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Governance conflict in Chinese family firms: Managed by family-based managers or external managers?

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Managed by family-based managers or external managers?

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Abstract

Purpose – According to the real environment of China, the authors collect micro data about Chinese family firms (FFs) to explain why some Chinese FFs still tend to introduce external managers though they have to face governance conflict between family-based managers and external managers.

Design/methodology/approach – This study analyzes the effect of governance conflict between family-based managers and external managers on firm performance by using ordinary least square test, which is also used to test which factor has influence on governance conflict's profit promotion effect.

Findings – This study finds that governance conflict significantly improves firm performance (profit promotion effect). The governance conflict caused by the introduction of external managers in Chinese FFs can significantly improve a firm's performance by raising its management efficiency and capital investment.

Research limitations/implications – The governance conflict of the family business needs to be further refined in following research. Besides, this study is only based on the empirical study of cross-section data.

Originality/value – Different from the existing related research is mainly based on the sample data of listed family enterprises, the China employer-employee matched survey data includes a large number of small and medium-sized FFs, and has obtained the actual situation of how many of the middle and senior managers are external not family members.

Keywords Family firms, External manager, Family-based manager, Governance conflict

Paper type Research paper

1. Introduction

The expansion in scales over the recent years drives Chinese family firms (FFs) to face the critical choice: to introduce external managers or to leave the firm to family members. Having been flourishing since reform and opening up, Chinese FFs contribute a lot to the national economy. In 2014, Tharawat reported that 85.4 per cent of the private firms in China are family-run, undertaking 65 per cent of the total employment and over 65 per cent of the gross domestic product. Yet, as for the firm size, most of the Chinese FFs in manufacturing industries are much smaller compared with the state-owned ones. According to China Employer-Employee Survey (CEES) data in 2015, the average employment scale of FFs in Chinese manufacturing industries is 453, while such figure in the state-owned enterprises, HKT firms and foreign firms amounts to 1,368, 1,470 and 1,783, respectively. Normally, the larger a firm is, the higher propensity a firm has to introduce professional managers to standardize management process, and vice versa. The fact is, on the contrast, FFs in Chinese manufacturing industries are small, and few of them choose to introduce

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professional managers to improve management efficiency. Owing to this, there is scant literature studying how professional managers improve the performance of FFs in China, compared to the numerous researches under the foreign context (Diéguez-Soto *et al.*, 2016; Classen *et al.*, 2012). Meanwhile, in the face of the dual pressure of market competition and internal management accompanied by expansion of family business, firm owners usually resort to a "transiting" method. That is, they would employ experienced personnel in sales, technological development and finance to be mid-and-senior managers instead of employing a professional manager to be the CEO, as the firm is not too large to need one. As mature management structure is still under construction in such FFs, the introduced mid-and-senior managers undertake professional work and, more importantly, play a crucial role in firms' development as they participate in the decision-making of investment, innovation, etc. Therefore, to reveal the governance mode of Chinese FFs under the new economic background, we need to study whether the firms appoint external managers or use family members as mid-and-senior managers in the first place. Actually, recently, attention has been paid to the problem of mid-and-senior managers in Chinese FFs recently (Wąsowska, 2017; Cabrerasuárez and Martínsantana, 2013). Nevertheless, current literature has not come up with a unanimous opinion on the effect of professional managers on firm performance. There are mainly two strands of views.

Some researchers have posited that *FF*s in China are better suited to managed by family members, arguing that a trust mechanism is necessary between the owners and managers to prevent governance conflicts (Zellweger *et al.*, 2010; Venter *et al.*, 2005; Gomez-Mejia *et al.*, 2011). It is easier to organize and develop stronger relationships of trust among family members (Zellweger *et al.*, 2010). As the trust between owner and family members is based on relationship rather than institution, the owner has a lower risk of losing control of his/her business to managers when giving them more managerial control rights. Having more managerial control rights can encourage managers to make greater efforts to increase the enterprise's profits (Venter *et al.*, 2005). Besides, this can be achieved even with little or no managerial control reward. Other studies have pointed out that management by family members can harm the owner's interests, despite the ostensible shared goals between both sides (Bertrand *et al.*, 2008). This is because as an FF grows, the manager's abilities will inevitably fail to match the expectations. Thus, the relationship-based trust can enable managers to become free riders, who continue to administrate the firm to meet their own benefits, even when their abilities no longer meet the firms' growing demands. Meanwhile, the growing scale of the firm also makes it difficult for owners to recognize what kind of managers are free riders (Osnes, 2011). This will ultimately harm the FFs' founders or owners.

Supporters of governance by external managers believe that the external professional managers can effectively reduce free riding behaviors. They argued that FFs hire external managers to improve their firms' management efficient, thus increasing their final performance, which is easily measured by parameters such as sales income and profit rates (Nordqvist *et al.*, 2013). If performance decreases, the FFs' owners would employ new managers to replace the old one. Through this selection process, the FFs owner would ultimately find a manager whose abilities perfectly match the current state of the firm. This strategy effectively mitigates free riding. However, some studies have also noted that external managers create a considerable risk to externalize the firm's control rights. Compared to non-FFs, FFs, besides maximizing economic gains, have another goal: preserving the family heritage (Kellermanns *et al.*, 2008). To introduce external managers, FFs often choose to reward them with some residual control right, in addition to the contractual salaries and bonuses. Giving them more residual control right is likely to introduce managers better, but handing over too much power creates the risk of the firm being taking over by these managers. Current research has shown that owners of FFs in China do not greatly trust managers because of factors including traditional culture and inadequate legal stipulations (Wheelock and Baines, 1998). They have been unwilling to give too much residual control rights to managers. By so doing, this increases the agency costs and keeps the motivations of owners and managers from lining up. In some cases, the firms would go back to managed by family members after trying external professional managers.

Based on the above analysis, further discussion is needed in the following aspects: first, existing literature scarcely studies the impact of whether the Chinese FFs hire professional managers on firm performance. As foreign market of professional managers is more mature, vast research study how employment of professional managers impacts firm performance. Yet, FFs in China prefer mid-and-senior managers to professional managers to govern the firm. However, there is less literature on the impact of introducing mid-and-senior on firm performance. Second, current literature seldom considers multiple influencing mechanisms of how different governance modes impact firm performance. There exist various mechanisms of introduction of professional managers on firm performance; however, current studies mostly choose only one among management, investment and innovation, which may overestimate or underestimate the effect.

To define governance conflict of FFs in a more objective sense, this study investigates whether the firm introduces mid-and-senior managers to indicate governance conflict. Compared with the FFs that did not introduce external managers, FFs that introduced external managers face the conflict between current managers and external managers. We call this conflict *governance conflict*. This study will empirically test whether it has a positive incentive effect on business performance. The conclusion of this study can explain why some FFs choose to introduce external people as middle and senior managers. When analyzing these issues, we will use the findings as a basis to provide policy suggestions to FFs. In existing studies, the topic is largely measured by whether the firm has employed professional managers. However, the CEES data (this study is based on data from the survey, and detailed information about CEES is given in Section 3.1) indicate that most of *FF*s in China are of small size. Furthermore, they did not have modern institutional structure and generally did not employ professional managers. Plenty of Chinese FFs also displayed no intention to hire professional managers to govern the firm and were more likely to introduce external managers to be in charge of finance, production and sales department. Thus, if we approach the topic of governance conflicts in FFs by only using the data of professional managers, most small firms will be excluded from the sample, and this will create a bias. Therefore, this paper will focus on whether the middle and senior external managers (the governor above the head of the department) are introduced into a firm to measure the governance conflict of Chinese FFs.

Meanwhile, to comprehensively explore the influencing mechanisms of governance conflict on firm performance, this study builds variables to measure management efficiency, investment efficiency and innovation ability based on CEES data. These three indicators almost cover all the influencing mechanisms that have been discussed in the literature. Hence, this study will unfold analysis over the above three mechanism of how governance conflict impacts firm performance.

The rest of the article contains the following parts: Section 2 reviews related literature, based on which four theoretical hypotheses are proposed; Section 3 introduces the data source, defining variables and building an ordinary least squares (OLS) regression model; Section 4 describes the statistics of the main variables, while Section 5 unfolds the econometric examination; Section 6 discusses the results so as to set forth political implications, and research limitations are stated in Section 7. At last, Section 8 draws the conclusion.

2. Literature overview and hypotheses

One of the characters of Chinese FFs is the governance conflict between family-based managers and external managers. When the FFs have completed the primitive accumulation of capital, the enterprises begin to grow and develop with their daily management. However, they still rely too much on the traditional family system to integrate the enterprise resources. This situation will seriously hamper the further development of these enterprises, and the management efficiency, which is based on blood relationship, will decrease. A large number of studies suggest that the non-family management members is a very important group (Kraus *et al.*, 2016; Stadler *et al.*, 2017). A considerable part of FFs chooses to introduce "de-familial" method and absorb external middle and senior managers (e.g. deputy general manager, financial officer and sales supervisor) into corporate governance. These FFs also need to recruit external professional managers to increase the scale and scope of internalization (D'Angelo *et al.*, 2016). As external managers are more specialized than family members, coupled with their economic interests are also closely related to business performance, the addition of these non-family executives not only will not damage the interests of FFs but also, to some extent, can improve the operating performance of enterprises (Fama and Jensen, 1983).

According to the existing literature, after the introduction of external managers, FFs can improve their performance in three aspects. First, as external managers have more managerial skills and knowledge (Miller *et al.*, 2013), they can use their own expertise and management experience to improve management efficiency and thereby enhance business performance (Lambrecht, 2005). Second, by means of increasing capital investment and improving the quality of input elements of production, external managers can improve the performance of enterprises based on improving product quality (Jensen, 1999; Jensen, 1999). Third, external managers can improve the overall performance of enterprises by increasing the input of innovations to enhance the value of unit products (Czarnitzki and Kraft, 2009; Urbinati *et al.*, 2017).

However, some research papers also point out that after the introduction of external managers in FFs, the profits of enterprises will decline. The mistrust of firm owners to external managers leads to inadequate incentives for external managers, and the firm owners fear that giving them excessive management control can affect the smooth succession of business to their children (Redding, 1986). For this reason, family business owners often give incentives to external managers through year-end awards, etc., in place of giving them enterprise equity. Such a mode of operation will result in insufficient incentives after a period of time, and external managers' motivation to continuously improve corporate performance will gradually diminish and the potential generic advantages of external managers can be reduced (Stadler *et al.*, 2017). On the other hand, there are studies indicating that because of the imperfect management of the current talent market in China, external managers have very low credit costs, so they do not have too many external constraints to improve business performance (Gupta and Levenburg, 2012). In summary, after the introduction of external managers, FFs will have conflict between external managers and existing managers on the knowledge of management, investment and innovation. This conflict may further evolve existing knowledge and form more optimized knowledge of management, investment and innovation, which can improve firm performance. For this reason, this article proposes *H1*:

H1. Governance conflict between owners of Chinese FFs and external managers has a significant impact on the financial performance of enterprises.

Familial management places too much emphasis on human nature, while ignoring the system construction and professional management, so the enterprise management efficiency is generally low. Enterprise management efficiency is generally divided into decision-making efficiency and implementation efficiency. The decision-making efficiency is mainly related to the ability of decision-makers and the level of their relevant knowledge (Hayek, 1945). However, as entrepreneurs in FFs rely on a lifetime guarantee of holding their management positions, they may invest less in education and training (Bloom and Van Reenen, 2006), thus managing firms with insufficient human capital (Stadler *et al.*, 2017). At different stages of development, familial management will have different impact on the efficiency of the decision-making of enterprises. As entrepreneurs' age grows, the knowledge they possess is already very difficult to effectively match the knowledge needed for the business decisions at current stage. It is also very difficult for the second-generation entrepreneurs to absorb a large amount of tacit knowledge of the first-generation entrepreneurial enterprises (Lambrecht, 2005). This makes it difficult for the second-generation entrepreneurs to make correct decisions based on their limited knowledge storage. The implementation efficiency is mainly related to the corporate culture and management system. FFs members are more familiar with each other and prone to "free riding" phenomenon, that is, some employees will receive additional benefits from investing more workforce of other member's in the same department. This situation will result in declining in employees' enthusiasm for the work, thereby reducing the implementation efficiency.

At the same time, FFs often lack advanced management systems and cannot identify "free-rider" individuals well. Therefore, with the expansion of the scale of FFs and faced with the increasingly complex large-scale business management issues, the objective requirements of business operations must be replaced by professionals who specialize in the operation and management, that is, the principal-agent system must be adopted. As professional managers are normally selected from a large pool of managerial talent (Villalonga and Amit, 2006), the introduction of them can effectively increase the diversity and breadth of human and social capital available to the FFs and improve decision-making efficiency and implementation efficiency (Stadler *et al.*, 2017). In terms of decision-making efficiency, external managers usually have more rich experience and expertise in managing the business. According to their own knowledge level, the risk of decision-making can be effectively reduced and the decision-making efficiency can be improved. By improving the internal management efficiency of FFs, external managers effectively align individuals and business's goals and interests, and thus improve the business performance (Hillman and Dalziel, 2003; Sundaramurthy *et al.*, 2014). From the discussion, external managers will conflict the existing managers in management knowledge. This conflict may gradually evolve into the absorption of new knowledge by the original management knowledge, which can form new management knowledge that is more conducive to improving business performance. To this end, this article proposes *H2*:

H2. The governance conflict caused by the introduction of external managers in Chinese FFs can significantly improve the performance by improving their management efficiency.

Compared with non-family businesses, one of the important goals of FFs is to inherit the business. Therefore, family-owned businesses are more risk-sensitive. Capital investment is a high-risk corporate behavior, and FFs often choose capital investment prudently. Jensen (1986) argues that the external managers of a family business may use the free cash flow of a firm for project investments that do not increase the shareholders' interests. Stulz (1990) also believes that under the separation of the two rights, professional managers tend to make enterprises big, and their investment preferences are more intense. Professional managers possess more managerial talent, human capital and capabilities than the firm managers (Chang and Shim, 2015; Yildirim-Öktem and Üsdiken, 2010). Thus, they generally increase the internal capital investment to achieve a certain degree of production efficiency and production scale, such as the purchase of certain machinery and equipment and investment in other projects. In other words, after external managers are introduced, they are more inclined to take risky investment behavior.

A large number of existing literature analysis found that the introduction of external managers has a positive impact on corporate capital investment, thereby enhancing business performance. Jensen (1999) points out that for improving performance in business management, professional managers are more investment-oriented, investing in new capital for more resources and higher operating performance. Stulz (1990) study also found that external managers are rewarded for their investments and are therefore willing to invest more. The hiring of external professional managers can help firm acquire social capital and the knowledge of investment in internationalization trade (D'Angelo *et al.*, 2016). Studies have shown that the increase in management power has significantly increased the investment of listed companies (Myers and Majluf, 1984). The conflict of agency between shareholders and management has affected the company's investment behavior. The concrete manifestation is that the greater management power, the greater investment intensity (Li and Liu, 2005). However, Bertrand *et al.* (2008) argue that because the investment will bring private costs to the external managers of the family business, if such costs are too high, the external managers will be lazy and then lead to underinvestment, thus resulting in the failure of maximizing the business performance. From the discussion, external managers will conflict the existing managers in knowledge of investment. This conflict may gradually evolve into investment knowledge based on their respective advantages, which can improve business performance. Therefore, this article proposes *H3*:

H3. The governance conflict caused by the introduction of external managers in Chinese FFs can significantly improve the performance by raising their capital investment.

It is pointed out in the literature that familial management is prone to tunneling and is not conducive to the innovation of enterprises. In family-managed enterprises, family shareholders tend to encroach on the interests of the company through asset transfers, internal transactions and other means. Czarnitzki and Kraft (2009) found that family-managed businesses have fewer patent citations than non-family-managed businesses, and thus familial management reduces the entrepreneurial ability to innovate. Chen and HSU (2009), based on an empirical study of Taiwanese electronics firm data from 2002-2007, found that familial management was negatively correlated with corporate R&D investment. FFs have greater incentive to governance how money is spent, which facilitates a culture of parsimony (Carney, 2005) but discourage the expenditure of innovation (Chrisman *et al.*, 2015). On the other hand, innovation means high-risk investment and family managers will tend to resist. Based on survey data from 1998 to 2008, Cucculelli *et al.* (2016) found that familial management inhibits companies from introducing technologies to develop new products. Gomez-Mejia *et al.* (2011) found that to have long-term control over the assets of the enterprise, FFs are more inclined to avoid financial innovations so as to prevent them from seizing control over the high proportion of external equity financing.

However, with the continuous development of Chinese FFs, more and more enterprises are beginning to pay attention to the medium- and long-term development of the enterprises, rather than short-term interests. The intention to transfer the firm to the next family generation make the firm owners to think long term (Block, 2012). This may cause that some FFs with emphasis on long-term development tend to support external managers for technological innovation activities. The existing literature points out that external managers have much higher preference for innovation than family members who focus more on overall corporate development. Urbinati *et al.* (2017) pointed out that external managers working in FFs are more interested in effective approaches of innovation. As long as the FFs give enough incentives to external managers, it can drive external managers to initiate innovative behaviors. For this reason, the literature on external managers and business innovations focuses more on how to motivate external managers (Holmstrom, 1989; Francis and Smith, 1995). From the discussion, product innovation knowledge of external manages will conflict with existing knowledge. This conflict may further evolve into knowledge that better meets market needs, which is conducive to promoting the quality of product. Therefore, this article proposes *H4*:

H4. The governance conflict caused by the introduction of external managers in Chinese FFs can significantly improve the performance by improving their innovative capabilities.

3. Variable description and model construction

3.1 Data source

Plenty of extant studies on FFs use data of listed firms because of their easier access. Nevertheless, samples in the data set of listed firms contain a limited analysis of big-size FFs in China. The lack of research on the Chinese case means that they fail to illustrate the overall status of this special type of firms in China, who perform an important part of the economy. Meanwhile, according to statistics of our firm survey, most FFs are small and medium-sized. Most do not meet the basic requirement that require them to be listed. Thus, access to representative samples for FFs is a crucial prerequisite to research Chinese FFs.

To carry out research that could reflect the reality as much as possible, the Institute of Quality Development Strategy at Wuhan University of China, where the authors work, conducted the CEES in 2015 and 2016. To ensure balance in the samples, CEES adopted a rigorous sampling method – probability proportionate-to-size sampling based on the database of Chinese Third National Economic Census in 2014. CEES samples randomly in three aspects. Initially, the data of the Third National Economic Census in 2014 were used as CEES sample frame, and districts (counties) are sampled by their employment level in the manufacturing sector. Similarly, in each district (county), firms are sampled based on their total number of workers. Hence, in the sense of employment scale, the sampled firms are representative. As for employees sampling, one-three middle and senior managers were sampled, and the choice was based on the firm size.

With probability proportionate-to-size sampling, CEES finally acquired data of 540 manufacturing family business, and the corresponding 1,718 middle and senior managers during the 2013-2015 financial year. This study focuses on the governance conflict in Chinese FFs. As the degree of China's marketization rises, an increasing number of FFs are seeking to improve management efficiency or operating performance through introducing external professional managers as firm middle and senior managers. As family business belong to private wealth of the founder(s), numerous studies have shown that because of mutual distrust among participants, aroused by incomplete information, founders of Chinese FFs are inclined to adopt governance by family members to seize control completely (Hoberg and Phillips, 2008; Balakrishnan *et al.*, 2011). When the family enterprise introduces external managers, there will be a conflict of governance between the enterprise owner and the external manager.

Compared with data set used by extant literature, CEES have two explicit strengths. First, CEES covers a comprehensive and large FFs sample. The data set contains a plentiful sample of private firms of small and medium size, especially the FFs, as the sampling was conducted based on the whole sample of manufacturing firms. Additionally, the CEES data set not only contains the firm founder and CEO but also middle and senior managers and firm performance. This offers valuable data for observing "governance conflicts" in Chinese family business.

3.2 Variable description

3.2.1 Family firms. The particularity of FFs lie in ownership in the family members whose ties are blood and kinship, so the key to judge FFs lies on whether a family or several closely linked families directly or indirectly control(s) the firm operation (Gersick *et al.*, 2010). Hence, this paper values the FFs by the relationship between the middle and senior manager and the firm owner. When the middle and senior managers of enterprises are the firm's initiator or his/her family members, we define them as FFs in this paper. The specifics are as follows:

$$Family\ Firm = \begin{cases} 1 & if\ senior\ manager = the\ firm's\ initiator \\ & or\ his/her\ famliy\ members \\ 0 & if\ middle\ or\ senior\ manager = the\ external\ manager \end{cases} \tag{1}$$

3.2.2 Independent variable: governance conflict. The most distinctive conflict of Chinese FFs is the governance conflict between the family member owner and the external managers. Usually, the private-owned enterprises in China are owned by families and are managed by the family management system. More and more Chinese FFs are introduced in external managers to support the firm sustainable development now. If the FFs' internal government is controlled by the family members or relatives, the government conflict is generally very low because of the mutual confidence, information sharing or the same family interest. When the FFs introduce external managers, the government conflict is generally high because of the interests' inconsistency between firm owner and external managers (Cheng *et al.*, 2017).

The way to judge the governance method is shown as follows:

$$Conflict = \begin{cases} 1 & if\ the\ family\ firm's\ governed\ by \\ & the\ external\ managers \\ 0 & if\ the\ family\ firms's\ governed\ by \\ & the\ family\ members\ or\ relatives \end{cases} \tag{2}$$

3.2.3 Dependent variables: firm performance (ROS). FFs distrusting the external managers and giving them low incentives lead to external managers not having enough motivation to improve firm performance. However, from the analysis of *H2-H4*, we can infer that after the introduction of external managers, the professional competence of managers may help FFs to improve business performance (Lambrecht, 2005; Jensen, 1999; Czarnitzki and Kraft, 2009). Based on the existing literature, this study selects the profit ration of sales (ROS) as proxy of FFs' business performance (Murphy, 1985; Coughlan and Schmidt, 1985).

3.2.4 Mediation variable. The existing literature has reported that the governance conflict in FFs can improve the firm performance by enhancing management efficiency, capital investment and innovation ability. Therefore, this paper tries to construct three mechanism variables for management efficiency, capital investment and innovation ability.

3.2.4.1 Management efficiency. The related literature points out that FFs introduce external managers and formulate a more professional management system based on their own experience to improve management efficiency (Lambrecht, 2005). This paper applies the item "The board of display output and other key performance indicator of the enterprise" to form 0-1 continuous variables after score normalization from the perspective of the firm management system. The higher the score, the higher the firms' management efficiency.

3.2.4.2 Capital investment. Compared with the high sensitivity of FFs to high-risk capital investment, it is obvious that the external managers have lower sensitivity to capital investment. Enormous literature studies have proved that FFs introduce external managers, the external managers have more investment impulsion. The greater the power of the management, the higher the intensity of the investment (Li and Liu, 2005). This paper applies the item "whether the firm has purchased the machine of origin outside of the mainland of China (including Hong Kong, Macao and Taiwan)" to form variables of 0 and 1 from the perspective of capital investment; 1 represents that the firm purchased foreign machines, that is, the firm having made the investment. On the other hand, 0 represents that firm making no investment.

3.2.4.3 Innovation ability. Compared with family members, external managers do not have to undertake too much of the losses caused by innovation failure. The existing literature has reported that FFs can drive external managers to increase innovation by improving their salaries (Francis and Smith, 1995). This paper applies the item "whether the firm has launched new products" to form variables of 0 and 1 from the perspective of firm innovation; 1 represents that the firm launched new products, and the innovation ability has been improved, and 0 represents that firm has no improvement in innovation ability.

3.2.5 Control variables. According to the literature overview, the characteristics of the firm, entrepreneurs and regional marketization will impact governance conflict and its effects of FFs. So, the control variables include firm characteristics (firm age and employee's education), entrepreneurs characteristics (age and education) and regional marketization (Table I).

3.3 Model construction

This study adopts OLS regression to analyze the effect of governance conflict between Chinese family-based managers and external managers and uses OLS to test the influence factors of this effect in controlling the firms, leaders and regional characteristics.

The OLS regression model is as follows:

$$ROS_{ijd} = \alpha_1 + \alpha_2 Conflict_{ijd} + \alpha_3 Z_{ijd} + D_j + A_d + \varepsilon_{ijd} \quad (3)$$

Variables	Variable symbol	Definition
Dependent variable		
Firm performance	*ROS*	Net profit margin on sales
Independent variable		
Governance conflict	*Governance conflict*	Governance mode of the firm (1 = external governance, 0 = family-based governance)
Control variable		
Firm characteristics	*Firm age*	Existing years of a firm
	Employee's education	The proportion of high school and above of the employee
Boss characteristics	*Entrepreneur's age*	Age of the boss
	Entrepreneur's education	The highest degree obtained (1 = no schooling, 2 = primary school, 3 = middle school, 4 = high school, 5 = technical secondary school/technical school/vocational senior middle school, 6 = junior college/vocational and technical college, 7 = bachelor, 8 = master, 9 = doctor)
Regional marketization	*Marketization*	Marketization degree (1 = municipality\special administrative region\sub provincial city\special economic zone city\provincial capital\coastal open city\key economic city, 0 = others)
Sector	*Industry*	Industry dummy variable (8 sectors)
City	*City*	Area dummy variable (26 districts)
Mediation variable		
	Management efficiency	Where does the firm show performance index boards?
	Capital investment	Whether the firm purchases foreign machine? (1 = yes, 0 = no)
	Innovation ability	Whether the firm releases new products? (1 = yes, 0 = no)

Table I. Statistical definition of main variables

The mediating effect regression model is as follows:

$$ROS_{ijd} = \alpha_1 + \alpha_2 Conflict_{ijd} + \alpha_3 M_{ijd} + \alpha_3 Z_{ijd} + D_j + A_d + \varepsilon_{ijd} \quad (4)$$

In Models 3 and 4, where i, j, and d represent the sample firm i of industry j in the sample district d, $\boldsymbol{M}_{ijd}$ represents the mediation variables, $\boldsymbol{Z}_{ijd}$ represents the series of control variables and D_j and A_d represent the industry and the region fixed effect respectively.

Model 3 aims to check that after controlling for firm characteristics, boss characteristics, marketization characteristics ($\boldsymbol{Z}_{ijd}$) and those of area (A_d) and industries (D_j), whether the firm performance (Ros_{ijd}) is higher when governance conflict of the FFs ($Conflict_{ijd}$) is more intense. If the coefficient α_2 is significantly positive in the statistical sense, it shows that *H1* stands, and the value of the coefficient measures the impact of governance conflict on performance. Model 4 aims to check that after controlling for the variables in Model 3, whether governance conflict exerts its impact on firm performance through mediation variables (M_{ijd}), including management efficiency, capital investment and innovation ability. It also checks whether the mediation effect is divided into two cases: if $Conflict_{ijd}$ and $\boldsymbol{M}_{ijd}$ are both significant, it indicates that the latter has a partial mediation effect and the value of α_3 measures the degree of such effect; if $Conflict_{ijd}$ is insignificant while M_{ijd} is significant, it shows that M_{ijd} has a complete mediation effect.

4. Descriptive statistics

The descriptive statistics on main variables is shown in Table II.

Variables	Observation	Mean	SD	Minimum	Maximum
Dependent variable					
ROS	522	0.036	0.077	−0.154	0.224
Independent variable					
Governance conflict	522	0.357	0.480	0	1
Control variable					
Entrepreneur's age	522	49.067	9.126	20	75
Firm age	522	11.607	6.183	3	44
Employee's education	522	49.961	28.827	0	100
Marketization	522	0.573	0.495	0	1
Mechanism variable					
Management efficiency	471	0.53	0.44	0	1
Capital investment	269	0.17	0.38	0	1
Innovation ability	519	0.40	0.49	0	1

Table II.
Descriptive statistics

Table III shows the basic distribution of the samples from two aspects: entrepreneur characteristics and enterprise characteristics. From the entrepreneurial characteristics, most of the Chinese FFs bosses are nearly middle-aged. Among them, 37.13 per cent of the bosses are in the 40-50 years old age bracket. The level of education of bosses has reached a relatively high level, with those having graduated high school and above accounting for more than 80 per cent. Among them, those who are university graduates and above account for more than 30 per cent. From the enterprise characteristics, the size of China's FF is small. Less than 50 enterprises account for 27.1 per cent, 50-100 enterprises account for 20.09 per cent and 100-500 enterprises account for 35.83 per cent. Most enterprises have matured; 38.33 per cent of the entrepreneurs are over 12 years old.

From Table IV, we can find that the FFs that introduce external managers have higher profit margin, higher proportion of the employees with the educational attainment of high school and above and higher firm age. These variables are significant at the level of 10 per cent and above. Besides, the age of the bosses of the FFs that introduced external managers is higher than others. However, the statistical result is not significant. From the results in the table, there are obvious differences between FFs that introduce external managers and FFs governed by family members.

5. Empirical test

5.1 Governance conflict and firm performance

Statistics show that 35 per cent of Chinese FFs introduce external managers. Why does this happen? Table V illustrates the regression result of governance conflict and firm performance. By adding control variables gradually, the Rows 1-4 in Table V reflect that governance conflict has a positive effect on net profit margin on sales (*ROS*) at a significant level of 10 per cent. The result shows that the higher the conflict, the higher the *ROS* of FFs is. Compared to firms that are managed by family-based managers, the *ROS* of firms that introduced external managers increases by 1.36 per cent. This conclusion supports *H1*. The results above can explain the reason why Chinese FFs introduce external managers even though they have to face governance conflict. Because of the profession of external managers, Chinese FFs will have different degrees of knowledge conflict in terms of management, investment and innovation. From the empirical results, this kind of conflict due to changes in governance structure will help improve the ability of firms in management, investment and innovation, in turn improving business performance.

Characteristics	N	(%)
Entrepreneurial characteristics		
Age (year)		
<30	15	2.34
30-40	73	11.39
40-50	238	37.13
50-60	236	36.82
>60	79	12.32
Mean	*49 years*	
Education		
Primary school and below	18	2.80
Junior school	58	9.03
High school	210	32.71
College	132	20.56
University and above	224	34.89
Mean	*High school*	
Enterprise characteristics		
Size (person)		
<50	174	27.10
50-100	129	20.09
100-500	230	35.83
500-1,000	55	8.57
>1,000	54	8.41
Mean	*453 persons*	
Age (year)		
<3	37	5.96
3-5	71	11.43
5-8	120	19.32
8-12	155	24.96
>12	238	38.33
Mean	*11 years*	

Table III. Characteristics of sample

Variables	Conflict = 1	Governance conflict Conflict = 0	*p*-value of diff
ROS	0.044	0.031	0.013**
Entrepreneur's age	49.500	48.742	0.758
Employee's education	53.137	48.978	4.159*
Firm age	12.059	11.025	1.034**
Marketization	0.540	0.546	−0.006

Notes: **Indicates the significant level of 5%; *indicates the significant level of 10%

Table IV. T Test based on governance conflict

5.2 Mediating effect

As analyzed above, Chinese FFs introduce external managers to participate in the company management aiming to promote firm performance. It is meaningful to focus on the question that which factor will reinforce the effect. According to relevant theoretical and empirical literature analysis, management efficiency, capital investment and innovation ability will

Variables	(1) ROS	(2) ROS	(3) ROS	(4) ROS
Governance conflict	0.0146** (0.00719)	0.0147** (0.00741)	0.0141* (0.00730)	0.0136* (0.00735)
Log entrepreneur's age		−0.0697* (0.0403)	−0.100** (0.0433)	−0.103** (0.0437)
Log employee's education		−0.0598 (0.133)	−0.0588 (0.136)	−0.079 (0.136)
Log firm age			0.216 (0.626)	0.168 (0.609)
Marketization				−0.00530 (0.0479)
Entrepreneur's education	Yes	Yes	Yes	Yes
Industry fixed effect	Yes	Yes	Yes	Yes
City fixed effect	Yes	Yes	Yes	Yes
Observations	585	556	521	521
R^2	0.114	0.126	0.154	0.157

Notes: Values in brackets are robust standard errors; **indicates the significant level of 5%; *indicates the significant level of 10%

Table V.
Governance conflict and ROS (OLS)

have an effect on the firm choice of introducing external managers. Therefore, based on the basic regression, this part will test the effect of management efficiency, capital investment and innovation ability degree by using OLS. Table VI indicates the regression result.

Table VI, Row 1, shows the effect of governance conflict on business performance under the premise of not adding any mechanism variable. Rows 2-4 show that whether the mechanism variable exert the mediating effect and the extent of its exertion on the basis of basic regression, adding management efficiency, capital investment and innovation ability. From Row 2, we can find that after adding management efficiency, it has significant positive correlation with ROS at the level of 10 per cent, and governance conflict became non-significant. It shows that management efficiency has a complete mediating effect in the effect of governance conflict on business performance. The result indicates that governance conflict caused by the introduction of external managers in family businesses can significantly promote the family business performance by improving management

Variables	(1) ROS	(2) ROS	(3) ROS	(4) ROS
Governance conflict	0.0140* (0.00739)	0.00807 (0.00800)	−0.00805 (0.0111)	0.0125* (0.00729)
Log management efficiency		0.0157* (0.00803)		
Capital investment			0.0307** (0.0143)	
Innovation ability				0.0194*** (0.00698)
Log entrepreneur's age	−0.0848** (0.0430)	−0.0763* (0.0445)	−0.142** (0.0646)	−0.0900** (0.0428)
Log employee's education	−0.0956 (0.134)	−0.0836 (0.143)	−0.136 (0.189)	−0.122 (0.133)
Log firm age	0.133 (0.625)	−0.0984 (0.674)	−0.210 (1.19)	0.239 (0.610)
Marketization	−0.00994 (0.0469)	−0.00665 (0.0490)	0.00627 (0.0306)	−0.00464 (0.0473)
Entrepreneur's education	Yes	Yes	Yes	Yes
Industry fixed effect	Yes	Yes	Yes	Yes
City fixed effect	Yes	Yes	Yes	Yes
Observations	539	487	278	537
R^2	0.151	0.170	0.201	0.166

Notes: Values in brackets are robust standard errors; ***indicates the significant level of 1%; **indicates the significant level of 5%; *indicates the significant level of 10%

Table VI.
Mediating effect (management efficiency, capital investment and innovation abilities)

efficiency. When external managers are introduced by FFs, its management knowledge will conflict with the existing management knowledge. Repeated game of conflict will promote the management efficiency of the firms iteratively. From Row 3, we can find that after adding capital investment, it has significant positive correlation with ROS at the level of 5 per cent, and governance conflict became non-significant. It shows that capital investment has a complete mediating effect in the effect of governance conflict on business performance. This result indicates that governance conflict caused by the introduction of external managers in family businesses can significantly promote the family business performance by improving capital investment. The investment knowledge of external managers will gradually form a higher investment rate of investment decisions through conflicting with existing investment knowledge of firms. The optimization of investment decisions is ultimately reflected in the improvement of business performance. From Row 4, we can find that after adding innovation ability, it has significant positive correlation with ROS at the level of 1 per cent, and there was no change in significance of governance conflict, but the coefficient was reduced from 0.0140 to 0.0125. It shows that innovation ability has a partial mediating effect in the effect of governance conflict on business performance. Using Sobel index to test the extent of partial mediating effect of innovation ability, we found that the partial mediating effect of innovation ability is 7.21 per cent. The result indicates that governance conflict caused by the introduction of external managers in family businesses can significantly promote the family business performance by improving partial innovation ability. The innovation knowledge of external managers must be different from that of current product managers. Differences in knowledge will create conflicts, such as intense confrontation at the seminar. From the empirical results, this conflict is ultimately beneficial to the improvement of business performance, because this conflict can help firms to create innovative products which are more conducive to market.

5.3 Subgroup regression results

To further examine the heterogeneity of management efficiency, capital investment and innovation ability in the influence of governance conflict on performance, this section will group sample firms by the average of employees' educational attainment, boss's age and boss's educational attainment separately. The regression results are shown in Tables VII-IX. Table VII lists the regression results after grouping according to the average education attainment of employees. Among them, Rows 1, 3 and 5 are the regression results of higher education attainment, and Rows 2, 4 and 6 are the opposite. The results show that FFs whose employee's education attainment is higher than the average have no significant mediating effects of management efficiency and capital investment (Rows 1 and 3). But FFs whose employee's education attainment is lower than the average have a significant result, which is at the 5 per cent level (Rows 2 and 4). This shows that with lower employee's education level, FFs can improve business performance by introducing external managers to increase management efficiency and capital investment income.

Table VIII lists the regression results after grouping according to the average boss's age. Among them, Rows 1, 3 and 5 are the regression results of older age, and Rows 2, 4 and 6 are the opposite. The results show that the mediating effect of capital investment and innovation capacity are significant at the 10 per cent level in the older age group (Rows 3 and 5), and the mediating effect of management efficiency is significant at the 5 per cent level in another group (Row 2). The results show that FFs with younger age of boss improve business performance by improving management efficiency. But FFs with older age of boss improve business performance by conducting more risky capital investment and innovation.

Table VII.
Mediating effect (group by employee's education) (management efficiency, capital investment and innovation abilities)

Variables	(1) ROS > = mean	(2) ROS <mean	(3) ROS > = mean	(4) ROS <mean	(5) ROS > = mean	(6) ROS <mean
Governance conflict	0.007 (0.011)	0.011 (0.011)	−0.020 (0.016)	0.005 (0.016)	0.011 (0.011)	0.013 (0.010)
Log management efficiency	0.002 (0.014)	0.026** (0.012)				
Capital investment			0.027 (0.021)	0.047** (0.022)		
Innovation ability					0.023** (0.011)	0.027*** (0.010)
Other control variables	Yes	Yes	Yes	Yes	Yes	Yes
Observations	239	268	151	143	250	308
R^2	0.343	0.274	0.382	0.329	0.343	0.262

Notes: Values in brackets are Robust Standard Errors; ***indicates the significant level of 1%; **indicates the significant level of 5%; *indicates the significant level of 10%

Table VIII. Mediating effect (group by entrepreneur's age) (management efficiency, capital investment and innovation abilities)

Variables	(1) ROS > = mean	(2) ROS <mean	(3) ROS > = mean	(4) ROS <mean	(5) ROS > = mean	(6) ROS <mean
Governance conflict	−0.009 (0.011)	0.029** (0.013)	−0.024 (0.017)	0.010 (0.016)	−0.004 (0.010)	0.035*** (0.012)
Log management efficiency	0.009 (0.012)	0.030* (0.016)				
Capital investment			0.033* (0.019)	0.032 (0.025)		
Innovation ability					0.018* (0.010)	0.014 (0.012)
Other control variables	Yes	Yes	Yes	Yes	Yes	Yes
Observations	260	229	134	146	283	256
R^2	0.253	0.286	0.379	0.295	0.231	0.256

Notes: Values in brackets are robust standard errors; ***indicates the significant level of 1%; **indicates the significant level of 5%; *indicates the significant level of 10%

Table IX.
Mediating effect (group by entrepreneur's education) (management efficiency, capital investment and innovation abilities)

Variables	(1) ROS > = college	(2) ROS <college	(3) ROS > = college	(4) ROS <college	(5) ROS > = college	(6) ROS <college
Governance conflict	0.013 (0.011)	−0.004 (0.012)	−0.005 (0.015)	0.005 (0.017)	0.019* (0.010)	0.004 (0.012)
Log management efficiency	0.011 (0.013)	0.035** (0.014)				
Capital investment			0.042** (0.020)	0.032 (0.023)		
Innovation ability					0.020* (0.010)	0.016 (0.011)
Other control variables	Yes	Yes	Yes	Yes	Yes	Yes
Observations	273	214	149	129	302	235
R^2	0.207	0.317	0.306	0.300	0.214	0.241

Notes: Values in brackets are robust standard errors; ***indicates the significant level of 1%; **indicates the significant level of 5%; *indicates the significant level of 10%

Table VIII lists the regression results after grouping according to the average educational attainment of bosses. Among them, Rows 1, 3 and 5 are the regression results of higher educational attainment, and Rows 2, 4 and 6 are the opposite. The results show that the mediating effect of capital investment and innovation capacity are significant at the 5 and 10 per cent level, respectively, in the higher attainment group (Rows 3 and 5), and the mediating effect of management efficiency is significant at the 10 per cent level in another group (Row 2). The results show that FFs with lower educational attainment of bosses, whose professional management skills are poor, improve business performance by improving management efficiency. But FFs with higher educational attainment of bosses improve business performance by conducting capital investment and innovation.

6. Discussion

Over the past 30 years of reform and opening up, Chinese FFs have undergone a gradual transformation from germination, development to maturity. On the one hand, with the growth of FFs, it plays an increasingly important role in economic growth. On the other hand, its management problems are gradually exposed. It is a practical problem for Chinese FFs to specialize the family-based management of low governance conflict or the external management of high governance conflict now.

In this paper, the study finds that some Chinese FFs began to introduce external personnel to participate in corporate governance. Although it leads to a certain governance conflicts, it significantly improves the firm business profit. Therefore, the governance conflict between the owner and the external managers is not totally negative. Because of the professionalization of external managers, FFs gain higher profit margins can be improved.

On this basis, this paper further put forward the hypothesis that FFs which choose family governance can achieve more controlling right at the cost of profit. The empirical results of this paper confirmed the hypothesis that the regression results of the corporate governance mode on profit margin show that enterprises managed by family members have lower profit margins than those managed by external managers. This empirical result is consistent with the existing literature. Therefore, in this paper, the study found that most of the Chinese FFs find it difficult to complete the professionalization process of management at present, and the controlling right of family members is still high. The reason is that the family business owners do not want to lose more controlling rights.

How can the introduction of external managers in family businesses improve the performance of the business? Based on OLS regression, we found that business management efficiency and capital investment have significant mediating effects, while technical innovation has a partial mediating effect. In other words, the governance conflict caused by the introduction of external managers in family businesses can promote the firm performance through significantly improving the performance management and machinery equipment standard of the business. Chinese family businesses are going through the evolution of modernization governance with nearly 40 years of development. Professional management is the inevitable choice for the growth of family businesses. This paper provides empirical evidence for the needs of Chinese family businesses introducing external managers. In the premise of family holding, the current introduction of external managers in Chinese family businesses can improve the management efficiency, that is, restraining all members with a production target, harmonizing the personal goals and interest with enterprise goals and interest, forming an objective and fair management mechanism and organizational order and avoiding the nepotism management. At the same time, the data also show that external managers are more concerned about the quality of the product. They improve the stability of the product quality by upgrading the machine and equipment.

However, the results show that the impact of governance conflict on the development of new product is not quite significant. There is a possibility that external managers have a certain tendency to develop new products, but the business owners are reluctant to do it. The external managers are suppressed by family businesses in strategic decision-making, related sources, etc. and are unable to effectively launch the R&D innovation activities. Thus, the main function of the introduction of external managers in Chinese family businesses reflects in the improvement of management efficiency and production conditions, and it is not quite significant for new product development.

Are there any differences in the effectiveness of different FFs in improving corporate performance after introducing external managers? In this paper, further tests are performed by subgroup regression. Form the results, employees with lower educational attainment lack professional management capabilities. Therefore, FFs using professional management of external managers can quickly improve the overall management efficiency. At the same time, employees with lower educational attainment also cannot operate complex digital equipment skillfully. After introducing external managers, FFs can purchase more advanced equipment through extensive social relationships of external managers. Besides, professional competence of external managers can be imparted to employees through training or other methods. Ultimately, FFs with lower educational level can improve the return on capital investment and performance by external managers.

This paper divides firm samples into two groups according to the average age of bosses for heterogeneity testing. The results show that bosses with younger age, especially the second-generation bosses in China, are relatively young and have a good education. They are very clear about the importance of management efficiency for long-term development of enterprises. Compared to the older generation of bosses, they are more willing to restructure management architecture by introducing external managers. When the bosses get older, they think more comprehensively and clearly about the strategic direction of future development. So, older bosses can make more accurate investment and innovation decisions by the accumulation of experience. As a result, older bosses are more willing to introduce external managers for capital investment and innovation.

Furtherly dividing the firm samples according to the average educational attainment of the bosses, subgroup regression results show that FFs are usually small in the early stage where standardized management process is unnecessary. As management efficiency becomes a core key performance indicator with expansion of the scale, for FFs whose bosses do not obtain much education, introduction of external managers would effectively make up for the deficiency of the previous management and improve management efficiency in a short time. For more educated bosses, their professional knowledge drives them to be more cautious when making decisions of capital investment and innovation; thus, managers with competence in information collection and analysis are in need. The econometric results above also prove such deduction that more educated bosses are more inclined to introduce external managers to facilitate investment decision-making and innovation improvement.

7. Theoretical and practical implications

7.1 Theoretical implications

The main concern of this study, governance conflict between family members and external managers in the FFs, is a conflict in a broad sense, which refers to the mutual conflict of choice costs of two or more participants. The governance conflict is one of the most significant features of FFs (Gomez-Mejia *et al.*, 2011). According to Chassang and Miquel (2010), information asymmetry exists between the founder himself or his family members and external managers of FFs, leading to the mutual distrust of the participants. There is no party among them able to predict the next action of the others. Thus, to win the first-mover advantage, the founder or his family members of FFs will have the incentive to initiate the conflict. The most direct action is to assign family members to participate in the core management of the firm; thereby, the conflict between family members and external managers is called *governance conflict*.

The existing research on governance conflict between Chinese FFs owners and external managers is basically based on the data of listed companies and did not cover a large number of small and medium-sized firms. Therefore, based on the disclosure data of listed companies, the measure of governance conflict was mostly based on external managers and FFs owners. But, for FFs in China, the reality is that most are small and medium-sized and generally introduce external managers as mid-level managers, which are responsible for certain departments such as sales and production rather than the entire firm. Therefore, there is a certain deviation in observing the governance of FFs of different scales in China only by whether they introduce professional managers. From the perspective of Chinese reality, this paper achieves the conditions of whether the managers are family members of the firm founders so that the empirical results are more close to the reality of China. In the current study on Chinese FFs, research on this respect is relatively rare mainly because of the lack of relevant data.

7.2 Practical implications

Since China's reform and opening in the 1980s, China's private enterprises have gradually gained the legitimacy of survival and development in ideology and system and have an important position in the areas of output value, employment, export and taxation. Most are FFs. Thus, the family business is an important part of China's economic development. This study on governance mode of the FFs has very significant practical implications in the context of the current slowdown in the Chinese private economy.

This study here shows that most Chinese family enterprises are small in size. When the FF size is smaller, the possibility that a firm adopts the model of governed by family acquaintances will be larger, as the trust-based management by family acquaintance will have a better effect than FFs governed by external managers. China's particularity in this case is that managers are rarely professional. In China, which is such a large developing country and has a large number of market opportunities, it also has low barriers to entry. This provides a very good market condition and possibility for Chinese FFs to introduce professional external managers. This study proves that the current Chinese FFs' governance conflicts produced by the introduction of external managers have significant positive effect on firm performance, although part of equity is sold.

Therefore, we suggest that the Chinese Government needs to further support the growth of FFs. The sources and prospects for economic growth in China with a focus on human capital (Li *et al.*, 2017; Cheng and Xu, 2015). The rapid growth of FFs will bring about the growth of demand for professional managers. In this realistic context, management by family acquaintance is a type of institutional arrangement that avoids the risks of agency. However, the family-based management limits the introduction of entrepreneurial ability. With entrepreneurial ability that constrains the further development of the enterprise, FFs that continue to maintain this governance method will reduce the efficiency of the organization and will bring a disadvantage in the competitive market (Posthuma, 2013). The existing conflict theory points out that the individual conflict management model can be divided into five types: integration, accommodation, domination, avoidance and compromise.

The study confirms that the conflict between the owners and managers of Chinese FFs does not have negative effects on firm performance. They have good cooperation base on the process of communication, compromise and game and have a good positive incentive effect on firm performance. So, the Chinese Government should actively guide enterprises to introduce external managers to improve firm performance efficient. Although there will be a period of conflict between FF owners and external managers, the conflict will eventually improve the market competitiveness of the firms and then continue the sustainable development of FFs.

7.3 Limitations and future research directions

There is still space for further improvement in the following two aspects: first, the conflict between the owners and managers of the FFs needs further refinement. The focus is on the structural measures of the conflict, such as whether there are conflicts in terms of finance, product research and development, enterprise development strategy and so on. In this way, the governance conflict between the owners and managers of FFs can be more accurately measured, and more specific empirical evidence can be provided for specific countermeasures. Second, the impact of governance conflict on the development performance of enterprises requires a longer time series of panel data to be tested. This study is only a cross-sectional data study. This study will be based on the observation of CEES for a long period of time.

8. Conclusion

At present, Chinese FFs are more and more aware that the development of enterprises needs to bring in external managers to participate in corporate governance. In this process, there will be a governance conflict between external managers and family business owners. Why are FFs still willing to introduce outsiders into corporate governance? Based on micro data from Chinese manufacturing enterprises, this paper answers this question empirically.

First, this study finds that 30 per cent of Chinese FFs has introduced external managers in the middle and senior management. Based on information and profit asymmetry, FFs that introduce external managers have some governance conflicts between the owners and the external managers. So, Chinese FFs that introduce external managers have had to lose some of their management rights due to conflicts between owners and managers. It also shows that one important reason why Chinese FFs do not bring in outsiders is that they do not want to lose more control. Second, this paper also finds that governance conflicts produce significant "profit promotion effect". The profit level of the FFs that introduce external managers, compared with those that do not introduce external managers, is higher in control of other factors. This indicates that current governance conflicts between the external managers and the owners of Chinese family enterprises are not completely negative. Third, based on the OLS regression analysis, we find that the governance conflict caused by the introduction of external managers in Chinese FFs can significantly improve a firm's performance by raising its management efficiency and capital investment.

The average duration of Chinese FFs is 11 years, and the expansion of the enterprise is not in one day. It is the result of the constant struggle of the founders and their family members. Entrepreneurship is easy, but implementation is hard. After start-up stage, the cost and risk of only relying on family members to govern the firm is increasingly high during the implementation and development process. Firms should introduce modern governing mode and bring in external managers to make professional management. Therefore, it is suggested that the Chinese Government should encourage small and medium-sized FFs to actively introduce external professionals to improve management efficiency and business performance and offer special human capital subsidies to the external managers introduced in the firms.

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