# Chapter I
# Introduction

## Background of the Study

In the recent decades, the topics of family firm have been raised in financial studies. The importance of family firms has been pointed out because of their special characteristics. The definition of family firms may be slightly different from one research to another; nevertheless, the general definition of family firms is the firms that have the family's involvement by ownership or management. There are several reasons why family wants to preserve their controls. First, the family may has personal pleasure from seeing their son or daughter run the business. Second, the family name may be a carrier of a reputation, which its name may represent quality or political connection. The family may have run the business for generations. There is a long bond connection between business and family reputation. Because of these incentives to preserve the control of the company, it creates a positive long term commitment from the owner to the firm. Not only reputation of family is related with the business, the family's wealth also depends on the business performance. Moreover, when the control of the family firm comes from both ownership and management, it will reduce the agency problem between shareholder and manager. Thus, the corporate governance mechanism in the family should be different from others.

Board of director is an important component in corporate governance. A board member is appointed by the shareholder as their representatives to provide advices and monitor the management team. Business roundtable (1997) discussed the roles of corporate board as followed: (1) Select, regularly evaluate and, if necessary, replace the chief executive officer; determine management compensation; and review succession planning; (2) Review and, where appropriate, approve the major strategies and financial and other objectives and plans of the corporation; (3) Advise management on significant issues facing the corporation; (4) Oversee processes for evaluating the adequacy of internal controls, risk management, financial reporting and compliance, and satisfy itself as to the adequacy of such processes; and (5) Nominate directors and ensure that the structure and practices of the board provide for sound corporate governance. The five functions of the board are the essential duties to ensure the shareholder's welfare maximization practice.

Thus, good corporate board leads to good corporate performance. There are attempts to find the optimal board size and composition. Board of director consists of inside director and outside (independence) directors. Insider directors are the directors that have the management position in the company. They contain important firm-specific information. Firm-specific information is necessarily important to be given to each of the board director to make important decision. Nevertheless, if the board consists of many insiders, the agency problem will rise. The insiders may implement many policies that benefit the management team and shareholder welfare will be exploited. Independence directors are directors who are not firm's employee and have enough qualifications to be a director. Advantages of independence director are: first, they monitor the management team better than the insider director. Second, they can bring new information from other sources to the company. The optimal combination of the two types of board will bring benefit to the company. Thus, there are many studies and regulation to create the optimal board structures.

To address the optimal and the best practice of board structure, there are calls for smaller board with larger outside representation (Sarbanes-Oxley Act of 2002). However, the empirical studies suggest that there is no one optimal board size and composition fit all kinds of firms. Field, Karpoff, and Raheja (2007) test the empirical data on scope of operation, monitoring, and negotiation hypothesis to board structure. It turns out that the firm characteristics have great impact on board composition and size. For example, the conglomerate business needs larger board size and more independence directors than the small single product business. This is because conglomerate needs more advice and monitoring to operation their various business segments efficiently. Coles, Daniel, and Naveen (2007) answer whether one board size fit all the firms. The results show that either very small or very large board is optimal. The relation causes from the difference between complex and simple firms. Moreover, some firms are more optimal to have mainly inside directors; in consistence with Harris and Raviv (2008). It shows that in the firm that the cost of transferring firm specific information to the outsider is higher than benefit of additional outside director, insider control is optimal. Thus, determinants of board structure of different type of firm should be different.

As mentioned earlier about the special characteristics of family firm and structure of corporate board, existing studies have focus on the effects of family firm on the firm value (Mishra, Randoy, and Jenssen, 2001; Anderson and Reeb, 2003; Bertand et al., 2004, and Maury, 2006) or purely the determinant of corporate board size and composition (Yermack, 1995; Field, Karpoff, and Raheja, 2007; Linck, Netter, and Yang, 2008). There are few studies concerned about the determinant of board structure in family firm. Since the corporate governance of family firms and nonfamily firms are different, it is interesting to explore the determinants of family firms' board structure.

There are gaps from previous studies. Most of the paper studies the determinant of board structure in high shareholders protection countries. Lins (2003) finds that the block holder impact the firm is influenced by the type of shareholder protection environment. The profound findings of the determinants of board structure might not be applicable in the low protection of minority shareholders. Thus, I choose Thailand as the sample. Thai capital market provides us the unique setting to investigate the issues for several reasons. First, the majority of the Thai firms are family firms. Wiwattankatang (2000) found that out of the non financial company listed sample, 80% are family firms in Thailand in 1996. Further, the study suggests that the family firm shows the most involvement in the management comparing to other controlling shareholder types. Second, the information on the family structure data in Thailand could be constructed acceptable accurately. There is a great deal of publicly available data for publicly traded Thai family firms. This enables the study to explore the relationship of the ownership properly. Third, most of the researches on the board structure determinants use the samples in the developed countries, which have high corporate governance environment. While the results from those studies are profound findings, it may not necessary applicable to the low corporate governance environments. To study the determinants of family firms' board structure in Thailand will extend the study of characteristic of family firms and the determinants of board composition.

**Statement of Problem**

Board of director is an interesting topic to focus on because of director is an important variable in the corporate governance system, which is linked with the corporate performance. While the topic of family firm are famously discussed in literature papers about their characteristics, effects to firms' performance, agency costs, and value, there are very few discussions on their effects on the board structure determinants. Thailand is suitable to conduct the study on family firm as majority of firms are family controlled firm. Moreover, there is no study on the determinants of family firms' board structure in Thailand. Due to the different firm's characteristic in Thailand, the determinants of board structure might be different than other countries. Thus, I hypothesize that the determinants of board structure in family firm and nonfamily firm are different in Thailand.

**Objective of the Study**

To test empirically whether that family and non family business have the same determinants of board structure by using Thai capital market firms.

**Scope of the Study**

I use a sample of all nonfinancial publicly Thai listed firms on the Stock Exchange of Thailand (SET) that have continuous financial data from 2003-2008. This sample period provides good insights to study the corporate governance as it extends the period of study from pervious study of board structure.

**Contribution**

This paper has two main contributions:

- It fills in the gap of the literature on the family firms influence on corporate board structure in the low corporate governance environment. There are many papers on determinants of board structure but they mostly have done in developed countries, where shareholder rights are high. Using Thailand as a sample may or may not have the identical results of those profound findings

- It benefits to the regulators in Thailand to set appropriate rules and policies with the understanding of determinants of board structures as many of Thai listed are family firms. Thailand has different shareholder protections from most of the literatures; this paper will be a profound contribution on the structure of the board in Thailand.

**Organization of the Study**

This thesis proceeds as follows. Chapter 1 is an introduction section. It discusses objectives, contributions, and motivation in short of this research. Chapter 2 is the literature review and hypothesis development; it explains the previous works on characteristics of family firms, theories on board structure determinants, and process of developing hypothesis. Chapter 3 discusses about the sample, identification of family firms and methodology. Chapter 4 shows and analyzes the result of the tests. Chapter 5 summarizes the findings of this study.