Do Family Firms Outperform Nonfamily Firms? Case of a Developing Country

Author Details: Dr Md Tariqul Islam
Department of Finance and Banking, Jatiya Kabi Kazi Nazrul Islam University, Mymensingh-2224, Bangladesh

Abstract
The study investigates the association between family business and the performance of the firms. To underscore this relationship, the case of nonfinancial companies is analysed between 2012 and 2017. The generalised method of moments (GMM) is employed as the econometric method that effectively controls all categories of endogeneity. The study finds that family firms outperform their nonfamily counterparts in terms of firm performance. The result is positively significant for both the financial performance measure, ROA, and the market measure, Tobin's Q. The outcome of this research suggests that policymakers should initiate the necessary governance mechanisms to control the actions of the family firms that might jeopardise the interests of the minority shareholders.

Keywords: Family firms, firm performance, GMM, ROA, Tobin’s Q, developing country

INTRODUCTION
The purpose of this study is to determine if family companies outperform nonfamily enterprises in Bangladesh, a developing nation. As interest in the study of family companies has increased in recent years (Dibrell and Memili, 2019), academics have focused more on comparing the outcomes of family and nonfamily enterprises (Arredondo & Cruz, 2019). A company is termed a family business if a significant portion of its shares are held by a family or group of families (Fang et al., 2021). In the case of family businesses, the existence and control of business groups results in a pyramidal organizational structure (Chhillar and Lellapalli, 2015) that provides them absolute control over the company's activities. Consequently, family enterprises with significant shareholdings handle operations with discretion (Gedajlovic et al., 2004), which aids in maintaining investor confidence. Bangladesh was selected as a case study because family domination is prevalent in the corporate sector. In addition, similar to underdeveloped nations, it has weak legal systems, ineffective governance processes, and a predominance of concentrated ownership.

In developing nations, corporate governance (CG) practices are hampered by insufficient external governance mechanisms (Peters et al., 2011), a weak legislative framework (Young et al., 2008), and a lack of protection for minority shareholders' interests (Claessens and Yurtoglu, 2013; Globerman et al., 2011; La Porta et al., 2000; Young et al., 2008). Concentrated ownership is the norm in emerging countries, with controlling shareholders owning two-thirds of the companies (La Porta et al., 1999). As a result, organizations are particularly vulnerable to controlling shareholder expropriation (Chen et al., 2011), in which big owners use their authority at the expense of smaller shareholders, jeopardizing company performance (Young et al., 2008). Controlling shareholders' shareholdings are clearly dominated by family and commercial entities.

Distinct firm features and institutional frameworks of various nations result in a distinct connection dimension between the organizations (Chhillar and Lellapalli, 2015). Researchers (e.g., Dharwadkar et al., 2000; Shen et al., 2015; Young et al., 2008) refer to this issue as a 'principal-principal' issue. Scholars (e.g., Sauerwald and Peng, 2013; Young et al., 2008) contend that principal-principal disagreement will exist only when following conditions hold: (1) the presence of concentrated ownership and (2) the incompetence of formal institutional settings as external governance instruments in protecting minority shareholders. Therefore, the traditional Anglo-American model of CG, which is mostly adopted by the UK and the USA, is in conflict with that of emerging nations due to the prevalent institutional structures of these developed nations. The Anglo-American nations are characterized by a dispersed ownership system in which ownership and management are separated (Aguilera and Jackson, 2003). Moreover, substantial liquidity and robust efficiency of the capital market (La Porta et al., 1998) contribute to the investors' trust. Additionally, the market provides exceptional protection for minority stockholders (La Porta et al., 1998).
In contrast, the ownership structure of businesses in emerging nations is characterized by individuals and families expropriating the interests of minority investors (Shleifer and Vishny, 1997). Pursuant to this, Chen et al. (2011) suggest that the widespread adoption of OECD codes in emerging economies is counterproductive since these regulations were created to address principal-agent issues. While ownership concentration is viewed as a solution to the principal-agent dilemma in the Anglo-Saxon area (Grossman and Hart, 1986), it is incongruous in the setting of emerging economies (Singh and Zammit, 2006) and may make the situation more difficult in developing countries (Faccio et al., 2001). Therefore, "a new set of governance procedures" is appropriate for these types of economies where shareholder protection and legal system effectiveness are typical (Young et al., 2008, 199).

Ownership in family businesses may be described as the firms in which "founding-families represent a unique class of shareholders that hold poorly diversified portfolios, are long-term investors (multiple generations), and often control senior management positions" (Anderson and Reeb, 2003, 1304). Scholars seek to examine the unique impact of family enterprises in comparison to nonfamily firms (Daspit et al., 2021). There have been studies conducted in both advanced and emerging nations to examine the impact of family businesses vs nonfamily businesses. However, few studies have utilized an econometric method that adequately addresses the endogeneity issue. Muttakin et al. (2015) did a study to determine the performance impact of family businesses. This study did not, however, evaluate a model that is free of endogeneity issues, for example, dynamic endogeneity. This study fills a void by employing a dynamic estimating approach that effectively manages reverse causality, bias from missing variables, and dynamic endogeneity.

The remaining parts of the paper are detailed below. The second part of this article is a general summary of the superiority of family businesses in Bangladesh's commercial sector. The development of the theory is the focus of the third section. The data sources, methods, and regression models are all discussed in the fourth section of the study. In the fifth section of the study, we describe and discuss the findings of the analysis, followed by concluding remarks.

STATE OF FAMILIAL DOMINANCE IN THE CONTEXT OF BANGLADESH

In Bangladesh, family businesses in publicly traded companies are also widespread (Sobhan and Werner, 2003; Farooque et al, 2007; Uddin and Choudhury, 2008; Siddiqui, 2010; Khan et al, 2011). Kochanek (1996) claims that family domination existed in Bangladesh well before the country's sovereignty in 1971. Major corporate entities were made state-owned following independence, but with the enactment of legislation incorporating a market-based economy within the socialist system after 1975, many were returned to family ownership (Belal and Cooper, 2011). In this line, Sobhan and Werner (2003) ascertain that sponsors control around 73% of nonbank listed companies on Bangladeshi board, particularly influenced by members of a particular clan, in which the parent functions as chairperson and a successor functions as CEO/MD. New companies to Bangladesh's private sector are hampered by the country's weak rule of law and the difficulty of starting a firm due to bureaucracy. According to Young et al. (2008), family businesses can surpass their nonfamily peers in nations where assets are few and investment possibilities are restricted (Anderson and Reeb, 2003).

Businesses in many diverse sectors, such as manufacturing, service, banking, and finance, are controlled by families with the same sponsors in Bangladesh (Nuruzzaman, 2004). Furthermore, Farooque et al (2007) report that 78% of Bangladeshi business sector CEOs are either from the original company or the following generation of those families. Families with a sizable investment in the companies they own, hold executive directorship roles, allowing them to exert control over the company's managerial decisions, according to this study. As a result, family businesses have the ability to alter financial data to create low-quality earnings for their own benefit (Khan et al., 2015). Because of their long-term and strong relationship with the enterprises they own (Stein, 1989), family businesses take great care to control the flow of information which may well jeopardize the company's prospects or challenge its management abilities. That is why controlling shareholders and/or families may want to disconnect distinct reporting narrative papers such CG compliance statements from one other. However, Ahmed and Uddin (2018) suggest that huge family-owned businesses and business houses are able to cement their dominance regardless of whether they
are in the organisation or not. A total of 60 corporate tycoons from families or business groups participated in dishonest trading practices to enrich themselves at the cost of other investors during the stock market volatility between 1996 and 2010. (Probe Committee, 2011).

HYPOTHESIS DEVELOPMENT

The majority of publicly traded companies in developing countries are family-owned (Filatotchev et al., 2007). An additional agency issue may arise in companies dominated by family members (Faccio et al., 2001). The significant ownership and control of family enterprises, on the other hand, can be considered as an effective monitor of management operations in accordance with agency theory (Shleifer and Vishny, 1986). Due to the substantial risk associated with their big investments, these companies are known to be cautious in their decision making. Stewardship theory and the agential view are both equally valid when it comes to determining who has the upper hand in a family. According to the notion, organizations benefit from family control since benevolence serves as a motivating factor for employees (Salvato and Melin, 2008). To further reduce opportunistic behaviour of management, administration and control should be combined (Demsetz and Lehn, 1985). As a result, family businesses have lower agency costs than nonfamily ones. Firm performance, therefore, is favourably influenced by family enterprises because of their long-term investment plan (Stein, 1988).

The results of the link between family businesses and their success are mixed. Holderness and Sheehan (1988) found a negative association between company performance and firms’ family identity in a study of 114 NYSE or AMEX-listed enterprises. Moreover, family firms discount firm performance, according to research by Morck (2005) in international corporate practices and Cronqvist and Nilsson (2003) in a study on Swedish corporations. In a study on India, Bhatt and Bhattacharya (2017) failed to discover a significant link between family companies and company success. Other studies (e.g., Isakov and Weisskopf (2014) in Sweden; Maury (2006) in Western European cross-country analysis, among others) show that active family control improves family company performance. In research conducted in the United States, Anderson and Reeb (2003) discovered that family businesses outperform their nonfamily counterparts. Muttakin et al. (2015) conducted a study on nonfinancial listed companies in Bangladesh and found that family-owned companies demonstrate higher profit than nonfamily firms. Therefore, findings of noteworthy past investigations support the development of the following hypothesis:

**H1**: Ceteris paribus, family firms positively affect firm performance in Bangladesh.

RESEARCH DESIGN

Data

The research sample is comprised of nonfinancial firms listed on Bangladesh's major stock exchange, the Dhaka Stock Exchange (DSE), spanning 2012 and 2017. Except for family ownership, all of the information has been collected from the annual reports of the firms. According to Muttakin et al. (2015), the ownership data of family businesses is largely gathered through the portion of financial reports that details the holdings structure of the parents and spouse. Companies include the ownership information in the Directors’ Report to Shareholders. For cross validation and to avoid any mistakes in determining family members, the equityholder data is verified by examining the business prospectus.

Variables

Market measure, such as Tobin's Q, and Accounting measurement, such as return on assets (ROA), are the two primary types of business performance indicators employed in CG research. In this study, both the Tobin's Q and the ROA are utilized as performance measures.

To test the aforementioned hypotheses, family enterprises are viewed as the most important explanatory variable, given their predominance in Bangladesh. Family companies not just to limit its influence via ownership, but it also influences a firm by intervening with its CG practices and management (Villalonga and Amit, 2006), which eventually improves the firms’ profitability. In accordance with Muttakin et al. (2015), a company is regarded to be family-possessed when it meets two of the following
requirements. First, the explicitly or implicitly total shareholdings of the members of a family are not less than 20 percent. Second, minimum one member of the family was involved in the company in some capacity, serving either as a director or the chief executive officer.

In accordance with previous research (Wintoki et al., 2012; Nguyen et al., 2014; Liu et al., 2015; Abdallah and Ismail, 2017, among others), this analysis employs additional control factors that have been shown to influence company performance. As a result, the research covers control variables, such as the proportion of government ownership, leverage, company size, firm age, and sales growth. The variable descriptions for the investigation are included in Table 1.

Table 1. Variable Descriptions

<table>
<thead>
<tr>
<th>Variable</th>
<th>Acronym</th>
<th>Scale of Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dependent Variables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Assets</td>
<td>ROA</td>
<td>Earnings before interest and taxes (EBIT) divided by the book value of total assets at the end of the year</td>
</tr>
<tr>
<td>Tobin’s Q</td>
<td>TQ</td>
<td>Market value of Assets (Equity and Liability) divided by the total assets</td>
</tr>
<tr>
<td>Key Independent Variable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Family Firms</td>
<td>FAM</td>
<td>Indicator variable equals 1 if it is a family firm, 0 if nonfamily firm</td>
</tr>
<tr>
<td>Control Variables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Govt. Shareholdings</td>
<td>GOVT</td>
<td>Percentage of shares held by the government</td>
</tr>
<tr>
<td>Leverage</td>
<td>LEV</td>
<td>Amount of total debt divided by book value of total assets</td>
</tr>
<tr>
<td>Firm Size</td>
<td>SIZE</td>
<td>Natural logarithm of firms’ market value of common equity</td>
</tr>
<tr>
<td>Firm Age</td>
<td>AGE</td>
<td>Natural logarithm of the number of years since the firm is incorporated</td>
</tr>
<tr>
<td>Sales Growth</td>
<td>SG</td>
<td>Rate of change in the amount of sales revenue compared to the previous year</td>
</tr>
</tbody>
</table>

Model and Methodology

This section provides an overview of the model that was used for this research. According to a number of studies (including those conducted by Akbar et al., 2016, and Wintoki et al., 2012), the connection between CG structures and company performance is one that is inherently dynamic. It suggests that the success of the company at the present time is impacted by the performance of the company in the past. Accordingly, following two empirical models are constructed:

\[ \text{ROA}_{it} = \alpha + \delta \text{ROA}_{i,t-1} + \beta_1 \text{FAM} + \beta_2 \text{GOVT} + \beta_3 \text{LEV} + \beta_4 \text{SIZE} + \beta_5 \text{AGE} + \beta_6 \text{SG} + \text{year dummies} + \text{industry dummies} + \epsilon_{it} \]

\[ \text{TQ}_{it} = \alpha + \delta \text{ROA}_{i,t-1} + \beta_1 \text{FAM} + \beta_2 \text{GOVT} + \beta_3 \text{LEV} + \beta_4 \text{SIZE} + \beta_5 \text{AGE} + \beta_6 \text{SG} + \text{year dummies} + \text{industry dummies} + \epsilon_{it} \]

To determine the association between CG practices and business performance, this study applies the generalised method of moments (GMM), a dynamic panel estimate approach. This study used a two-step GMM technique. According to Wintoki et al. (2012), this assessment is more accurate when time-invariant traits are associated with other independent variables. In the same line, Schultz et al. (2010) contend that GMM estimation efficiently adjusts three categories of endogeneity: dynamic endogeneity, omitted variable bias, and simultaneity. After conducting the regression using GMM estimation, two post-estimation tests, including 2nd order autocorrelation, AR (2), and the Hansen J statistic for over-identifying limitations, are also undertaken. AR (2) and Hansen J were found to be non-significant in both models, indicating their general validity.

RESULTS AND DISCUSSIONS

Table 2 displays the Pearson's coefficients of pairwise correlation between the explanatory variables. From the table, it is found that GOVT, AGE, and SIZE are negatively and significantly related with FAM, while LEV, and AGE are positively associated with GOVT. Although AGE is positively associated with LEV, SIZE shows a negative relationship. Moreover, the highest extent of correlation prevails between GOVT and FAM, while the lowest significant association reports amid AGE and FAM.

If there is considerable collinearity, regression equations automatically remove explanatory variable(s). In similar spirit, Gujarati (2003) suggests that the VIF values should not exceed 10 in order to avoid multicollinearity. The VIFs for explanatory variables range from 1.42 to 1.00, as shown in the table.
As a result, there is no reason to believe that the models will suffer from a major multicollinearity problem.

**Table 2. Pearson’s Correlation Matrix**

<table>
<thead>
<tr>
<th>Variables</th>
<th>FAM</th>
<th>GOVT</th>
<th>LEV</th>
<th>AGE</th>
<th>SIZE</th>
<th>SG</th>
</tr>
</thead>
<tbody>
<tr>
<td>FAM</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GOVT</td>
<td>-0.476***</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEV</td>
<td>-0.029</td>
<td>0.229***</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AGE</td>
<td>-0.111***</td>
<td>0.239***</td>
<td>0.263***</td>
<td>1.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>-0.221***</td>
<td>-0.112***</td>
<td>-0.308***</td>
<td>-0.039</td>
<td>1.000</td>
<td></td>
</tr>
<tr>
<td>SG</td>
<td>0.0178</td>
<td>-0.001</td>
<td>0.023</td>
<td>0.971</td>
<td>0.002</td>
<td>1.00</td>
</tr>
<tr>
<td>VIF</td>
<td>1.34</td>
<td>1.42</td>
<td>1.26</td>
<td>1.12</td>
<td>1.18</td>
<td>1.00</td>
</tr>
</tbody>
</table>

*** denotes significance at the 1% level of significance

For ROA and Tobin's Q models, regression analysis utilizing GMM estimate is shown in Table 3. All of the models exhibited a strong positive relationship between the performance of the company one year ago and the performance of the company in the current year. This indicates that the performance of the company in the previous year has a significant influence on the performance of the company in the current year. For both the models FAM is positively and significantly associated with profitability and value of the firm, demonstrating $\beta = 0.026$ ($p=0.037$) for ROA and $\beta = 0.778$ ($p=0.082$) for Tobin’s Q. The findings regarding family firms are consistent with the study of Isakov and Weisskopf (2014) and Muttakin et al. (2015) that family firms outperform nonfamily firms in terms of performance. Because family businesses are more concerned with transmitting ownership to the next generation (Casson, 1999), they want to place a greater focus on monitoring management actions that maximize the return on their investment over a longer period of time.
Table 3. Multiple Regression Results

<table>
<thead>
<tr>
<th>Variables</th>
<th>ROA</th>
<th>Tobin’s Q</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>β (p-value)</td>
<td>β (p-value)</td>
</tr>
<tr>
<td>ROA&lt;sub&gt;t−1&lt;/sub&gt;</td>
<td>0.559 (0.000)***</td>
<td>0.519 (0.000)***</td>
</tr>
<tr>
<td>TQ&lt;sub&gt;t−1&lt;/sub&gt;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FAM</td>
<td>0.026 (0.037)**</td>
<td>0.778 (0.082)*</td>
</tr>
<tr>
<td>GOVT</td>
<td>-0.064 (0.094)*</td>
<td>-1.539 (0.095)*</td>
</tr>
<tr>
<td>LEV</td>
<td>-0.007 (0.613)</td>
<td>-0.814 (0.240)</td>
</tr>
<tr>
<td>AGE</td>
<td>0.012 (0.077)*</td>
<td>0.807 (0.037)**</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.017 (0.001)***</td>
<td>0.312 (0.065)*</td>
</tr>
<tr>
<td>SG</td>
<td>0.002(0.057)*</td>
<td>0.044 (0.072)*</td>
</tr>
<tr>
<td>Year and Industry Dummy</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>F Statistic (p-value)</td>
<td>31.34 (0.000)</td>
<td>67.10 (0.000)</td>
</tr>
<tr>
<td>AR (1)</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>AR (2)</td>
<td>0.176</td>
<td>0.137</td>
</tr>
<tr>
<td>Hansen J Statistic</td>
<td>0.132</td>
<td>0.209</td>
</tr>
</tbody>
</table>

*, **, *** denote significance at the 10%, 5% and 1% level of significance, respectively

For other explanatory and control variables, govt. shareholdings negatively and significantly affect performance measures. It suggests that proportion of shareholdings by the government reduces profitability and value of the firms. The results support the views of Martin and Parker (1995) and Wortzel and Wortzel (1989) that the companies owned by state are less efficient in terms of CG practices compared to the other private owned companies. There could be two verifiable reasons in the context of Bangladeshi companies in which government owns share: First, these businesses are shielded from the risk of insolvency and external market regulation (Haque et al. 2006). Second, because quality is not a priority in most cases, these organizations are less competent when it comes to hiring directors (Khatun, 2013). The results regarding AGE are quite consistent with the study of Pillai and Al-Malkawi (2018) that reports a positive association between age of the firms and firm performance. In case of SIZE, the findings of this study support Muttakin et al. (2015)'s claim that larger enterprises with significant investment generally receive preferential market treatment, resulting in improved company performance. Finally, SG finds a positive significance with both the profitability and value of the firm.

CONCLUSION

This study makes a contribution to the limited body of research that has been done, particularly in the context of an emerging economy, on the link between family ownership and the performance of firms. Only a few research has used the GMM estimate technique to investigate the influence of firms' familial dominance on profitability and firm value. Therefore, the findings of this study may be applied to other emerging markets with comparable institutional characteristics.

This research investigates whether family firms outperform their nonfamily counterparts in terms of performance. In finding this association, the study employs GMM estimation that effectively controls for omitted variable bias, simultaneity, and dynamic endogeneity. Family businesses outperform nonfamily ones in terms of financial and market success, even after considering all three types of endogeneity. Stewardship theory, in this vein, contends that inside shareholdings have a greater impact on a company's success than outside shareholdings. Consequently, family engagement in management helps organizations' long-term...
prosperity. Further avenues of research could also be considered to measure the effect of familial dominance on the other consequences of the firm, such as cost of equity, level of working capital, or earnings management.

REFERENCES


http://www.ijmsbr.com/


