IMPACT OF FAMILY OWNERSHIP CONCENTRATION ON A FIRM'S PERFORMANCE: EVIDENCE FROM KSE-30 INDEX

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ABSTRACT

The purpose of the study is to examine the relationship between family ownership concentration and firm performance in context of Pakistan so as to examine the structure of firms listed at KSE-30 Index with a sample of 20 non-financial firms for the duration of 4 years from 2009-2012. The independent variable is family ownership concentration & dependent variable is firm performance. After the Hausman Test Fixed and Random Effect Regression Model is applies on the panel data. The empirical results reveal a significant and positive relationship between dependent and independent variables. It means high concentration leads to better performance. The empirical results also expose a positive relation between Net Income and Size of the firm which indicates that family firms have good reputation and expend the business by retained earnings rather to distribute them. But these firms do not protect the minorities and other stakeholders.

Keywords: Family Ownership Concentration, Firm Performance, Agency Theory, Pakistan

JEL Classification: G32, L25

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1. Introduction

1.1 Background of the Study

"On the 21st day of April 1968, during the government of President Mr. Ayub Khan, Dr. Mahboob-ul-Haq (Chief Economist of Planning Commission of Pakistan), issue a fact list that provides the records of 22 most rich families in Pakistan, which created a stir in the business and elite circles of the country. According to Dr. Mahboob-ul-Haq, the above mention 22 families own 66% of the business corporations in Pakistan, and also own 87% of shares in financial sectors. These richest families included Crescent, Wazir Ali, Gandhara, Hispanic, Habib, Adamjee, Bawany, Khyber, Nishat, Beco, Gul Ahmed, Agar, Hafiz, Harim, Dada, Saigon, Colony, Lavalike, Fancy, and Walkmill Dawood. These business groups consolidated the holdings during the Ayub Khan regime and remained flourished in the early hours 1970's, when the PM Zulfiqar Ali Bhotto nationalized the industries in Pakistan. This, however, does not signify the logical end to these business giants and grouping, most of them survived and sustained their businesses during the nationalization period and flourished steadily in the later years".

A business is a family business if one or more than one person of the family own significant portion of holdings and also have more than 25% voting right or higher voting right than other shareholders. In many countries there are a number of, many of publicly listed family business. Examples of world's biggest family owned firms are Samsung Group (Korea), Walmart (US), Tata Group (India), Ibrahim Group, Nishat Group & Mian Mansha Group (Pakistan) and Foxconn (Taiwan).

1.2 Corporate Ownership Structure

According to Jake LeBrun, eHow Contributor Corporate structure is the arrangement through which control, authority and ownership are determined. In corporations, both ownership and control are distributed to the stockholders, but authority to attend to operational matters is vested in various officials within the company. While varied companies are structured according to the corporate model, the model itself always contains certain features.

Generally corporate structures are of two types 'concentrated' and 'dispersed' ownership structure. 'Concentrated ownership structures' contains the major control is in the hands of a small number of individuals, families, groups, directors, holding companies, banks and other financial & non-financial organizations. The major individual holders or groups are also called "insiders" as they control with strong influence on the working of a company, this 'concentrated structure' is known as the 'insider system'. Mostly the economies that are governed by the civil laws follow the 'concentrated ownership structures'.

The major holders work out their control in the companies in a different behavior. For example, when the insiders owns a great number of stocks of the company so have a high voting right, so run the organization at their own will, for the personal benefits even if they did not provide the greater part of the capital.

While in a dispersed ownership structure, a great number of holders own a little number of stocks. Minor shareholders enjoy fewer enticements or monitoring to company activities so did not have a propensity to concern in the managing the companies decisions. So these small/minor holders are known as 'outsiders', and this 'dispersed ownership structure' is referred as 'outsider system'. The economies that follow Common laws like UK and US enclose 'dispersed ownership structures'.

1.3 Ownership Structure and Agency Theory and Firm Performance

Traditionally, agency theory explores the connection between a 'firm's ownership' and 'managing structure' and its 'financial performance'. When a severance of 'ownership' and 'control' presents, agency control system inaugurate to ally the goals of managers (agents) with owners (principals).

Structure of firm is discrete in the hand of a huge number of minority shareholders and they are incapable to exert any force on the management of firm who in fact manage the affairs of firm. On the other hand minority share of firm's profit cannot be aggravated to perform in the best interest of owners. To increase the efficiency of firm through the professional knowledge and skills managers are hired by owners, but when the objective of managers and owners do not match firm efficiency undergo and firm has to bear the cost to overcome agency problem and this cost is called agency cost.

The solution of this problem is to concentrate the ownership of firm in few hands of large shareholder. These controlling shareholders force management to work according to their will, as a result firm assets will be utilized efficiently. All Shareholder have voting right but large shareholder participate in decision making and make policies for their own benefit at the cost of minority shareholder, this process is called extraction.

There are two reasons of conflict of interest. First, different investors have different goals and preferences. Second, the investors have inadequate information to each other actions, preferences and knowledge. However, the ‘‘family firms’’ works well than the ‘‘non family firms’’. When a family member is appointed as CEO performance of the firm is better than with outside CEO’s. If the family control is active the profitability is higher than ‘non family firms’. The family control reduces the agency problems among the owners and management but the chance of conflict among the family members and minor shareholder increases especially when the shareholders protection is small and the control is high.

1.4 Family/Concentrated/Insider Ownership and Firm Performance

A conversation on this region was begun with the view of Berle & Means in 1932. They argue so as to ‘disperse ownership’ is inversely associated with the ‘firm’s performance’. Many prior studies exhibit a positive relation between ‘ownership concentration’ and ‘firm’s performance’. However, in many developing countries including Pakistan family- and group-controlled businesses have a considerable part of family & associated firm’s holdings. So the major holders have sufficient right to reallocate the wealth in such ways so that the interests of other stakeholders may not be overlapped (Andrei Shleifer and Robert W.Vishny, 1997).

Many authors put forward that, in ‘family-owned firms’, the interface of a ‘family unit’, the ‘business entity’, and the individual members of a family creates a distinctive & systemic circumstances and constituency which blows the performance outcomes of the family business.(Michael C. Jensen and William H. Meckling, 1976) develop a widespread framework to put forward that ‘concentrated ownership’ is beneficial only in a case if the ‘controlling shareholders’ trim down the transactional costs as a result of negotiating the different clauses of agreements with stakeholders. (Andrei Shleifer and Robert W.Vishny, 1986) were also agreeing with the termination of (Berle et al.,) having a different justification.

They recommend that the ‘controlling shareholders’ are in a position to monitor the management, it means that the existence of ‘major shareholders’ improve the ‘firm’s value’ and if the company adopts the better governance practices in the control of ‘major holders’ there will be a better effect on its financial decision, but mostly in 'family owned firms' these good practices are not followed.

1.5 Problem Statement

Pakistan is a highly family/groups concentrated owned country not at political level, but also at corporate level. There is no proper check and balance of authorities, duties and responsibilities, although SECP has defined codes of corporate Governance, but there is no criteria of ownership in corporations, Big investors run corporations at their own will without concerning about interest of minorities.

Pakistan's economy is currently suffering from acute level corruption crisis and its economy heavily depends on corporate sector, 59% corporations are family owned, they significantly contribute in GDP, balance of payment and economic progress, only, when the rules of corporate governance will be designed and proper check and balance will be kept, so that interest of all stakeholders will be protected.

1.6 Research Questions

- What type of ownership pattern exists in KSE-30Index companies?
- Does family ownership affect the performance of the company?
- Is the affiliation between family ownership concentration and performance variables significant?

1.7 Objectives of the Study

The key purpose of this examination is to investigate the association between 'Family Ownership Concentration' and 'firm's performance' of KSE public listed firms. So I have made an effort to find a relationship between 'ownership concentration' and the 'firm's performance' variables. The other objectives are

- To provide protection to minority shareholders and investors
- To investigate the reasons that how the firm performance is affect by the family concentration.
- To find out the role of family firms in the development of economy.

1.8 Significance of the Study

This study will help the investors, to recognize the ownership pattern, practices and ways in Pakistani capital market, and suggest different practices and methods to solve the agency problems and also help to take corporation decisions & policies.

This paper will also support the investors to make decisions of ownership pattern, to exercise their control, to protect minorities and to achieve their corporate goal.

Finally this paper will contribute in the literature of corporate governance specifically the family concentrated firm's the effects the corporate financial decisions.

2. Literature Review

(Attiya Y. Javid and Robina Iqbal, 2008) study showed the link among 'Ownership Concentration', 'Corporate Governance' and 'Firm Performance'. They practiced model that was suggested by Pistor in 2003 and Klein in 2005 to check the 'Ownership Concentration', 'Corporate Governance' and 'Firm Performance'. ROA, ROE & Tobin's Q were taken as independent variable while Ownership concentration was taken as dependent variable. 'Concentration of ownership' had active effect on 'firms Performance measures' and passive between 'corporate governance' & 'concentration of ownership'.

(Abdullah et al., 2011) had examined the effect of 'group & family ownership' on 'firm performance' by using 'OLS & 2SLS' techniques on 158 KSE-Listed firms for 2003-2008 and did not find any significant association among both variables, also check the performance of 'family & non-family' with a sample of 28 and 26 companies respectively and suggest that performance of 'family firms' is better that 'non-family firms' bit this betterment is not significant statistically.

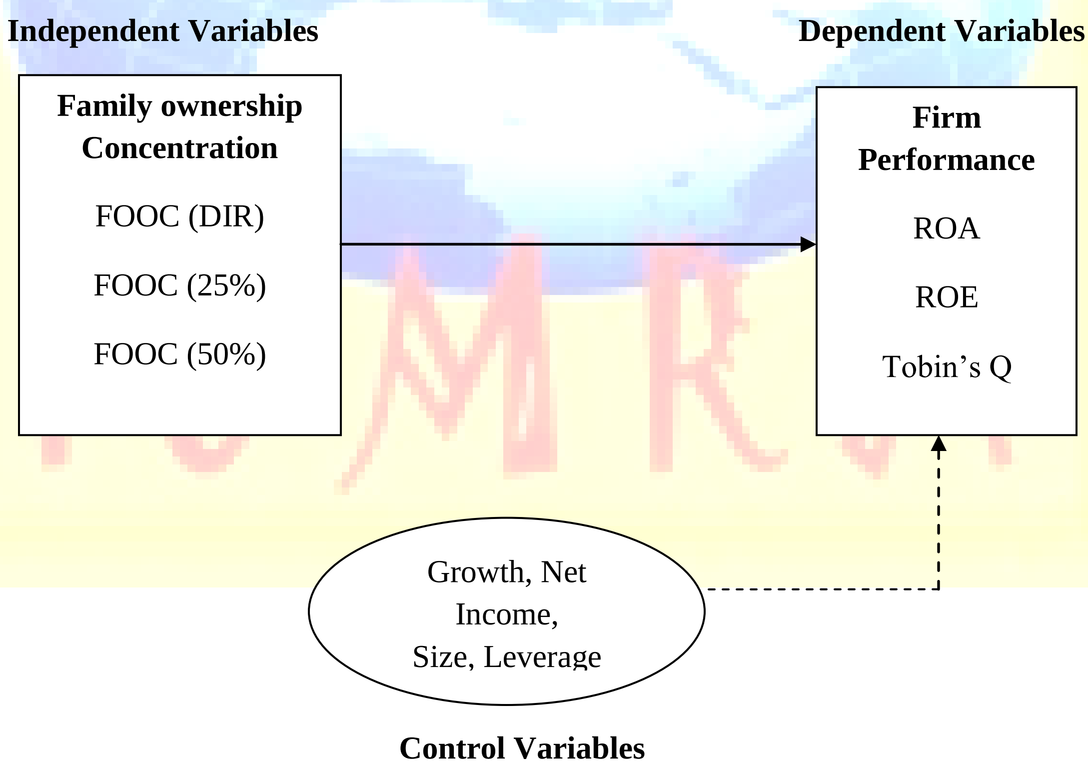
(Ghani et al., 2011) had examined the comparative financial performance of different 'business groups' in Pakistan from KSE. The do this for 5 years data and conclude the 'group firms' have better performance than 'non-group firms' because the ROA of 'group firms' was higher than others'.

(Alex Stewart and Michael A. Hitt, 2011) had conducted a survey to argument on the behavior of 'family & non-family/professional firms'. Except the several benefits of 'family firms' there is a large difference between 'family and professional firm' and suggest 6 ideal forms of firms that are (1) 'less professional family firms' (2) 'wealth providing/private family firms' (3) 'entrepreneur family firms' (4) 'entrepreneur family business groups' (5) 'artificial-professional/public family firms' and (6) 'mixed professional family firms', with many useful suggestions for future research.

(Clair, 2012) had observe the connection between 'ownership structure' by using proxy of shares hold by BOD's and 'firm performance' with Tobin's Q for the period of 2007-11 from the implication of 'panel data technique' with the findings of a mediating effect between market and ownership structure.

(Khan et al., 2013) had try to find out the answer of the question that "how does the 'family ownership' exert its effect on the 'debt agency conflict'? And found the answer by employing a sample of 100 non-financial KSE firms for a 5 year period of 2006 to 2010 by using 'Generalize Least Square' as a measurement tool. Consequently got that if the 'family ownership' increases, 'debt agency cost' decreases' and if 'profitability increases it does to vice versa.

3. Theoretical Framework



4. Research Methodology

This topic is a hot issue in the subject of corporate finance, from Pakistan's economy point of view. Different researchers have conducted research on this topic and find different results as discussed in the literature of this topic. I have also make effort to test following hypothesis in context of Pakistan economy.

4.1 Research Hypothesis

H_1= There is an association between 'family ownership concentration' and 'firm performance'.

H_2= Greater the 'Family concentrated ownership', higher the 'firms performance'.

4.2 Sources of Data and Sample Selection

Data is collected from Secondary sources. I have collect data from KSE site and also visit individual website of selected companies. The sample is selected from KSE-30Index, the major out-performing corporations, contributing heavily in the emerging economy. I have select non-financial firms, because financial institutions have different operations and mechanisms. The latest data is collected for the year 2009, 2010, 2011 and 2012. Due to unavailability of data for the year 2013, my final sample is 20 firms from KSE-30Index.

Data Description & Data Sample

Target population	KSE-30 Index
Financial Firms	6 firms
Non-Financial Firms	24 firms
Data not Available	4 firms
Available Data	20 firms
Final Sample	20 non-financial firms
Time Period	2009 to 2012

4.3 Explanation of Variables

Independent Variables

The variable that can influence the impact on some other variable is known as independent variable. I have selected the family ownership concentration (FOOC) as independent variable as it influences the firm performance. It is calculated as a %age of shares held by Directors, Spouse and Minors, and are multiplied by that is the shares held by top 5 shareholders, and is the family ownership concentration calculated by the number of board of directors having 25% or 25%+ voting right belong to 1 family, and multiplied by that is the %age of shareholding of top 5 shareholders. And is also calculated with same method but family holding is categorized by the number of board of directors having 50% or 50%+ voting right belong to same family, and multiplied by .

Dependent Variables

$$ROA = \frac{Net\ Income\ Before\ Tax}{Total\ Assets}$$

$$ROE = \frac{Net\ Income\ Before\ Tax}{Total\ Equity}$$

$$Tobin's\ Q = \frac{Long\ term\ Debt + Market\ Value\ of\ Common\ Stock}{Total\ Assets}$$

Control Variables

- LEVERAGE = the ratio of Long term liabilities & total assets
- SIZE = natural log of total assets
- NI = ratio of Income before Tax & Net Sales
- GROWTH = ration of book to market value of equity

4.4 Model Specification

The Regression model is choose to check the effect of 'family ownership' on 'firm performance' by controlling the effect of these controlling variables like leverage , sales growth, Net income and the size of the firm.

$$Yit = \alpha + \beta Xit + \varepsilon it$$

Yit is the dependent variable, the firm performance and ***Xit*** is the independent variable, the family ownership concentration and $\boldsymbol{\varepsilon it}$ is the erroe term and other Greek words are the coefficients. While $\boldsymbol{\alpha}$ is the constant and ***it*** is the time period.

5. Empirical Results

The Analysis is begun with Correlation analysis, purpose was to check the relationship between variables so that to avoid from co-linearity problem. Then descriptive statistics is find out to check the normality of data, after that Hausman Test is applied to check the fitness of model to be applied to check the impact of family ownership concentration on firm performance by applying Fixed effect Regression Model and Random Effect Regression Model.

5.1 Descriptive Statistics

As the name indicates, Descriptive statistics provides the complete detail of the input data used to analyze the theoretical framework. It provides the thoroughly detail of data in a snap shoot and used to check the normality, authenticity and reliability of the data used to analyze the proposed Hypothesis. Here the minimum value of FOOC (DIR), FOOC25, and FOOC50 has maximum 34.95, 95.07, 71.47 and minimum value 0, 0, 0 with 12.28, 32.33, 10.28 standard deviation. Where ROA, ROE and TOBIN'S Q has 59.73, 143.80, 2.77 maximum and -9.847, -62.15, -0.024 minimum values with standard deviation 15.76, 37.68, 0.718 respectively.

Most advanced economic analysis models study data for skewness and incorporate this into their calculations. Skewness risk is the risk that a model assumes a normal distribution of data when in fact data is skewed to the left or right of the mean.

When the median > mean the skewness is negative otherwise positive. Here FOOC (DIR), FOOC50, ROA, ROE and TOBIN'S Q are positively skewed and FOOC25 is negatively skewed. Kurtosis is a statistical tool used to measure the peakness of data. Here FOOC (DIR), FOOC25, TOBIN'SQ are < 3 so these are platycurtic where FOOC25, ROA and ROE are > 3 so they are leptocortic with 80 observations.

Table 1: Descriptive Statistics

	FOOC (DIR)	FOOC 25	FOOC 50	SIZE	GROWTH	LEV	NI	ROA	ROE	TQ
Mean	9.3	46.5	2.4	4.7	1.0	15.6	0.1	12.4	24.6	0.9
Median	0.1	50.8	0	4.6	0.9	13.2	0.09	7.0	15.8	0.6
Maximum	34.9	95.0	71.4	5.5	3.8	64.4	0.68	59.7	143.8	2.7
Minimum	0	0	0	3.83	0.16	-78.7	-0.1	-9.8	-62.1	-0.02
Std. Dev.	12.28	32.3	10.28	0.38	0.75	19.8	0.20	15.7	37.6	0.7
Skewness	0.86	-0.28	4.88	0.20	1.34	-0.52	1.3	1.2	0.5	0.9
Kurtosis	2.15	1.71	28.95	2.72	4.85	8.65	3.7	3.5	4.4	2.8
Jarque-Bera	12.42	6.53	2561.	0.81	35.52	10.1	22.9	19.5	11.9	13.0
Probability	0.020	0.03	0	0.67	0	0	0.01	0.06	0.04	0.01
Observations	80	80	80	80	80	80	80	80	80	80

5.2 Correlation Analysis

Correlation is a statistical tool to check the volume of association among the variables. Its value lies between -1 and +1; it's a scale to measure the level of significance among variables. Here the level of significance is 0.05 if the relation lies between +0.05 and -0.05 it will be a significant relation otherwise it will be an insignificant relation. In this correlation analysis FOOC (DIR) has significant relation NI (-0.012), ROE (0.006), FOOC25 has relation with ROA (-0.017), SIZE (-0.017), FOOC50 with NI (-0.014), ROA (-0.043), LEV with TOBIN'S Q (-0.047) & ROE with SIZE (0.1), as shown in table-2.

Table 2: Correlation Matrix

	FOOC (DIR)	FOOC 25	FOOC 50	GROWTH	LEV	NI	ROA	ROE	SIZE	TQ
FOOC(DIR)	1									
FOOC25	-0.14	1								
FOOC50	0.18	-0.007	1							
GROWTH	-0.12	0.08	0.08	1						
LEV	-0.11	0.23	0.05	0.35	1					
NI	-0.01	0.16	-0.01	-0.43	-0.05	1				
ROA	0.05	-0.01	-0.04	-0.53	-0.29	0.82	1			
ROE	0.006	-0.19	-0.06	-0.49	-0.26	0.59	0.87	1		
SIZE	-0.31	-0.01	-0.09	-0.21	0.07	0.38	0.15	0.1	1	
TQ	0.21	0.07	-0.06	-0.56	-0.04	0.69	0.74	0.56	0.59	1

5.3 Hausman Test

As the name indicates, it is a test applied on the panel data to check the fitness of the regression model to be applied according to the model specification. In this test the appropriateness of the Fixed or Random Effect model is measured and model is selected according to the results of this test. The result of the test is gives the output in the form of β(Prob.) and Chi-Square and selection of model is done on the base of Hausman Statistic called Chi-Square, if this value is greater than β (Prob.) than FEM will be used. If Chi-Square is less than β (Prob.), REM will be used to check the relationship between Dependent and Independent variables. So this test Differentiate the FEM and REM, REM is preferable under H_0 because of higher efficiency and FEM under H_1, due to lower efficiency and inconsistency. Here as dependent variables are three , the test with Tobin's Q have higher Chi^2 so FEM is selected and for ROA & ROE, Chi^2 is small so REM is selected as shown in table-3.

Table 3: Hausman's Test

Model	H0	H1	(β) Prob. Value	(Chi^2) Critical Value	Decision
Tobin's Q	REM	FEM	0.0171	20.1429	FEM
ROA	REM	FEM	0.2818	10.912208	REM
ROE	REM	FEM	0.4203	9.185888	REM

5.4 Family Ownership Concentration and Firm Performance

The selection of model is made according to the above criteria and the final results of the proposed hypothesis are regressed according to selected model. The following equation is run to get the desired results

$$\boldsymbol{ROAit} = \alpha 0 + \alpha 1\, FOOC(DIR)it + \alpha 2\, FOOC25it + \alpha 3FOOC50it + \alpha 4GROit + \alpha 5\, LEVit + \alpha 6\, NIit + \alpha 7SIZEit + \varepsilon i \quad (1)$$

$$\boldsymbol{ROEit} = \alpha 0 + \alpha 1\, FOOC(DIR)it + \alpha 2\, FOOC25it + \alpha 3FOOC50it + \alpha 4GROit + \alpha 5\, LEVit + \alpha 6\, NIit + \alpha 7SIZEit + \varepsilon it \quad (2)$$

$$\boldsymbol{Tobin'sQi} = \alpha 0 + \alpha 1\, FOOC(DIR)it + \alpha 2\, FOOC25it + \alpha 3FOOC50it + \alpha 4GROit + \alpha 5\, LEVit + \alpha 6\, NIit + \alpha 7SIZEit + \varepsilon it \quad (3)$$

In these equations $\alpha 0$ is the constant $FOOC(DIR)$ is the family ownership Concentration according to the criteria of %age of shares held by Directors, Spouse and Minors, and are multiplied by OC that is the shares held by top 5 shareholders, and $FOOC25$ is the family ownership concentration calculated by the number of board of directors having 25% or 25%+ voting right belong to 1 family, and multiplied by OC that is the %age of shareholding of top 5 shareholders. And $FOOC50$ is also calculated with same method but family holding is categorized by the number of board of directors having 50% or 50%+ voting right belong to same family, and multiplied byOC, With control variables LEV, GROWTH, NI and SIZE and this equation is run by three performance measuring variables like ROA, ROE, Tobin's Q and the results are shown in table-4.

Table 4: Impact of Family Ownership on the Performance Variables

Variables	Model 1	Model 2	Model 3
	Tobin's Q	ROA	ROE
C	0.3196** (1.784215)	0.3297** (20.34622)	0.9221 (-7.70904)
FOOC(DIR)	0.76 (-0.01045)	0.509 (-0.24089)	0.6152*** (0.696278)
FOOC25	0.8948 (-0.00105)	0.5708 (-0.03319)	0.5889 (-0.11588)
FOOC50	0.6331*** (0.067292)	0.9325*** (0.020992)	0.7505*** (0.290827)
GROWTH	0.0239	0.6606	0.2409

	(-0.28185)	(-0.69047)	(-7.11664)
LEV	0.6749 (-0.00123)	0.0003 (-0.16117)	0.1662 (-0.23383)
NI	0.4007 (-0.41712)	0* (54.79707)	0* (105.506)
SIZE	0.7888 (-0.10328)	0.5719 (-2.41578)	0.6462*** (7.412244)
R^2 DW N	0.912 2.163 80	0.613 1.812 80	0.344 1.948 80

Note: * express significant level at 1%, ** demonstrate the significant level at 5% & *** at 10%.

The empirical results support the hypothesis as the family ownership concentration effects the firm financial performance and its market value so H1 is accepted and family ownership concentration have positive impact on firm performance is also evidenced from level of significance of FOOC50 with all the performance indicator variables and also from the Directors holding with ROE but these results indicates that high concentration leads to better performance means it concentration increases by 1% the MV will increase by Rs. 6.7, ROA by 2% and ROE by 29%. So these results support the agency theory. The study showed a positive relation between firm Size and Performance of highly family concentrated firms. It means these family firms prefer to retain earnings to expend business rather than to distribute the dividend. And the positive and significant relation of NI with performance variables showed that family firms in Pakistan have good reputation and high sales to assets ratio.

6. Conclusion and Recommendations

The study investigates the relation between family ownership concentration and firm performance for the time period of 2009-2012 of the KSE-30 Index listed non-financial firms. The empirical results support the proposed hypothesis and showed the positive and significant relationship between family ownership concentration and firm performance. The study conducted by (Santor, 2008; Reeb, 2003 and Shabab-u-din and Attiya Yasmin, 2011) also supports these results. These results favor the Agency Theory, but it's important to note that excess of everything is bad. The performance of the firm becomes better but in reality, the companies work on the principal of profit maximization not on the principal of wealth maximization so the rights of minorities are expropriated and there is not law to safeguard the minorities so I will recommend to work at the principal of equality and work for the protection of rights of all the stakeholders. The study showed a positive relation between firm Size and Performance of highly family concentrated firms. It means these family firms prefer to retain earnings to expend business rather than to distribute the dividend.

Limitations of the Study

There are many gapes in this research, first of all there is not an authentic criterion to categorize the ownership of family firms and their concentration and there is gap in results due to unavailability of data and selection of suitable model to measure the relationship among the prescribed variables, all these gapes can be removed from further research.

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