Founder Succession and Accounting Properties*

JOSEPH P.H. FAN, The Chinese University of Hong Kong

TJ WONG², The Chinese University of Hong Kong

TIANYU ZHANG, The City University of Hong Kong

April 2009

*We acknowledge the financial support of the Research Grants Council of the Hong Kong SAR government (CUHK452407). Joseph Fan thanks the financial support by the Research Grants Council of the Hong Kong Special Administrative Region, China
Using a sample of 231 entrepreneurial firm successions in Hong Kong, Singapore, and Taiwan, we find that firms’ unsigned discretionary accruals decrease while timely loss recognition increases subsequent to successions, suggesting a shift in accounting toward a less insider-based system. We argue that the change in accounting properties is due to the loss of specialized assets in the succession process, such as the entrepreneur’s reputation and political/social networks, inducing the firm to adapt to market-based rather than relationship-based contracting. Moreover, we find that the extent of the shift in accounting is larger in founder successions than in subsequent (non-founder) successions, as the dissipation of specialized assets is greatest in founder successions.

Keywords: Succession, founder, corporate governance, accounting properties.

JEL classification: G32; L14; M41