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Does Nepotism Run in the Family? CEO Pay and Pay-Performance Sensitivity in Indian Family Firms

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Key Words: CEO Compensation; Family Firms; Emerging Markets; Business Groups; Pay-performance Sensitivity

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INTRODUCTION

Few topics in organization studies have received as much attention from a wide array of scholars in different fields as CEO compensation (e.g., Beatty and Zajac, 1994; Devers, McNamara, Wiseman and Arrfelt, 2008; Flammer, Hong and Minor, 2019; Gomez-Mejia, Neacsu and Martin, 2019; Jensen and Murphy, 1990; Wowak and Hambrick, 2010). Two key questions in this literature include (i) why some CEOs are paid more than others and (ii) to what extent is CEO pay sensitive to realized firm performance. Prior research, set mainly in the United States, has examined a variety of explanatory factors including organizational characteristics such as firm size and performance (Devers, Cannella, Reilly and Yoder, 2007); CEO characteristics such as political ideology (Gupta and Wowak, 2017) and human capital (Castanias and Helfat, 1991);

situational characteristics such as information processing demand (Henderson and Fredrickson, 1996) and corporate turnaround contexts (Chen, 2015); and social comparison processes (e.g., Porac, Wade and Pollock, 1999).

In addition, scholars have extensively examined the effect of corporate governance on CEO compensation, given that publicly listed firms are rife with agency problems between shareholders (principals) and managers (agents) (Jensen and Meckling, 1976) since ownership is separated from control. Thus, in large publicly listed firms in the United States, widely dispersed ownership coupled with managerial entrenchment create agency problems that result in higher CEO compensation and lower pay sensitivity to realized firm performance (Aguinis et al., 2018; Finkelstein, Hambrick and Cannella, 2009). Gomez-Mejia, Larraza-Kintana and Makri (2003) propose that the effect of such agency problems on CEO compensation would be *reversed* in the case of family-controlled firms because of greater alignment of interests between the shareholders and family CEOs. They provide empirical support for their arguments using US data, where family CEOs of family-controlled firms received lower total compensation compared to professional CEOs, although they do not examine drivers of pay-performance sensitivity.

Despite the advancement of research on this topic we do not know to what extent these conceptual models on CEO compensation design generalize to family firms in emerging economies, which have different formal and informal institutions (Berrone, et al., 2020). Indeed, prior scholarship suggests that in emerging economies, wealthy families are typically the largest shareholders and exercise management control over many large, publicly listed firms (Morck, Wolfenzon and Yeung, 2005). Scholars have found that principal-principal (P-P) conflicts between controlling and non-controlling shareholders (La Porta, Lopez-de-Silanes and Shleifer, 1999; Shleifer and Vishny 1997) are endemic in these settings because wealthy families may

take advantage of their controlling shareholder position to exploit minority shareholders by channeling corporate resources in ways that advantage the controlling family – which scholars refer to as tunneling behavior (e.g., Bertrand, Mehta and Mullainathan, 2002). However, we know less about how P-P conflicts might influence CEO compensation in emerging economy firms controlled by families.

Using a principal-principal agency theory lens (Morck et al., 2005; Young, Peng, Ahlstrom, Bruton and Jiang, 2008), we build a framework on how CEO compensation as well as CEO pay-performance sensitivity in family-controlled firms in emerging economy contexts is regulated by whether the CEO is drawn from the controlling family. Patterns in CEO compensation data from 277 large Indian family-controlled firms and 395 CEOs comprising 402 unique CEO-firm positions during 2004 to 2013 largely supports our theory that the controlling family's dominance over the focal firm's board of directors is reflected in CEO compensation design. Family CEOs receive higher compensation than professional CEOs. This pay-gap in favor of family CEOs is unaffected by poor firm performance and is disproportionately boosted by superior firm performance. This pattern in the data is consistent with a double standards approach (Foschi, 2000) whereby boards of directors hold family CEOs to a more lenient performance standard compared to their professional counterparts. Supplementary analyses on CEO compensation patterns across superior-performing eponymous firms (firms named after the controlling family) versus superior-performing non-eponymous firms lend additional support to our hypothesized mechanism. Overall, our findings suggest nuanced heterogeneity in the extent of nepotism in emerging economy family firms - some family firms' CEO compensation practices appear to be pathways for tunneling corporate resources. We contribute by advancing

the management literature on CEO compensation and bridging the hitherto disconnected literatures on business groups and family firms.

THEORETICAL DEVELOPMENT

Agency Theory and CEO Compensation in Family Firms

Agency theory underlines issues of conflict of interest between principals (shareholders) and agents (managers) and has been a foundational theory in explaining differences in CEO pay as well as in designing mechanisms to alleviate or manage conflicts of interest between shareholders and managers (Gomez-Mejia, Tosi and Hinkin, 1987; Tosi, Werner, Katz and Gomez-Mejia, 2000; van Essen, Otten and Carberry, 2015). The agency theory perspective suggests that in publicly listed firms with dispersed ownership and run by professional executives, CEOs may pursue a self-serving agenda that could conflict with principals' interests. In addition to closer monitoring, incentive alignment is a key mechanism to address potential agency problems, whereby a focal firm's board of directors tailor the CEO compensation contract to promote greater congruence of interests between agents and principals. Hence agency theorists propose structuring compensation contracts that make professional CEOs behave more like owners by granting equity or stock options - even if the resulting CEO compensation is high.

Gomez-Mejia *et al*. (2003) build on the driving logic of agency theory to examine CEO compensation in family-controlled firms. They propose that CEOs drawn from the controlling family will experience *lower* compensation than professional CEOs in such firms for the following reasons. First, greater job security afforded to family CEOs will reduce the need for higher compensation when compared to professional CEOs. Likewise, family CEOs derive greater non-pecuniary benefits – such as greater socio-emotional attachment to the firm – that reduces their need for monetary compensation. In contrast, compensation for professional CEOs in such firms are likely to be based on the competitive labour market for CEOs (James, 1999;

Gomez-Mejia, Nunez-Nickel and Gutierrez, 2001). Therefore, they predict and find that in the United States, family-CEOs experience *lower* compensation when compared to professional CEOs. It is unclear whether these findings generalize to emerging economy contexts.

Principal-Principal Agency Issues in Emerging Economy Contexts

Over the past decade, scholars have pointed to another layer of agency issues particularly salient in the context of emerging economies (Morck and Yeung, 2003; Young et al., 2008). Concentrated ownership by wealthy families coupled with weak institutional environment in emerging economies leads to conflicts between controlling and minority shareholders and exploitation of the latter by the former, often termed as principal-principal (P-P) agency problem (Bertrand et al., 2002; Morck et al., 2005; Young et al., 2008). This is because such wealthy families typically control numerous public and private firms through crossholdings (these inter-firm clusters are referred to as business groups). Controlling families often indulge in non-arm's-length transactions between related companies at the cost of minority shareholders (Cheung, Stouraitis and Wong, 2005; Morck and Yeung, 2003) to maximize their overall family wealth. In such settings, a nepotistic relationship could develop between controlling shareholders and key executives such as CEOs, who jointly are likely to exploit minority shareholders (Young et al., 2008). Indeed, Chittoor, Aulakh and Ray (2017) provide evidence that controlling family members occupying powerful top executive positions is a common phenomenon in emerging economy family firms.

Family CEO Compensation in Emerging Economy Contexts

The boards of publicly listed companies are expected to oversee the process of hiring, evaluating, compensating and terminating the CEO (Jensen, 1993; Finkelstein et al., 2009). Boards are expected to negotiate an arms-length compensation contract with the CEO that aligns interests of

the CEO with all shareholders (Bebchuk and Fried, 2004; Finkelstein et al., 2009). However, in emerging economy contexts rife with P-P conflicts and underdeveloped institutions, this could be problematic under certain structural conditions in family firms (Bebchuk and Fried, 2004; Van Essen et al., 2015). Specifically, in family firms where the CEO position is occupied by an individual from the controlling family, the family wields greater power over board members and thus exerts undue influence in board-level decision-making processes. We draw two implications of this power imbalance for executive compensation in family firms.

First, this power imbalance creates few incentives for boards of directors to forcefully challenge compensation arrangements that are more in the interest of the controlling family than the minority shareholders. Controlling families can thus more easily set higher levels of CEO pay for family CEOs compared to otherwise similar professional CEOs. Thus, we expect to observe that, in emerging economy family-controlled firms, family CEOs receive a higher total pay compared to their professional counterparts, irrespective of their firm's performance.

Second, this power imbalance is also manifested through the board implicitly adopting double standards (Foschi, 2000) in attributing firm performance outcomes to CEO competence versus luck (Bertrand and Mullainathan, 2000); essentially family CEOs and professional CEOs are evaluated by differently calibrated yardsticks (Gomez-Mejia et al., 1987). The logic of the double standards mechanism implies that superior realized firm performance is disproportionately attributed to family CEOs competence rather than good luck, when compared to otherwise similar professional CEOs. In sum, board members hold family CEOs to a more lenient performance standard. This suggests an asymmetry in the sensitivity of family CEOs pay to realized performance of the focal firm (i.e., pay-performance sensitivity). We expect that family CEOs receive even higher pay compared to professional CEOs when their firm

experiences superior realized performance[1]. This implication is contrary to the standard P-A agency theory argument that pay-performance sensitivity represents an optimal incentive design which ties CEO pay to firm performance.

We note that these implications, derived using a P-P lens, are the exact opposite of prior research on family firms in mature economies (e.g. Gomez-Mejia *et al.*, 2003; McConaughy, 2000). This prior work uses a principal-agent (P-A) lens to propose that family CEOs, due to pre-existing strong interest alignment, experience lower pay and lower pay-performance sensitivity compared to professional CEOs. In contrast, our P-P perspective emphasizes the greater opportunities available to controlling families in emerging economies to engage in tunneling behavior to appropriate corporate resources – summarized by the two formal predictions below:

H1: *In family-controlled emerging economy firms, family CEOs receive higher compensation compared to professional CEOs*

H2: *In family-controlled emerging economy firms, family CEOs of high performing firms will have higher pay-performance sensitivity compared to professional CEOs of other high performing firms*

DATA AND METHOD

Data Sample

India is an appropriate empirical context for this study because of its large population of family businesses (Credit Suisse Research Institute, 2018). We obtained financial data of our sample companies through the widely used *Prowess* database (e.g. Khanna and Palepu, 2000; Chacar and Vissa, 2005; Chittoor, Kale and Puranam, 2015). India lacks secondary databases with

[1] The logic of the double standards mechanism also implies there will be no difference in pay-performance sensitivity of family CEOs versus professional CEOs for firms experiencing poor performance. Because this is in essence a null effect, we offer no formal prediction for pay-performance sensitivity in poorly performing firms.

reliable information on CEO characteristics and comprehensive details on CEO compensation. This necessitated laborious hand collection and coding of data; hence we chose the top five hundred companies that constituted the BSE 500 index (as on September 2012), an Indian index comparable to S&P 500, as our initial sample set – which was well balanced in terms of firms' size, age, ownership and industry diversity. Our data spans the ten-year period from 2004 because regulatory changes in 2004 mandated corporate disclosure on executive compensation.

CEO compensation data was available only for 399 of the BSE 500 firms. Testing our model requires a sample of listed family-controlled firms which we assembled in two steps. First, we eliminated listed Indian subsidiaries of foreign multinational companies (49) as well as government firms (39). We then followed prior research in the Indian context (Singla, Veliyath and George, 2014) to classify the remaining Indian firms into family and non-family businesses. This classification is robust because Singla et al. (2014) classify an Indian firm as a family business using more stringent cut-offs on the same yardsticks used by family business research in the United States (Handler, 1989; Astrachan, Klein and Smyrnios, 2002). Specifically, a family firm is classified as such if the following two conditions are both satisfied. First, the family's shareholding represents more than 20% of the firm's equity. Second, a family member is chairman of the board or managing director or CEO or two or more family members are on the board of the firm. The classification was also independently verified by two expert analysts. After eliminating non-family firms and outliers, our final sample included data on 277 family firms consisting of 402 unique family-firm-CEO combinations yielding an unbalanced panel dataset with 2,011 non-zero observations for all the variables of interest. Our sample is biased towards larger firms due to data availability issues. But this represents a conservative test of our

model since the relationships we predict are likely to be even stronger in smaller firms where family-owners face much less public scrutiny.

Measures

CEO pay: To measure our dependent variable *CEO pay*, we take the natural logarithm of total CEO compensation reported in the annual report, which includes salary, bonus, commission and all other benefits. Stock options are rare in our context. Even for the 3.8% observations in our sample that do report stock options, they are not a material component of overall CEO compensation design. Further we lack data on the accumulated stocks of options held by CEOs and hence cannot compute changes in the value of unexercised options granted in previous years. Our analyses thus exclude stock options, unlike typical US-based studies. Our findings are robust to dropping the 3.8% observations that report stock option grants to CEOs.

Firm performance: The financial return on assets (ROA), adjusted by industry median ROA, is our measure of focal firm performance. We first defined industry boundaries using the National Industrial Classification (NIC) to identify which 3-digit industry the focal firm belonged to. We then used ROA data from the full sample of BSE-500 firms to identify the industry median ROA each year. We use ROA at the same year as the CEO compensation to capture the notion that CEO pay (which includes performance related bonuses) is responsive to *realized* accounting performance. Because Indian stock markets are less efficient compared to the United States and stock options are a rarely used element of CEO compensation, we do not use share price performance or change in shareholder wealth to measure firm performance (Jensen and Murphy, 1990; Schaefer, 1998). Furthermore, we consider firms with ROA at or above the industry median as superior performers whilst firms with ROA below the industry median are considered poor performers.

Family CEO: We operationalize *family CEO* as an indicator variable that is set to 1 when the CEO is drawn from the controlling family – termed promoter in Indian parlance - and 0 otherwise (i.e. a professional CEO). Specifically, we browsed company annual reports and company filings with the regulator SEBI (Securities Exchange Board of India) to identify the promoter family controlling the firm. We then coded *family CEOs* based on documentary evidence of kin relationship between the CEO and the controlling family.

To test H2 – family CEOs of high performing firms will have a higher pay-performance sensitivity compared to professional CEOs of other high performing firms - we utilize spline functions (Greene, 1993: 235–238), which allow a piecewise linear specification to ensure that the slope of the regression line can differ above and below a given threshold and are commonly used in attainment discrepancy models (Greve, 2003). The spline specification was made by entering separate variables for *family CEO* above and below median industry ROA which respectively yielded the variables *high performing firm run by family CEO* and *low performing firm run by family CEO*. Thus, *high performing firm run by family CEO* takes the value of *family CEO* for superior performing firms and is zero otherwise, which spotlights the effect of *family CEO* on *CEO pay* for high performing firms. Likewise, *low performing firm run by family CEO* takes the value of *family CEO* for poorly performing firms and is zero otherwise, thus illuminating the effect of *family CEO* on *CEO pay* for poorly performing firms.

Other control variables: We control for several variables that are expected to have an impact on CEO compensation design. We account for CEO-level effects through *CEO education* measured as a dummy variable if the CEO has a college degree and *CEO tenure* measured as the number of years of experience as CEO. We control for firm-level effects through *firm size* calculated as the natural log of firm sales and *firm age* calculated as the number of years since

the firm was founded. We control for ownership driven governance effects by including *owners' shareholding* measured as the percentage ownership by controlling shareholders and *institutional shareholding* measured as percentage ownership by institutional shareholders. Finally, we control for industry and year specific effects using indicator variables. We use OLS regression models with robust standard errors clustered at the firm level to correct for non-independence within firms over time, as well as adjusted for heteroscedasticity (White, 1980).

Model

Model (1) below is the starting point for testing our hypotheses empirically:

$$CEO\ pay = \beta_0 + \beta_1 family\ CEO\ + \beta_2 firm\ performance + \beta_i controls + year\ \&\ industry\ fixed\ effects + \varepsilon \quad (1)$$

We regress *CEO pay* on *family CEO, firm performance* and a number of control variables. Our H1 predicts a positive value for coefficient β_1 which captures the effect of *family CEO* on *CEO pay*. Coefficient β_2 estimates whether *CEO pay* is responsive to *firm performance* - referred to as pay-performance sensitivity (Gao and Li, 2015; Murphy, 1999). If β_2 is positive, it suggests that an increase in firm performance will have a positive impact on CEO pay. To examine whether family CEOs have higher pay-performance sensitivity, we add an interaction term between *family CEO* and *firm performance* to model (1) and expect the coefficient for the interaction term is positive. To test our H2 on the asymmetry in family CEO's differential pay-performance sensitivity we add interaction terms between the splined *family CEO* variable (*high performing firm run by family CEO* and *low performing firm run by family CEO*) and *firm performance*. Specifically, in model (2) below, if the coefficient β_4 of the interaction term *high performing firm run by family CEO X firm performance* is positive it provides evidence supporting H2.

$$CEO\ pay = \beta_0 + \beta_1 high\ performing\ firm\ run\ by\ family\ CEO + \beta_2 low\ performing\ firm\ run\ by\ family\ CEO + \beta_3 firm\ performance + \beta_4 high\ performing\ firm\ run\ by\ family\ CEO\ X\ firm\ performance + \beta_5 low\ performing\ firm\ run\ by\ family\ CEO\ X\ firm\ performance + \beta_i controls + year\ \&\ industry\ fixed\ effects + \varepsilon \quad (2)$$

RESULTS

Table 1 reports the descriptive statistics and correlations of all variables used in our hypothesis testing. Average CEO compensation is about rupees (Rs) 16 million (about USD 338,000 at the exchange rate of 47.4 rupees to the dollar prevailing at the midpoint of our study period). In our sample, 64% of CEOs are drawn from the controlling family, consistent with Chittoor and Das (2007) who show professionalization of top management is still low in Indian family firms. The 64% of family CEOs in our sample are distributed as 38% in firms with superior realized performance and 26% in firms with poor realized performance (F=0.08; p=0.78). About 79% of CEOs have a college degree and average CEO tenure is 7 years. The average firm in the sample has net sales of about Rs.12,332 million (about USD 260 million) and is 35.5 years old. The controlling family's shareholding averaged 52% and institutional shareholding averaged 21.8%.

=== Insert Tables 1 & 2 here ===

Panel A (models 1 to 2) and panel B (models 3 to 5) of Table 2 respectively present the results of the OLS regression analysis for testing H1 and H2 in our sample. Model 1 reports the base model with only the control variables. In model 2, we include our independent variable – *family CEO*, and find that it has a positive effect on CEO pay (b=0.327, p=0.001), suggesting that family CEOs are higher paid compared to professional CEOs. This effect is also economically sizeable – holding all other covariates constant, the pay for a family CEO is 38.7% ($e^{0.327}$-1) higher than professional CEOs. The pattern of results in model 2 provide strong evidence in support of H1 - family CEOs receive higher compensation than professional CEOs.

Panel B (models 3 to 5) of Table 2 explores the sensitivity of CEO pay to realized firm performance. In model 3, the coefficient of *Family CEO* is 0.316 (p=0.002), and the coefficient of the interaction term *family CEO X firm performance* is positive (b=2.635, p=0.044), suggesting that family CEOs' pay, which is already higher than professional CEOs, is also more sensitive to realized firm performance. Specifically, a one-standard-deviation increase in a firm's industry-median adjusted ROA (=0.08) is associated with an increase of a family CEO's pay by 23.5% ($e^{0.08*2.635}$-1). Drawing on the logic of the double standards mechanism, our H2 predicts that this pay-performance sensitivity operates only for superior performing firms. To explore this asymmetric effect for superior versus poorly performing firms, we introduced the splined variables for *family CEO* and its interaction with *firm performance*. In model 4, the splined variable *high performing firm run by family CEO* is constructed by defining high firm performance as firm ROA at or above industry median ROA; likewise, *low performing firm run by family CEO* is constructed by defining low firm performance as firm ROA below industry median ROA. As can be seen, the interaction term *high performing firm run by family CEO X firm performance* is positive (b= 3.027, p=0.079). We tested the robustness of this result by using an alternative spline specification where high firm performance is defined as firm ROA at or above the 25th percentile of industry ROA; likewise, low firm performance is defined as firm ROA below the 25th percentile of industry ROA. Model 5 reports results using these alternative spline specifications; as can be seen, the interaction term *high performing firm run by family CEO X firm performance* is still positive with a lower p-value (b= 2.270, p=0.049). These patterns are also robust to alternative performance measures such as mean-adjusted or unadjusted ROA as well as coarser (NIC2) industry boundary definitions. Overall, our results from panel B of Table 2 suggest that family CEOs experience higher pay and higher pay-performance

sensitivity compared to professional CEOs. However, this pay-performance sensitivity is asymmetric such that family CEOs receive a bigger pay raise than their professional counterparts when their firm experiences superior performance relative to industry peers[2], thus supporting H2.

Supplementary test on nepotistic orientation

Panel C (models 6 and 7) of Table 2 examines a further implication of our theorizing. We reasoned that controlling families could be heterogenous in their nepotistic orientation - which refers to the controlling family's mindset that the focal firm is their fiefdom and wellspring of *material resources* over which the family is legitimately entitled to have first rights. Greater nepotistic orientation likely leads to resource-transfer practices that benefit the controlling family at the expense of other stakeholders of the focal firm. Nepotistic orientation is conceptually distinct from socio-emotional wealth (SEW) which refers to *non-pecuniary* endowments (Gomez-Mejia, Cruz, Berrone and De Castro, 2011; Firfiray et al., 2018).

We propose that a controlling family will have a greater nepotistic orientation towards an eponymous firm compared to a non-eponymous firm because eponymy enhances the controlling family's sense of entitlement towards material resources available from a focal firm which has resources that can be potentially extracted. By eponymous firms (Belenzon, Chatterji and Daley, 2017) we mean firms whose corporate name overlaps with the names of the controlling family – for example *Aditya Birla Capital* and *Aditya Birla Fashion and Retail* are eponymous firms controlled by the Aditya Birla family while *UltraTech Cement* and *Hindalco* are non-eponymous firms controlled by the same Aditya Birla family. This reasoning implies that our observed

[2] In addition, we note that the coefficient of *low performing firm run by family CEO X firm performance* in model 4 (b= 2.526, p=0.393) and model 5 (b= 0.302, p=0.930) indicates no difference in pay-performance sensitivity of family CEOs versus professional CEOs for firms experiencing poor performance. Thus, consistent with the double standards mechanism, family CEO's already high pay levels (compared to professional CEOs) is *not* adversely affected when their firm experiences poor performance.

effects of family CEOs enjoying higher pay will be stronger in a sub-sample of superior performing firms that are eponymous compared to superior performing firms that are non-eponymous, since superior performing firms have resources that can be potentially extracted.

Models 6 and 7 of Table 2 report results on the drivers of CEO pay respectively for subsamples of eponymous (517 observations in model 7) and non-eponymous (1,494 observations in model 8) firms, where we introduced the splined variables for *family CEO* to focus attention on the superior performing firms. The coefficient of *high performing firm run by family CEO* in the subsample of eponymous firms (model 6) is 0.831 (p=0.002) which as expected, is higher than the coefficient size of 0.257 (p=0.043) for the subsample of non-eponymous firms (model 7). A chow test reveals these coefficients are different (Chi2=4.3. Prob>Chi2 = 0.039). The results in panel C of Table 2 provide support for our supplementary prediction that high pay for family CEOs will be even greater for superior performing eponymous firms compared to superior performing non-eponymous firms.

DISCUSSION

CEO compensation continues to be a widely researched topic, but we still do not fully understand the determinants of CEO compensation in family firms (Aguinis et al., 2018; Devers et al., 2007; van Essen *et al.*, 2015; Finkelstein et al., 2009), particularly in the context of emerging economies. We contribute to this literature by examining drivers of both the level of CEO pay and its sensitivity to realized firm performance using a sample of publicly listed family firms from India, one of the fastest growing emerging economies. Using a principal-principal agency theory perspective our conceptual model sought to understand the circumstances under which controlling families might exert undue influence on executive compensation in ways that enhance the controlling family's private benefits at the expense of minority shareholders. We

first provided strong evidence that Indian family CEOs enjoy both higher pay and asymmetrical pay-sensitivity to superior firm performance compared to professional CEOs. Our findings corroborate other limited work in this context (Veliyath and Ramaswamy, 2000) and is in sharp contrast to the effects of insider ownership on CEO pay predicted by traditional agency theory, including in the context of family firms in developed economies (McConaughy, 2000; Gomez-Mejia et al., 2003). In supplementary subsample analyses we show the effect of higher pay for family CEOs compared to professional CEOs is stronger for superior-performing eponymous firms compared to superior-performing non-eponymous firms. In summary, we provide robust findings of nuanced heterogeneity in the extent of nepotism in family firms from emerging economies. We note that our findings are based on a relatively small observational dataset where strong causal identification is hampered due to lack of a natural experiment, quasi-experiment or suitable instruments. Despite these limitations, we advance the management literature on CEO compensation, and theoretically bridge the hitherto distinct literatures of family business in mature economies with the literature on business groups in emerging economies, thus offering fruitful future research pathways.

Advancing the literature on CEO compensation

We contribute to the literature on CEO compensation by disentangling two alternative explanations on the role of family CEOs. Prior family business research, set mainly in the developed economy context and using a principal-agent theoretical framework, theorized and found that family CEOs receive lower compensation with lower pay-performance sensitivity compared to professional CEOs (cf. Gomez-Mejia et al., 2011). However, corporate governance research in emerging economies (cf. Young et al., 2008) proposes that weak institutions in emerging economies makes a principal-principal agency framework more appropriate in such

settings. The P-P lens suggests that controlling families of business groups (Chang, 2003; Morck et al., 2005) may exploit minority shareholders. Our robust results that compared to their professional counterparts, family CEOs experience higher pay which is unaffected by poor firm performance and is disproportionately boosted by superior firm performance, is consistent with the P-P lens and is the opposite of prior findings on CEO compensation in family firms in mature economies like the United States (Gomez-Mejia et al., 2003) or Sweden (Cieslak, 2018).

More broadly, our findings on family CEOs advances the literature on family business groups, a salient organizational form in emerging economies, by providing empirical evidence that CEO compensation might be a new mechanism for tunneling (Cheung et al., 2005). One strand of business group research has highlighted tunneling (Bertrand et al., 2002) as a significant governance concern for family business groups (cf. Bertrand and Schoar, 2006). However, this dysfunctional picture of business groups is at odds with another strand of business group research which extols the virtues of family business groups. Thus, Siegel and Choudhury (2012) argue that tunneling may be less important and others argue that family business groups might represent efficient responses to weak or missing formal institutions as well as informal institutions that underpin markets (e.g. Khanna and Palepu, 2000; Vissa, Greve and Chen, 2010; Berrone et al., 2020). As outlined below, our findings and supplementary analyses represent a theoretical advance because they help to bridge the currently unconnected literatures on family firms and family business groups and potentially help reconcile this inconsistent portrayal of family-controlled business groups.

Theoretically bridging family business and business group research

Family business research is set largely in mature economies and is organized around the construct of socio-emotional wealth (SEW) (Berrone, Cruz and Gomez-Mejia, 2012; Martin et

al., 2017; Miller and Le-Breton Miller, 2014). This research implicitly assumes the existence of national institutional infrastructure that allows for (the semi-strong form of) efficient financial markets and hence uses the principal-agent lens to view the relationship between CEOs and shareholders. Scholarship in family business has conceptualized SEW as an *affective endowment* of the controlling family which help deliver *positive* and benign consequences to all stakeholders – such as long-term orientation, stewardship behaviors, lower CEO compensation etc. (Gomez-Mejia et al., 2011). On the other hand, scholarship on family business groups, set in emerging economies, does not utilize the construct of SEW in its conceptual toolkit. Rather this literature defines business groups as constellations of legally independent firms that are accustomed to taking coordinated action because they are controlled by a single extended family (Khanna and Palepu, 2000). Research in this field focuses on the costs and benefits to multiple stakeholders of group affiliation and provides a Janus-faced account of family business groups as noted earlier.

We propose that our novel construct of nepotistic orientation, together with SEW, are theoretically useful bridging constructs that can integrate these two management sub-fields that have hitherto been unconnected. Nepotistic orientation captures the controlling family's mindset that legitimizes the family's first rights over the material resources of the focal firm. Nepotistic orientation is conceptually distinct from SEW because the former emphasizes how the focal firm could become a wellspring for the controlling family's material needs, whereas SEW emphasizes how the focal firm contributes to the controlling family's emotional and other non-pecuniary endowments. From the perspective of external, disinterested observers, nepotistic orientation suggests a *negative* influence of the controlling family towards the focal firm because greater nepotistic orientation implies a controlling family's greater sense of entitled, privileged access to

material firm resources, which likely legitimizes actions and practices that enrich the controlling family at the expense of minority shareholders and other stakeholders.

Because of relatively weak selection environments, currently surviving family firms in emerging economies likely vary widely in their nepotistic orientation as well as SEW. In addition, because nepotistic orientation and SEW are conceptually distinct constructs tapping respectively into pecuniary versus emotional aspects of the relationship between the controlling family and the focal firm, theoretically, nepotism and SEW could co-exist in the same family. We also speculate that because nepotism is heterogeneously distributed in family-controlled firms, less nepotistic controlling families may be rewarded by public financial markets in emerging economies. Future research should examine these and other new questions that arise from our conceptualization such as: Do first-generation family business founders in emerging economies have more SEW and less nepotism? How does nepotistic orientation and SEW influence other dimensions of CEO compensation design, such as systematic and unsystematic risk, pay volatility and so forth. In addition, we encourage scholars to use alternative theoretical perspectives (e.g., Conyon, 2006; Gomez-Mejia, Berrone and Franco-Santos, 2010) to delve deeper into executive compensation in family firms. In summary, we offer a theoretically strong future research agenda to examine family businesses in emerging economy settings.

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Table 1: Sample Descriptive Statistics

		Mean	S.D.	1	2	3	4	5	6	7	8	9	10
1	CEO pay [a]	16.59	1.24	1.00									
2	Family CEO	0.64	0.48	0.13	1.00								
3	High performing firm run by family CEO	0.38	0.48	0.12	0.58	1.00							
4	Low performing firm run by family CEO	0.26	0.44	0.00	0.45	-0.47	1.00						
5	Firm performance	0.01	0.08	0.18	0.07	0.45	-0.41	1.00					
6	CEO education	0.79	0.41	0.16	0.00	-0.03	0.04	0.01	1.00				
7	CEO tenure	7.05	2.73	0.08	0.39	0.23	0.17	0.06	0.01	1.00			
8	Firm size [b]	9.42	1.55	0.45	-0.08	-0.03	-0.05	0.11	0.04	0.03	1.00		
9	Firm age	35.51	26.05	0.08	-0.17	-0.15	-0.02	-0.04	0.02	0.02	0.18	1.00	
10	Owners' shareholding	51.98	16.49	0.01	0.03	-0.00	0.03	0.13	-0.03	-0.10	-0.12	-0.14	1.00
11	Institutional shareholding	21.80	13.05	0.26	-0.07	-0.01	-0.06	-0.02	0.05	-0.00	0.33	0.14	-0.53

Data consists of N = 2011 observations comprising 402 unique family-firm-CEO combinations during 2004 to 2013 from 277 firms and 395 CEOs

$p < .01$ for mod values of 0.06 and more

[a] Natural logarithm of total annual CEO compensation in Indian Rupees

[b] Natural logarithm of annual firm sales in millions of Indian Rupees

Table 2: Regression Models to Predict CEO Compensation in Indian Family Firms

	Panel A: Drivers of CEO pay level (H1)		Panel B: Drivers of CEO pay performance sensitivity (H2)			Panel C: Additional tests on sub-samples of eponymous & non-eponymous firms	
	(1)	(2)	(3)	(4)	(5)[a]	(6)	(7)
						Eponymous firms	Non-eponymous firms
Family CEO		0.327	0.316				
		(0.001)	(0.002)				
High performing firm run by family CEO				0.274	0.255	0.831	0.257
				(0.033)	(0.035)	(0.002)	(0.043)
Low performing firm run by family CEO				0.339	-0.030	0.470	0.399
				(0.015)	(0.905)	(0.045)	(0.004)
Family CEO x Firm performance			2.635				
			(0.044)				
High performing firm run by family CEO x Firm performance				3.027	2.270		
				(0.079)	(0.049)		
Low performing firm run by family CEO x Firm performance				2.526	0.302		
				(0.393)	(0.930)		
Firm performance	1.983	1.823	-0.045	-0.037	-0.921	1.764	1.629
	(0.028)	(0.044)	(0.959)	(0.967)	(0.691)	(0.187)	(0.069)
CEO education	0.405	0.400	0.400	0.395	0.397	0.880	0.277
	(0.016)	(0.018)	(0.017)	(0.024)	(0.019)	(0.103)	(0.036)
CEO tenure	0.046	0.024	0.027	0.028	0.028	-0.035	0.038
	(0.034)	(0.262)	(0.186)	(0.198)	(0.186)	(0.475)	(0.091)
Firm size	0.254	0.266	0.273	0.274	0.272	0.113	0.327
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.267)	(0.000)
Firm age	0.001	0.002	0.002	0.002	0.002	0.006	0.002
	(0.701)	(0.349)	(0.324)	(0.342)	(0.355)	(0.297)	(0.454)
Owners' shareholding	0.009	0.009	0.009	0.009	0.010	0.012	0.007
	(0.008)	(0.007)	(0.004)	(0.004)	(0.002)	(0.030)	(0.093)
Institutional shareholding	0.019	0.019	0.019	0.019	0.019	0.022	0.015
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.015)	(0.001)
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Constant	11.476	11.271	11.100	11.112	11.116	11.961	10.999
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	0.000	0.000
Observations	2,011	2,011	2,011	2,011	2,011	517	1494
Number of firms	277	277	277	277	277	72	205
R-square	0.3667	0.3790	0.3842	0.3847	0.3856	0.4333	0.4140
F statistic	20.74	23.79	24.58	23.18	21.97	10.30	18.77
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)

OLS estimations with natural log of CEO pay as the dependent variable. Robust p-values in parentheses; standard errors clustered by firms.

[a] Based on alternative splines where a *high performing firm* is defined as one whose ROA is equal to or greater than the 25th percentile value of industry ROA and a *low performing firm* is one whose ROA is less than the 25th percentile value of industry ROA