiring of external managers. Our results on the dynastic nature of the transition are however robust to the inclusion of this profitability measure. Although OROA before transition is only an imperfect proxy for a firm's economic prospects, we nevertheless believe that it reinforces our point on the link between commitment to implicit contracts and the scope of firm restructuring.

5.2 Instrumental Variables

Conceptual Issues

Dynastic successions might still be correlated with the intensity of internal restructuring in several ways. Indeed, the identity of the successor may depend on the firm's prospects at the time of succession. If control is likely to be relinquished to external investors when prospects are good and restructuring needs are lower, then there would be a spurrious positive correlation between family successions and restructuring. If, on the other hand, control is more likely to be relinquished to external investors when prospects are bad, a spurrious negative correlation would then arise. To the extent that such prospects vary with time across groups, our differences in differences approach might fail to account for these phenomena.

We therefore propose a new instrument: we observe in the data that certain characteristics of the name of the firm prior to succession are very correlated with the identity of the successor. In particular, those firms whose name is shared with

that of the incumbent owner have twice as many chances of undergoing a dynastic succession. We will call these firms "eponymous" firms. Our explanation for this strong pattern is that the name conveys information about the dynastic intentions of the current owner: indeed, Burkart, Panunzi and Shleifer (2003) argue that one of the main amenity potentials linked to keeping a firm within one's family is to have one's own name associated with a company's activities.

In our view, this instrument probably has the same advantages and disadvantages as the variable used by Bennedsen et al. (2007): it is decided far in advance of the succession and is therefore certainly uncorrelated with the prospects of the firm when the incumbent owner reaches retirement age. However, it is a static instrument in the sense that it does not change over time and therefore cannot both predict the identity of a successor and guarantee that the timing of the succession is random. It thus remains to control for variables prior to the succession that could predict the need for restructuring after the succession.

Estimation

We thus take into account the potential endogeneity of the succession decision by using epynomous firms to instrument for dynastic intentions. We require the name of the firm to influence restructuring decisions of the firm only through its impact on the identity of the successor. Our argument is that the exclusion restriction holds when conditioning on both observable and time constant unobservable characteristics.

We consequently estimate by Two Stage Least Squares the following system:

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\begin{aligned}
Dynastic_i &= \phi Eponymous_i + \beta X_{it-1} + \nu_{it} \\
\left[\overline{Y}_{t+1}^{t+2} - \overline{Y}_{t-1}^{t-2} \right]_i &= \alpha Dynastic_i + \beta X_{it-1} + \epsilon_{it}
\end{aligned}
\tag{2}
$$

where $Eponymous_i$ is a binary indicator of whether or not a firm shares the same name as the incumbent CEO. Under the usual IV-LATE assumptions, we thus obtain the average causal impact of dynastic transitions on the subset of compliers.

Results

In table 10 we instrument the probability of observing a dynastic transition by a dummy variable equal to 1 when the firm shares the same name as the in-

cumbent manager three years before the succession. Columns (1) to (4) present results of the two stage least squares strategy on the different measures of firm restructuring. All results are presented with respect to their impact on the overall management but extend to the different subcategories.

First stage estimates suggest that eponymity between the incumbent CEO and the name of the firm significantly increases the likelihood of a dynastic transition. The odds increase by 22 percentage points and are highly significant (t-statistic of 23). We therefore have a strong instrument to ex ante predict the dynastic character of a succession.

The magnitude of all the second stage estimates doubles with respect to OLS estimates. In column (1), the average reduction in layoff rates associated with dynastic transitions increases from 3.4 percentage points to over 7 percentage points, the difference being statistically significant. In column (2), the magnitude of the coefficient on dynastic transitions on wage raises of the incumbent workforce increases threefold. On average, dynastic transitions reduce increases in wage raises of managers by nearly 6 percentage points. The difference with respect to the non-instrumented coefficient is statistically significant. It suggests that nearly all the increase in wage raises associated with a control transition disappear in the case of dynastic transitions. Finally columns (3) and (4), suggest again that differences in management style are more pronounced when instrumenting the dynastic nature of the succession. Again, dynastic transitions rely more on the internal promotion of the workforce and less on the hiring of external managers.

The significant difference between OLS and IV estimates suggests that dynastic transitions tend to be more frequent when future layoffs are likely, as suggested by our third prediction. As discussed previously this could be caused by the fact that firm restructuring requires some legitimacy on the side of the owners, and the family tradition provides with legitimacy. All the evidence therefore suggests that the bias leads to an underestimation of the commitment effect of family-promoted management.

6 Conclusion

Why is inherited control of family firms' associated with lower firm performance, as compared to management by external professionals? One explanation is that family-promoted CEOs are less talented as compared to external CEOs (Perez-Gonzalez, 2007; Caselli and Gennaioli, 2003). They are selected from a smaller pool of applicants which is, on average, of lower quality (Bloom and Van Reenen, 2007).

Rather than focusing on the evolution of firm profitability at times of CEO transitions, this paper focuses on the evolution of labor contracts at times of CEO transitions. The basic idea developed in this paper is that, in contrast to external professionals, CEOs promoted from within the family not only inherit control of the firm, but also inherit a set of implicit contracts that affects their freedom to restructure the firm. Using a unique matched employer-employee dataset on CEO transitions in family firms, we find that family-promoted CEOs are associated with lower turnover of the workforce, lower wage renegotiation, and greater loyalty to the incumbent workforce. We address causality in a differences in differences setting well-suited to our analysis. We check robustness of our differences in differences estimates first by controlling for potentially confounding factors, and then by instrumenting for dynastic preferences.

We thus highlight an alternate view of how dynastic transitions might underperform relative to non-dynastic ones. The dynastic commitment hypothesis raises questions about the accepted explanation of the lack of talent of family-promoted CEOs, but does not exclude it. Indeed, more talented family CEOs might be better able to resist the constraints imposed by previous family-management and to restructure the firm as needed. Therefore, the interaction between commitment constraints and CEO talent would be of direct interest to further improve our understanding about family firms and family management.

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7 Appendix A: Variable Description

Management has been identified alternatively on the basis of the "Catégories Socioprofessionnelles" classification and on the basis of the wage earning distribution within the firm:

- *All Mgmt:* Employees with CSP categorization below 50;

- *High Mgmt:* Employees with CSP categorization below 40;

- *Middle Mgmt:* Employees with CSP categorization below 50 but above 40;

- *All Empl.:* All Employees regardless of CSP categorization;

- *Top 5 Mgmt:* Employees with CSP categorization above 50 and having one of the five highest weekly wages within the firm;

- *Top 10 Mgmt:* Employees with CSP categorization above 50 and having one of the ten highest weekly wages within the firm;

The dependent variable is the change in the considered outcome computed as the difference between the average two-year post-succession minus the two-year average pre-succession:

- *Layoff Rates:* Total number of layoffs in the considered management category divided by total management workforce in the same category;

- *Layoff:* Employee that left the firm during the year and that was employed by this firm at the beginning of the year;

- *Tenure:* (Average) Difference between the year of observation and the starting year of employment;

- *Wage Raise:* (Average) Difference between the weekly wage during the year of observation and the previous year divided by previous year's weekly wage;

- *Promotion Rates:* Total number of promotions in the considered management category divided by total management workforce in the same category;

- *Promotions:* In the case of CSP classification, this refers to an employee with a positive change in management classification between the current and the previous year of observation. In the case of the wage distribution classification this refers to an employee who entered the Top 5 or Top 10 ranking during the year of observation and who was employed by the firm the previous year;

- *Hiring Rates:* Total number of hirings in the considered management category divided by total management workforce in the same category;

- *Hiring:* Employee of the firm in a given year that did not receive a wage from this firm the previous year.

The following firm characteristics have been measured alternatively one year before the transition (multivariate analysis) or as two year averages before the CEO transition (descriptive statistics):

- *Dynastic Transition:* Binary indicator of whether the new CEO shares the same name as the departing CEO;

- *Age of Firm:* Administrative age of the firm as indicated in the BRN tax files;

- *Log of Sales:* natural logarithm of total sales;

- *Log of Total Employment:* natural logarithm of total workforce;

- *Pre-Transition Levels:* level of the outcome variable before the CEO transition;

8 Appendix B: Tables and Figures

Table 1: FIRM CHARACTERISTICS BY CEO SUCCESSION

Variable	All (1)	Type of Succession Dynastic (2)	Unrelated (3)	Difference (4)
Total Sales	36.6	16.3	41.7	-25.4***
	(2.5)	(2.1)	(3.1)	(6.3)
	[15160]	[3027]	[12133]	
Total Employment	179	99	199	-100*
	(22)	(12.2)	(27.2)	(54.8)
	[15160]	[3027]	[12133]	
Age of Firm	20.8	23.5	20	3.5***
	(.1)	(.22)	(.12)	(.26)
	[14239]	[2908]	[11331]	
Operating Returns on Assets	.24	.253	.237	.016**
	(.003)	(.006)	(.004)	(.008)
	[15160]	[3027]	[12133]	
Debt to Assets Ratio	.53	.4	.57	-.17**
	(.03)	(.01)	(.03)	(.01)
	[15118]	[3024]	[12094]	

Note: The table reports average firm characteristics over the two years preceding the CEO transition. CEO successions are classified into two groups: *Dynastic*, when the new CEO shares the same name with the departing CEO, *Unrelated* otherwise. *Sales* is defined as total sales of the firm in milions of Euros. *Total Employment* is defined as total employment of the firm. *Age* is defined as the administrative age of the firm as indicated in BRN tax files. *Operating Return on Assets* is computed as the ratio of operating profits to total assets. *Debt to Assets Ratio* is computed as the ratio of total debt to total assets. Standard errors are reported in parenthesis and the number of observations in square brackets. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 2: MANAGEMENT CHARACTERISTICS BY CEO SUCCESSION

		Type of Succession		
	All	Dynastic	Unrelated	Difference
Variable	(1)	(2)	(3)	(4)

A. Workforce Skill Composition

Management to Workforce Ratio (All)	.32	.2	.35	-.15***
	(.00)	(.01)	(.00)	(0.01)
	[14659]	[2794]	[11850]	
Management to Workforce Ratio (High)	.21	.1	.23	-.12***
	(.00)	(.00)	(.00)	(.01)
	[14659]	[2794]	[11850]	
Management to Workforce Ratio (Middle)	.09	.07	.1	-.03***
	(.00)	(.00)	(.00)	(.00)
	[14659]	[2794]	[11850]	

B. Workforce Age Composition

Age of Management Workforce (All)	43.9	44.9	43.7	1.2***
	(.05)	(.12)	(.05)	(.12)
	[14661]	[2795]	[11866]	
Age of Management Workforce (High)	42.3	42.7	42.3	.4**
	(.06)	(.15)	(.06)	(.15)
	[14661]	[2795]	[11866]	
Age of Management Workforce (Middle)	42.13	42.8	42	.8***
	(.07)	(.17)	(.07)	(.18)
	[14661]	[2795]	[11866]	

Note: The table reports the average management characteristics of the firm over the two years preceding the CEO transition. CEO successions are classified into two groups: *Dynastic*, when the new CEO shares the same name with the departing CEO, *Unrelated* otherwise. *Management to Workforce Ratio* is computed as the ratio of the total management workforce to total employment of the firm where total management workforce is identified according to the "Catégories Socioprofessionnelles" classification used by INSEE. *Age of Management Workforce* is computed as the average age of the management workforce. *All* defines management workforce as employees with CSP categorization below 50. *Middle* measures middle management workforce as employees with CSP categorization below 50 but above 40. *High* measures high management workforce as employees with CSP categorization below 40. Standard errors are reported in parenthesis and the number of observations in square brackets. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 3: TENURE OF WORKFORCE BY CEO TRANSITION

| | Type of Succession | | | |
| | All | Family | Unrelated | Difference |
Workforce Tenure	(1)	(2)	(3)	(4)
All Empl.	6.23	7	6	-1***
	(.04)	(.11)	(.05)	(.11)
	[13151]	[2541]	[10610]	
High Management	6.36	8.25	6.1	-2.14***
	(.12)	(.41)	(.12)	(.37)
	[2529]	[309]	[2220]	
Middle Management	6.16	6.75	6.01	-.74***
	(.04)	(.11)	(.04)	(.11)
	[12003]	[2400]	[9603]	
Workers	6.23	7	6.05	-.95***
	(.04)	(.11)	(.05)	(.11)
	[13151]	[2541]	[10610]	

Note: The table reports the average tenure of the total workforce of the firm. The table uses an extract of employees covering all individuals employed in French enterprises who were born in October of even-numbered years. This considerably reduces the size of our sample but allows us to compute *Tenure* as the difference between a given year of employment and the starting year of employment. *All Empl.* refers to all employees of the firm irrespective of their CSP classification. *Workers* refers to all employess with CSP categorization above 50. See appendix for the definition of the remaining variables. Standard errors are reported in parenthesis and the number of observations in square brackets. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 4: WORKFORCE TURNOVER AND TENURE

Dependent Variable: Changes in Management Turnover Rates (1,2,3) and Average Tenure (4)

| | Management Layoff Rates | | | Tenure |
| | All Mgmt | High Mgmt | Middle Mgmt | All Empl. |
	(1)	(2)	(3)	(4)
Dynastic Transition	-0.034***	-0.030***	-0.020***	0.172*
	(0.00)	(0.00)	(0.01)	(0.09)
Age of Firm	-0.001***	-0.001***	-0.001***	0.013***
	(0.00)	(0.00)	(0.00)	(0.00)
Log of Sales	-0.008***	-0.010***	-0.003	-0.251***
	(0.00)	(0.00)	(0.00)	(0.05)
Log of Total Employment	0.011***	0.012***	0.005	0.193***
	(0.00)	(0.00)	(0.00)	(0.06)
Constant	0.150***	0.166***	0.103***	3.786***
	(0.02)	(0.02)	(0.02)	(0.35)
Pre-Transition Levels	YES	YES	YES	YES
Fixed Effects (Industry-BG-Time)	YES	YES	YES	YES
R-squared	0.254	0.263	0.262	0.099
N	13635	11358	7962	9155

Note: The table reports OLS regressions of the effect of a dynastic transition on changes in layoff rates (cols 1-3) and on changes in average tenure of the workforce. Changes in layoff rates are computed as the difference between the average, two-year postsuccession layoff rates minus the two-year average before transition. Changes in average tenure of the overall workforce are based on an extract of **all** employees and are computed as the difference between the average, two-year postsuccession tenure minus the two-year average before transition. *Dynastic Transition* is a binary variable indicating whether the new CEO shares the same name with the departing CEO. *Age of Firm* is defined as the administrative age of the firm as indicated in the BRN tax files. *Log of Sales* is defined the natural logarithm of total sales. *Log of Total Employment* is defined as the natural logarithm of total employment. *Pre-Transition Levels* is defined as the average level of the outcome variable two years before the succession. Industry, Business Group and Year fixed effects are included. Robust standard errors are reported in parentheses. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 5: WAGE RAISE PATTERNS OF INCUMBENT WORKFORCE

Dependent Variable: Changes in Wage of Firm Raise Patterns

	All Mgmt (1)	High Mgmt (2)	Middle Mgmt (3)
Dynastic Transition	-0.019***	-0.021***	-0.012***
	(0.00)	(0.00)	(0.00)
Age of Firm	-0.000**	-0.000***	-0.000
	(0.00)	(0.00)	(0.00)
Log of Sales	0.001	0.003	-0.001
	(0.00)	(0.00)	(0.00)
Log of Total Employment	0.004	0.003	0.004
	(0.00)	(0.00)	(0.00)
Constant	0.072***	0.060***	0.068***
	(0.02)	(0.02)	(0.02)
Pre-Transition Levels	YES	YES	YES
Fixed Effects (Industry-BG-Time)	YES	YES	YES
R-squared	0.353	0.327	0.444
N	12989	10893	7710

Note: The table reports OLS regressions of the effect of a dynastic transition on changes in wage raise patterns. Changes in average wage raises are computed as the difference between the average, two-year postsuccession wage raise minus the two-year average before transition. See appendix for the definition of the remaining variables. Robust standard errors are reported in parentheses. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 6: AVERAGE WAGE OF HIRED WORKFORCE

Dependent Variable: Changes in Average Wage of Hired Workforce

	All Mgmt (1)	High Mgmt (2)	Middle Mgmt (3)
Dynastic Transition	-0.035*	-0.042*	-0.072***
	(0.02)	(0.02)	(0.03)
Age of Firm	0.000	0.000	-0.001
	(0.00)	(0.00)	(0.00)
Log of Sales	0.054***	0.042***	0.038***
	(0.01)	(0.01)	(0.01)
Log of Total Employment	-0.018*	-0.019*	0.006
	(0.01)	(0.01)	(0.01)
Constant	3.053***	3.143***	2.927***
	(0.09)	(0.10)	(0.13)
Pre-Transition Levels	YES	YES	YES
Fixed Effects (Industry-BG-Time)	YES	YES	YES
R-squared	0.470	0.438	0.445
N	4300	3357	1780

Note: The table reports OLS regressions of the effect of a dynastic transition on changes in the average wages of hired managers. Changes in average wages of hired managers are computed as the difference between the average, two-year postsuccession wage minus the two-year average before transition. See appendix for the definition of the remaining variables. Robust standard errors are reported in parentheses. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 7: MANAGEMENT PROMOTION & HIRING RATES

Dependent Variables: Changes in Management Promotion and Hiring Rates

| | Promotion Rates | | Hiring Rates | | |
	High Mgmt (1)	Middle Mgmt (2)	All Mgmt (1)	High Mgmt (2)	Middle Mgmt (3)
Dynastic Transition	0.010***	-0.014	-0.032***	-0.032***	-0.034***
	(0.00)	(0.01)	(0.01)	(0.01)	(0.01)
Age of Firm	0.000**	-0.000	-0.001***	-0.001***	-0.000*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Log of Sales	0.000	0.010*	0.006*	0.010**	0.016***
	(0.00)	(0.01)	(0.00)	(0.00)	(0.01)
Log of Total Employment	-0.003**	0.013**	-0.000	-0.002	-0.008
	(0.00)	(0.01)	(0.00)	(0.00)	(0.01)
Constant	0.019***	0.096**	0.156***	0.134***	0.077**
	(0.01)	(0.04)	(0.02)	(0.03)	(0.03)
Pre-Transition Levels	YES	YES	YES	YES	YES
Fixed Effects (Industry-BG-Time)	YES	YES	YES	YES	YES
R-squared	0.381	0.363	0.563	0.573	0.522
N	10815	9410	13320	11280	7843

Note: The table reports OLS regressions of the effect of a dynastic transition on changes in promotion rates (left, cols 1-2) and on hiring rates (right, cols 1-3) of the management workforce. Changes in promotion rates are computed as the difference between the average, two-year postsuccession promotion rates minus the two-year average before transition. Changes in hiring rates are computed as the difference between the average, two-year postsuccession promotion rates minus the two-year average before transition. See appendix for the definition of the remaining variables. Robust standard errors are reported in parentheses. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 8: ROBUSTNESS - AGE AND SKILL COMPOSITION

Dependent Variables: Layoffs (1), Wage Raises (2), Promotions (3) and Hirings (4)

	Layoffs (1)	All Management Workforce		
		Wage Raise (2)	Promotions (3)	Hirings (4)
Dynastic Transition	-0.034***	-0.019***	0.010***	-0.032***
	(0.00)	(0.00)	(0.00)	(0.01)
Age of Firm	-0.001***	-0.000*	0.000*	-0.000**
	(0.00)	(0.00)	(0.00)	(0.00)
Log of Sales	-0.012***	-0.001	0.001	0.004
	(0.00)	(0.00)	(0.00)	(0.00)
Log of Total Employment	0.015***	0.007**	-0.003***	0.001
	(0.00)	(0.00)	(0.00)	(0.00)
Average Age of Mgmt	-0.001**	-0.000	0.000	-0.001***
	(0.00)	(0.00)	(0.00)	(0.00)
Mgmt to Workforce Ratio	0.020***	0.011***	-0.003***	0.007
	(0.01)	(0.00)	(0.00)	(0.01)
Constant	0.194***	0.100***	0.015	0.216***
	(0.02)	(0.02)	(0.01)	(0.03)
Pre-Transition Levels	YES	YES	YES	YES
Fixed Effects (Industry-BG-Time)	YES	YES	YES	YES
R-squared	0.256	0.354	0.382	0.563
N	13635	12982	10810	13319

Note: The table reports OLS regressions of the effect of a dynastic transition on changes in layoff rates (column 1), wage raise rates (column 2), promotion rates (column 3) and hiring rates (column 4). *Management to Workforce Ratio* is computed as the ratio of the total management workforce to total employment of the firm. *Average Age of Mgmt* is computed as the average age the total management workforce. See appendix for the definition of the remaining variables. Robust standard errors are reported in parentheses. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 9: ROBUSTNESS - FIRM PROFITABILITY

Dependent Variables: Layoffs (1), Wage Raises (2), Promotions (3) and Hirings (4)

| | | All Management Workforce | | |
	Layoffs (1)	Wage Raise (2)	Promotions (3)	Hirings (4)
Dynastic Transition	-0.034***	-0.019***	0.010***	-0.032***
	(0.00)	(0.00)	(0.00)	(0.01)
Age of Firm	-0.001***	-0.000**	0.000**	-0.001***
	(0.00)	(0.00)	(0.00)	(0.00)
Log of Sales	-0.006**	0.002	0.000	0.005
	(0.00)	(0.00)	(0.00)	(0.00)
Log of Total Employment	0.009***	0.003	-0.002**	0.001
	(0.00)	(0.00)	(0.00)	(0.00)
OROA	-0.027***	-0.014***	0.002	0.013**
	(0.00)	(0.00)	(0.00)	(0.01)
Constant	0.151***	0.072***	0.019***	0.156***
	(0.02)	(0.02)	(0.01)	(0.02)
Pre-Transition Levels	YES	YES	YES	YES
Fixed Effects (Industry-BG-Time)	YES	YES	YES	YES
R-squared	0.256	0.354	0.382	0.563
N	13635	12989	10815	13320

Note: The table reports OLS regressions of the effect of a dynastic transition on changes in layoff rates (column 1), wage raise rates (column 2), promotion rates (column 3) and hiring rates (column 4). *OROA* is computed as the ratio of operating profits to total assets. See appendix for the definition of the remaining variables. Robust standard errors are reported in parentheses. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

Table 10: IV STRATEGY - EPONYMOUS FIRMS

Dependent Variables: Layoffs (1), Wage Raises (2), Promotions (3) and Hirings (4)

| | All Management Workforce | | | |
	Layoffs (1)	Wage Raise (2)	Promotions (3)	Hirings (4)
Dynastic Transition	-0.070***	-0.058***	0.025**	-0.072***
	(0.02)	(0.02)	(0.01)	(0.03)
Age of Firm	-0.000**	-0.000	0.000	-0.001***
	(0.00)	(0.00)	(0.00)	(0.00)
Log of Sales	-0.009***	-0.001	-0.000	0.008*
	(0.00)	(0.00)	(0.00)	(0.00)
Log of Total Employment	0.013***	0.006*	-0.002**	0.000
	(0.00)	(0.00)	(0.00)	(0.01)
Constant	0.152***	0.085***	0.019**	0.151***
	(0.03)	(0.02)	(0.01)	(0.03)
Pre-Transition Levels	YES	YES	YES	YES
Fixed Effects (Industry-BG-Time)	YES	YES	YES	YES
R-squared	0.251	0.334	0.375	0.520
N	11222	10763	8965	11062

Note: The table reports 2SLS regressions of the effect of a dynastic transition on changes in layoff rates (column 1), wage raise rates (column 2), promotion rates (column 3) and hiring rates (column 4), where *Eponymous* is used as an instrument for *Dynastic Transition*. *Eponymous* is a binary instrument indicating whether the departing CEO and the firm shared the same name three years before the transition. See appendix for the definition of the remaining variables. Robust standard errors are reported in parentheses. ***, **, * denote significance at the 1, 5 and 10 percent levels, respectively.

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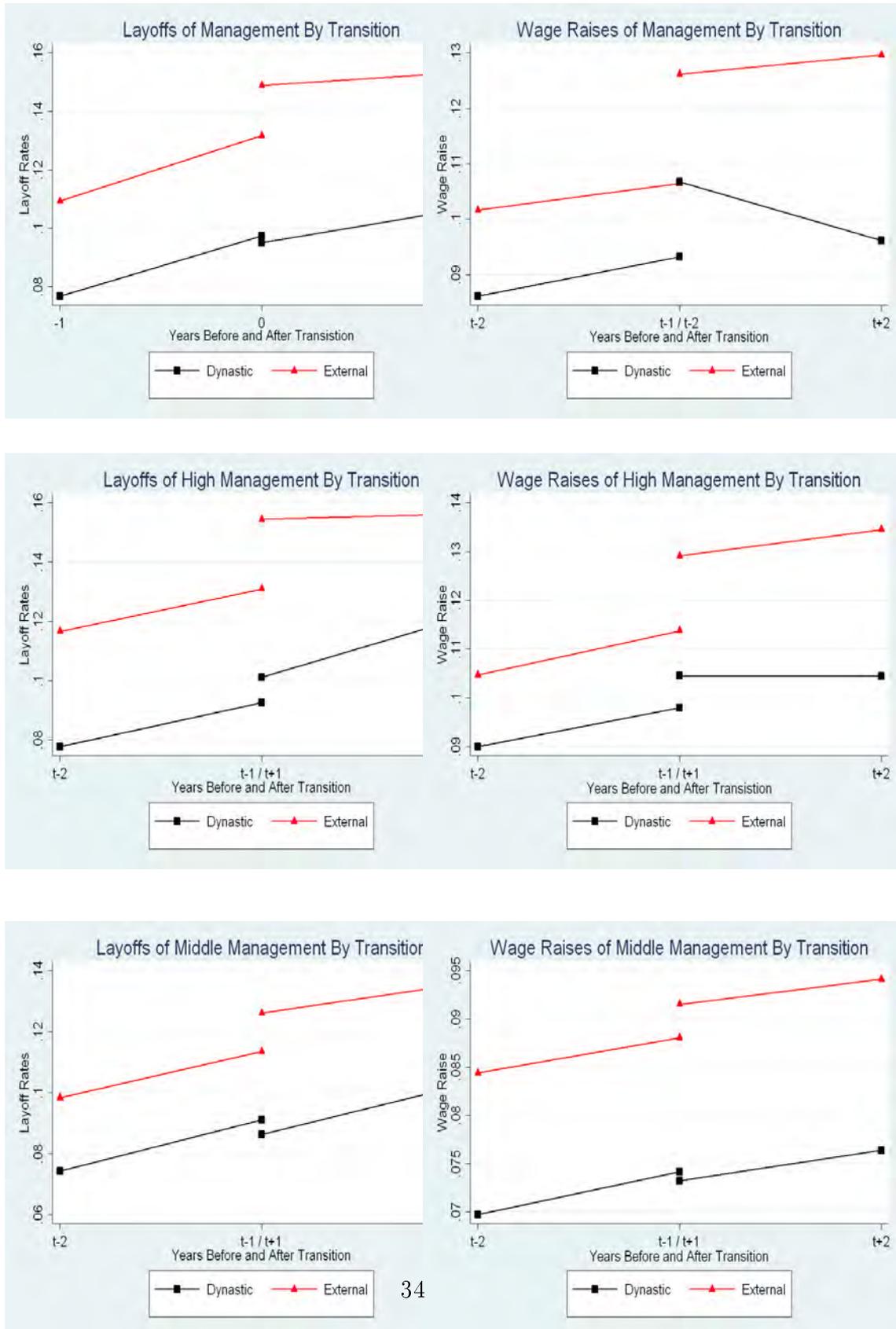
Note: The figure plots average layoff rates (left hand side) and wage raises (right hand side) for the management workforce of dynastic (black) and non-dynastic (red) firms for each year before and after the control transition. *All*, *High*, *Middle* refers to management categories defined on the basis of the "Catégories Socioprofessionnelles"

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