Governance of Family Owned Businesses: International Evidence

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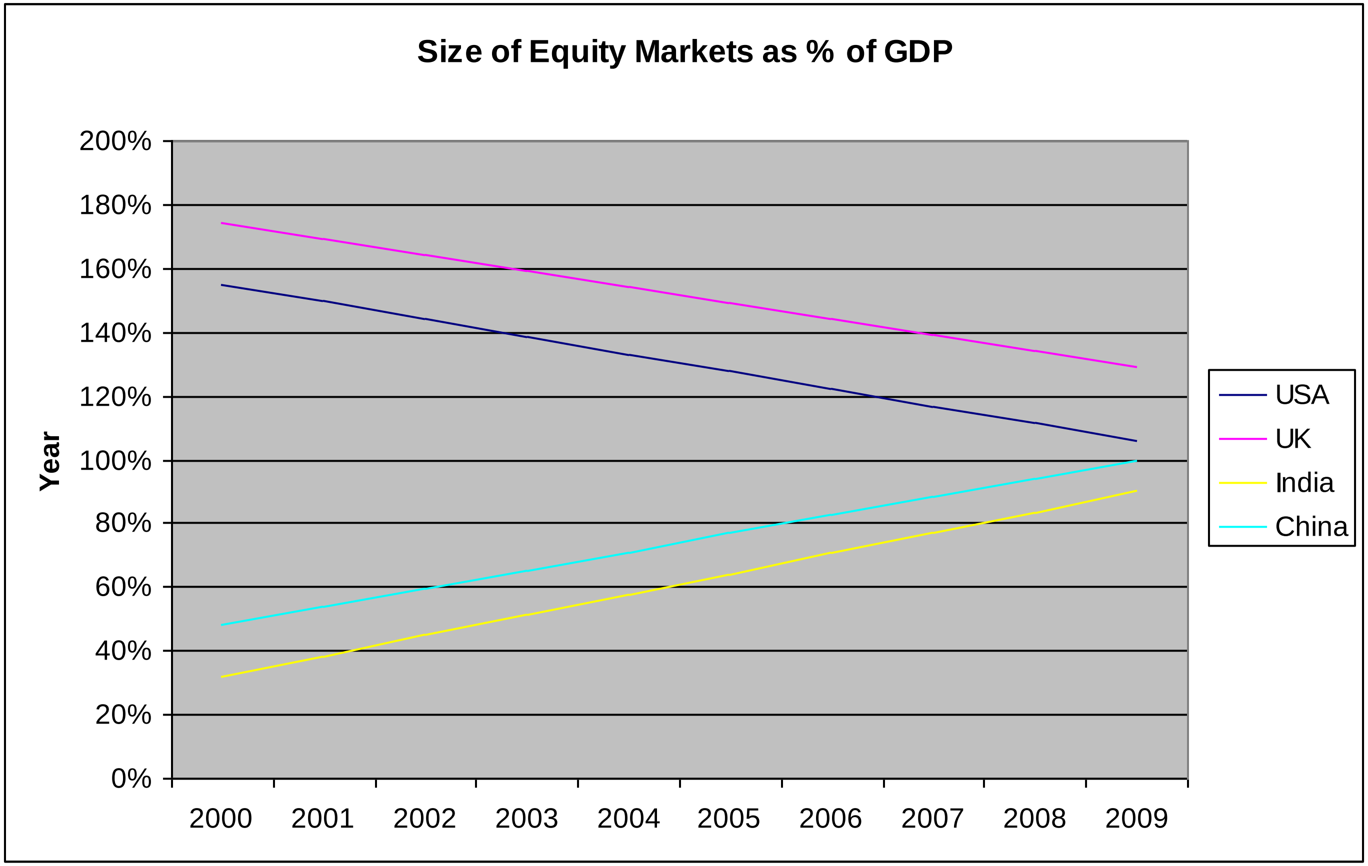
Introduction

- Why does ownership matter? Because it affects how companies are controlled and governed.
- An example: if you have a large shareholder, he (she) will probably choose the CEO. If the stakeholder is a family the CEO will often come from the family itself. If however, there is no large stakeholder the board of directors chooses the CEO.
- Why does this matter? In the event of poor performance the large shareholder will intervene possibly changing management, maybe even the strategy of the firm. In the firm with no large shareholder the board will make these decisions, possibly influenced by individual shareholders.
- Which is the better capital market? The one with dispersed ownership or the one with the large (family) shareholder?

Which one is better depends in part on the trade-off between agency costs and private benefits of control

- There is a ‘law and finance view’ that private benefits are larger than agency costs. They predict that stock markets with concentrated ownership underperform compared with those with dispersed ownership.
- One explanation:
  - stock markets with concentrated ownership often are accompanied by poor investor protection particularly for minority shareholders. Stock markets with more dispersed ownership tend to be associated with high levels of investor protection.
- Does it necessarily follow that concentrated ownership has to be accompanied by poor investor protection?
  - In other words, is there a ‘natural law’ that private benefits of markets with blockholders are greater than the agency costs of dispersed markets? An important question for policy makers.
- How does ownership differ across countries and how do different forms influence how companies are controlled and ultimately how they perform?

How relative size of 4 large stock markets has changed over the decade: what has produced this convergence?



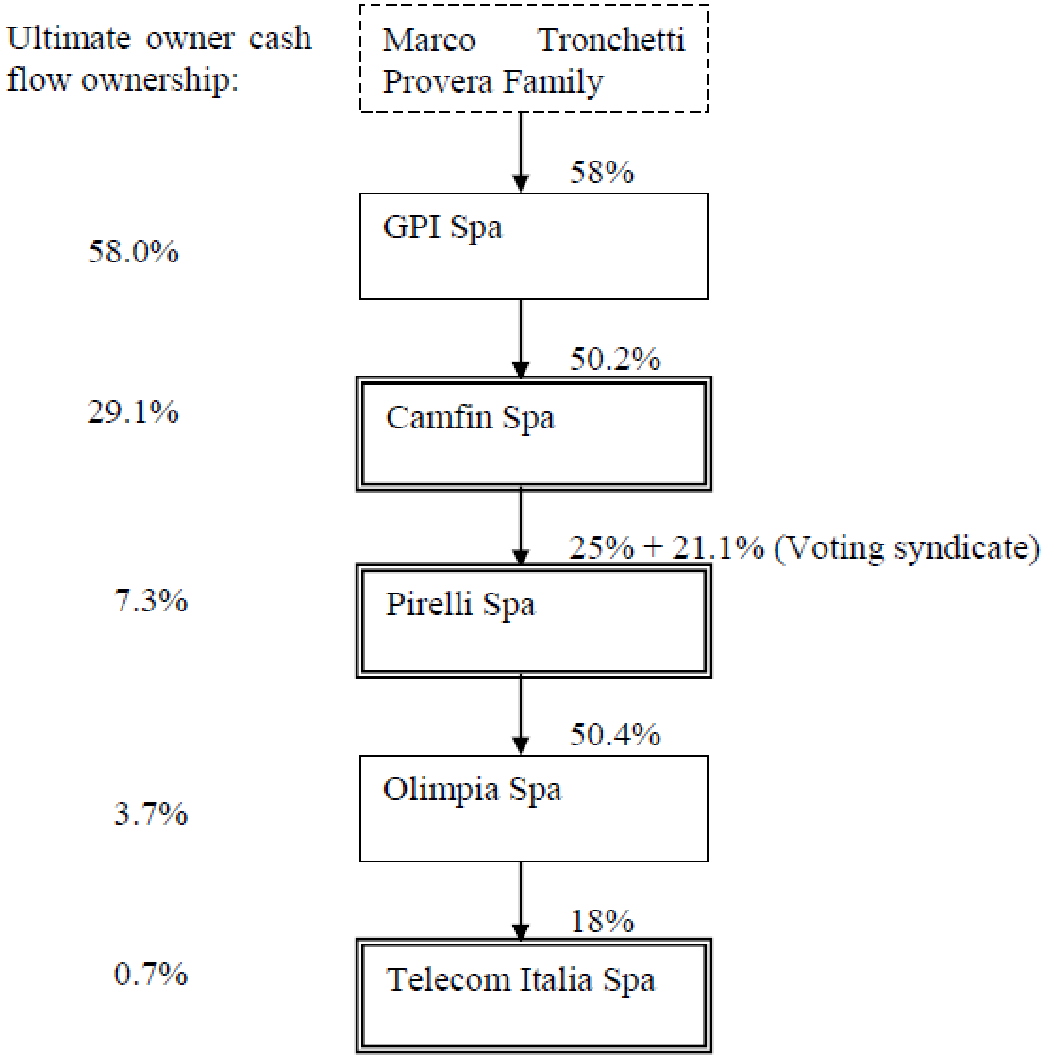
What is the dominant ownership model? Family, state or dispersed ownership models?

- Which would you prefer? Dispersed ownership markets of the UK or the family dominated markets of Italy or of Sweden? (I will not mention Israel yet) Is the answer obvious?
- Paul Myners (former Minister for the City): the UK Plc is characterised by ‘ownerless corporations’.
- Why? Small fragmented shareholders have little incentive to monitor & intervene in underperforming companies because of free riding and conflicts of interest.

Advantages & disadvantages of each

- UK: low private benefits curbed by regulation and independent boards. Enforcement against fraud, tunnelling etc.
- Agency costs are reduced by better boards of directors e.g. independent directors, separation of CEO and chairman.
  - Prejudice against ‘kinship’ (who succeeded Mr Murdoch?)
- Nevertheless high costs remain, witness the high premiums paid by private equity for public companies, the uncertain gains from takeovers and the low level of shareholder activism.
- Italy: high private benefits: voting premiums in Italy are almost 30%
  - Why? Wealth transfers from minority shareholders to the blockholder & pyramidal structures.

Example of a pyramid



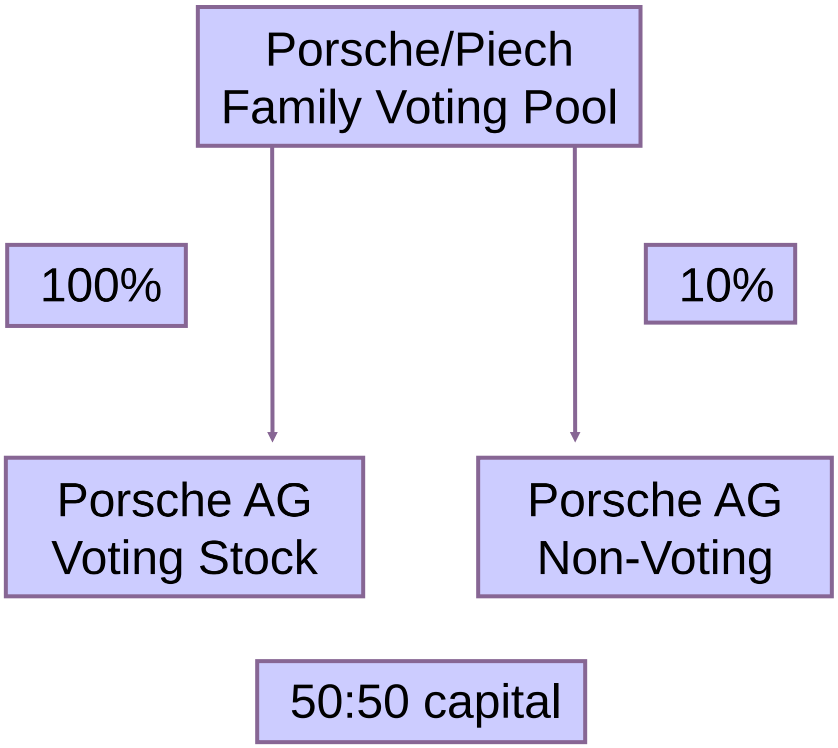
Source: Volpin and Enriques. (2003)

Germany: A quote from Mr Piech

(chair of supervisory board of VW and part of the family that owns Porsche)

- ‘Yes of course we have heard of shareholder value. But that does not change the fact that we put customers first, then workers, business partners, suppliers and dealers, and then shareholders’ (FT October 18 2005).

But then the dual class structure explains Mr. Piech's views!



Summary so far

- Which model of ownership is better?

- Can law and regulation curb the costs of private benefits of control of block holder capital markets so that they are less than the agency costs of dispersed ownership?

An international study of family ownership
(Franks, Mayer, Volpin and Wagner)

- We know family ownership is common in many countries and much less so in others (at least among large companies).

- Why is this the case?

Scope

- We study the landscape of ownership, particularly *family firms*, along three dimensions:
  - **Across countries –** in 27 European countries, with *detailed data for France, Germany, Italy and the UK*.
  - **Independent of listed status** - both private and listed companies
  - **Over time:** trace family firms over decade 1996-2006

Central hypothesis

- The life cycle view provides a central hypothesis to test across countries.
- We expect UK to follow such a cycle but not France, Germany and Italy.
- Why? The answer can be found in differences in their capital markets.

Our three samples

1 "The largest 4,000, both private and listed"

"TOP 4000 SAMPLE"
Hand-collected data for France, Germany, Italy, U.K.

1996
1000 largest firms in each country by sales, both private

- TOP 1000 - France
- TOP 1000 - Germany
- TOP 1000 - Italy
- TOP 1000 - UK

2006
Trace ownership changes and death events for all 1996

- SURVIVORS
  Firms existed in 1996, still exist in 2006
- EXITS
  Firms existed in 1996 and did not survive until 2006

2 "All private and listed, 27,000 firms"

"ALL FIRM SAMPLE"
Algorithm-processed data for 25 countries

2006
All firms in AMADEUS, both private and listed, with basic data items available, and minimum EUR 25 million sales in last fiscal year.

Austria, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Macedonia, Malta, Moldova, Netherlands, Norway, Poland, Portugal, Romania, Russian Federation, Serbia, Slovakia, Spain, Sweden, Switzerland, Ukraine, United Kingdom

3 "All listed family firms"

"LISTED FAMILY FIRM SAMPLE"
Hand-collected data for France, Germany, Italy, U.K.

1996
All listed family-controlled firms in each country (control at the 25% threshold

- France
- Germany
- Italy
- U.K.

2006
Trace ownership changes and death events for all firms

- SURVIVORS
  Firms existed in 1996, still exist in 2006
- EXITS
  Firms existed in 1996 and did not survive until 2006

Ownership in top 1000 private & public companies (2006)

	2006			
Ownership Type	Germany	France	UK	Italy
Multiple Blocks	2.0	1.0	0.4	1.2
Family	33.3	38.2	20.4	46.8
State	9.7	8.2	3.8	13.3
Widely Held	13.0	13.1	24.2	12.2
Widely Held Parent	36.5	36.1	46.0	25.8
No. of Companies	856	975	996	960

Definition of major shareholder: stake larger than 25% of equity.

Source: Franks, Mayer, Volpin and Wagner (2007).

Control of publicly traded companies in Asia

	China	Hong Kong	Japan	South Korea
Number of Firms	851(1998) 1599(2004) 2063(2010	330	240	345
Widely Held	2.1 (1998) 17(2004)	.6	42	14.3
Family	0 (1998) 1.8(2004)	64.7	13.1	67.9
State	43.8(1998) 54(2004)	3.7	1.1	5.1

Notes: Definition of major shareholder: stake larger than 10% of equity, 1996-1998.

*Source: Claessens et al. (2000), *Tian and Estrin (2008).*

Main results

- In the UK, 12% of firms are controlled by domestic families, 40-50% in Continental Europe.
  - Pattern is similar among both listed **and** private firms.
- Family firms follow a life cycle in the UK, but not in the other three countries.
- High turnover of family control in the UK, high stability of control in Continental Europe.
- Need for external financing and the market for corporate control reduce survival probability of family firms in the UK, but much less so in Continental Europe.
- Use of dual class shares and pyramids does not explain survival of family firms.

Proposition 1

- The evolution from family firm to public corporation runs smoother when
  - Private benefits of control are smaller;
  - Opportunities for risk diversification are greater;
  - Raising equity is less expensive;
  - Market for corporate control is more active & efficient;
  - …
  - In short, in "outsider" rather than "insider" systems.

Proposition 2

- **Survival of family firms:** Family firms will survive less as family-controlled firms in outsider compared with insider systems.
- **Age as a determinant of family control:** *family firms will be younger* in outsider systems than in insider systems.
- **Need for external financing:** Family ownership will be concentrated in industries with less need for external capital in UK than in France, Germany and the UK.
- **Differences in profitability:** Family controlled firms likely to be more profitable in insider systems but less so in outsider systems. Family firms favoured in countries like Italy, France & Germany. Much less so in the UK.

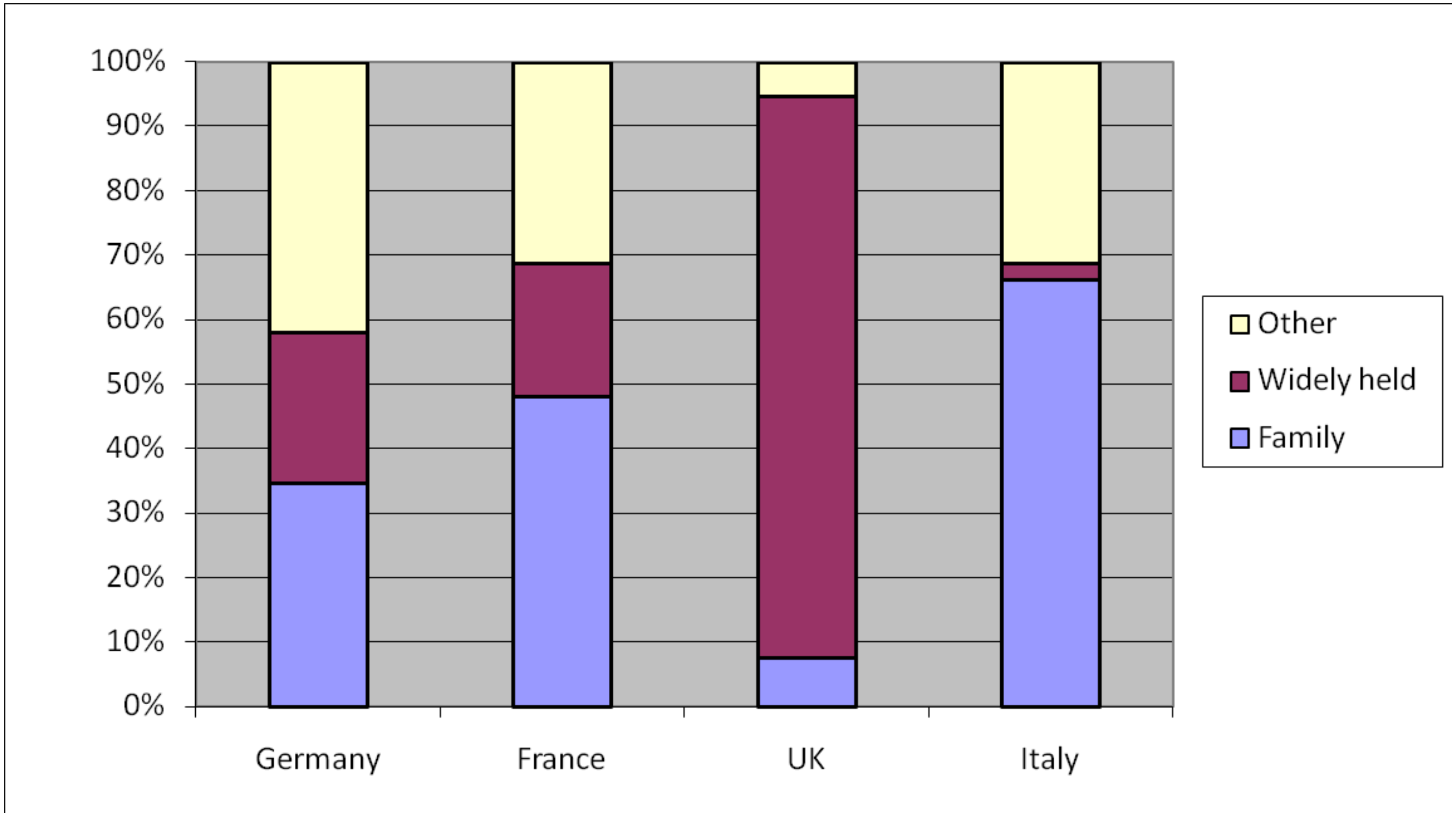
How important are listed firms?

Of the top 1,000 firms in the four countries, how many are listed?

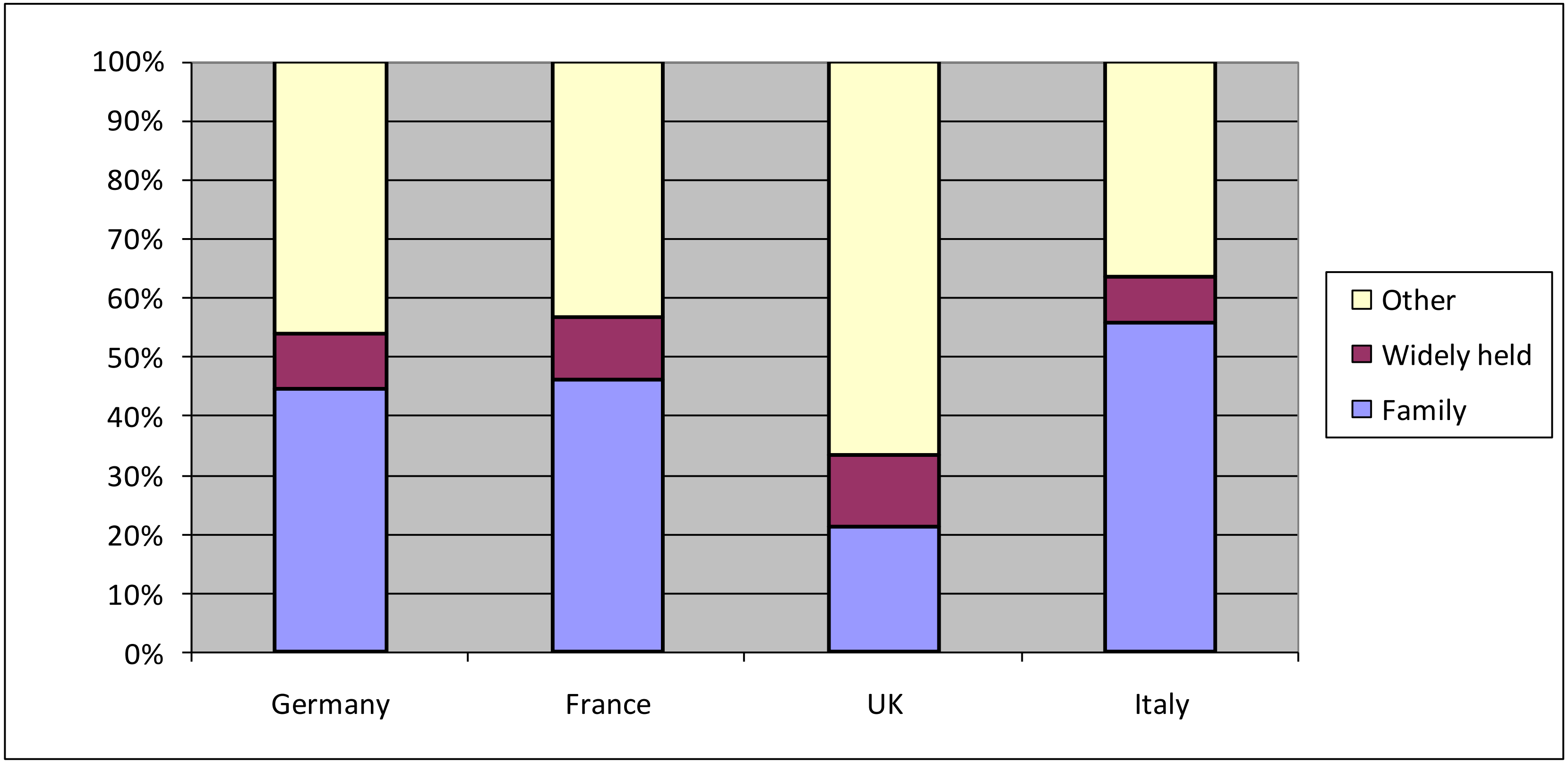
Frequency of listed firms among largest 1,000

	Germany	France	U.K.	Italy
Listed firms, % all firms	14.5	13.6	27.8	8.4

Analysis of Listed Firms: Family Firms Much More Common in Continental Europe, Widely Held Much Less Common



Analysis of Private Firms: Family Firms Less Common in the UK



Transition of control from family to non-family firms is more frequent in the U.K.

Germany

	Family in 2006		Widely held in 2006		State in 2006		Other in 2006		No of firms
Family in 1996	124	**(75%)**	17	(10%)	0	(0%)	25	(15%)	166
Widely held in 1996	5	(9%)	29	**(54%)**	1	(2%)	19	(35%)	54
State in 1996	7	(9%)	7	(9%)	39	**(51%)**	23	(30%)	76
Other in 1996	29	(18%)	5	(3%)	5	(3%)	123	**(76%)**	162

France

	Family in 2006		Widely held in 2006		State in 2006		Other in 2006		No of firms
Family in 1996	187	**(66%)**	19	(7%)	5	(2%)	74	(26%)	285
Widely held in 1996	7	(10%)	51	**(74%)**	0	(0%)	11	(16%)	69
State in 1996	11	(14%)	4	(5%)	41	**(53%)**	22	(28%)	78
Other in 1996	48	(20%)	8	(3%)	7	(3%)	177	**(74%)**	240

U.K.

	Family in 2006		Widely held in 2006		State in 2006		Other in 2006		No of firms
Family in 1996	68	**(50%)**	11	(8%)	2	(1%)	56	(41%)	137
Widely held in 1996	11	(6%)	106	**(62%)**	1	(1%)	53	(31%)	171
State in 1996	3	(21%)	0	(0%)	7	**(50%)**	4	(29%)	14
Other in 1996	53	(17%)	5	(2%)	6	(2%)	247	**(79%)**	311

Italy

	Family in 2006		Widely held in 2006		State in 2006		Other in 2006		No of firms
Family in 1996	243	**(77%)**	18	(6%)	6	(2%)	49	(16%)	316
Widely held in 1996	5	(14%)	29	**(81%)**	0	(0%)	2	(6%)	36
State in 1996	18	(28%)	4	(6%)	41	**(64%)**	1	(2%)	64
Other in 1996	25	(17%)	2	(1%)	7	(5%)	117	**(77%)**	151

Family firms in the U.K. die as they age, in Continental Europe they do not.

Dependent variable	Firm is family controlled (1) or not (0)		Firm survives the decade (1) or not (0)	
Sample	All firms	All firms	Family firms	Family firms
	(1)	(2)	(3)	(4)
Firm age	0.012	0.055	0.092***	0.107***
	[0.047]	[0.046]	[0.020]	[0.021]
(U.K.) X (Firm age)		-0.254***		-0.158***
		[0.040]		[0.018]
France	-0.012	-0.005	0.111***	0.113***
	[0.013]	[0.010]	[0.006]	[0.004]
U.K.	-0.145***	-0.039	0.143***	0.202***
	[0.021]	[0.027]	[0.016]	[0.012]
Italy	0.076***	0.087***	0.124***	0.128***
	[0.027]	[0.024]	[0.017]	[0.018]
Listed firm	-0.104*	-0.106*	0.110	0.109
	[0.056]	[0.059]	[0.075]	[0.076]
Foreign ultimate control	-0.184	-0.190	-0.019	-0.021
	[0.126]	[0.122]	[0.022]	[0.022]
Log (Sales)	-0.040***	-0.039***	0.005	0.005
	[0.010]	[0.010]	[0.011]	[0.011]
Industry fixed effects	YES	YES	YES	YES
Observations	3732	3732	1359	1359
Pseudo R2	0.138	0.142	0.0574	0.0583

Family firms are concentrated in a small number of industries in all countries…

Concentration of family firms in top 5 and top 20 industries:

Out of all 48 Fama French industries:	Germany	France	U.K.	Italy	Total
5 top industries with largest concentration of family firms	59%	63%	55%	36%	48%
20 top industries with largest concentration of family firms	95%	94%	87%	86%	88%

…but industry-wide high external financing requirements and M&A activity only matter in the UK.

Dependent variable	Firm is family controlled (1) or not (0)			Firm survives the decade (1) or not (0)		
Sample	All firms	All firms	All firms	Family firms	Family firms	Family firms
	(1)	(2)	(3)	(4)	(5)	(6)
Firm age	0.016	0.012	0.014	0.109***	0.105***	0.108***
	[0.046]	[0.047]	[0.045]	[0.011]	[0.014]	[0.011]
(U.K.) x (*Ext Dep*)	-0.064***		-0.078***	-0.168***		-0.178***
	[0.021]		[0.023]	[0.007]		[0.005]
(U.K.) x (*M&A Act*)		-0.128***	-0.135***		-0.163***	-0.169***
		[0.028]	[0.028]		[0.022]	[0.022]
U.K.	-0.151***	-0.077**	-0.075**	0.152***	0.265***	0.257***
	[0.023]	[0.036]	[0.036]	[0.013]	[0.024]	[0.026]
France	-0.011	-0.013	-0.013	0.113***	0.111***	0.113***
	[0.011]	[0.013]	[0.012]	[0.010]	[0.008]	[0.010]
Italy	0.056***	0.055**	0.056***	0.134***	0.132***	0.133***
	[0.021]	[0.022]	[0.021]	[0.021]	[0.017]	[0.020]
Listed firm	-0.116**	-0.114**	-0.115**	0.107	0.097	0.106
	[0.055]	[0.054]	[0.054]	[0.074]	[0.081]	[0.075]
Foreign control	-0.189	-0.191	-0.192	0.001	-0.005	-0.003
	[0.126]	[0.125]	[0.125]	[0.026]	[0.028]	[0.026]
Log (Sales)	-0.038***	-0.038***	-0.037***	0.007	0.007	0.007
	[0.007]	[0.007]	[0.007]	[0.012]	[0.010]	[0.012]
Industry fixed effects	YES	YES	YES	YES	YES	YES
Observations	3,371	3,384	3,371	1,280	1,289	1,280
Pseudo R2	0.135	0.138	0.138	0.0653	0.0649	0.0679

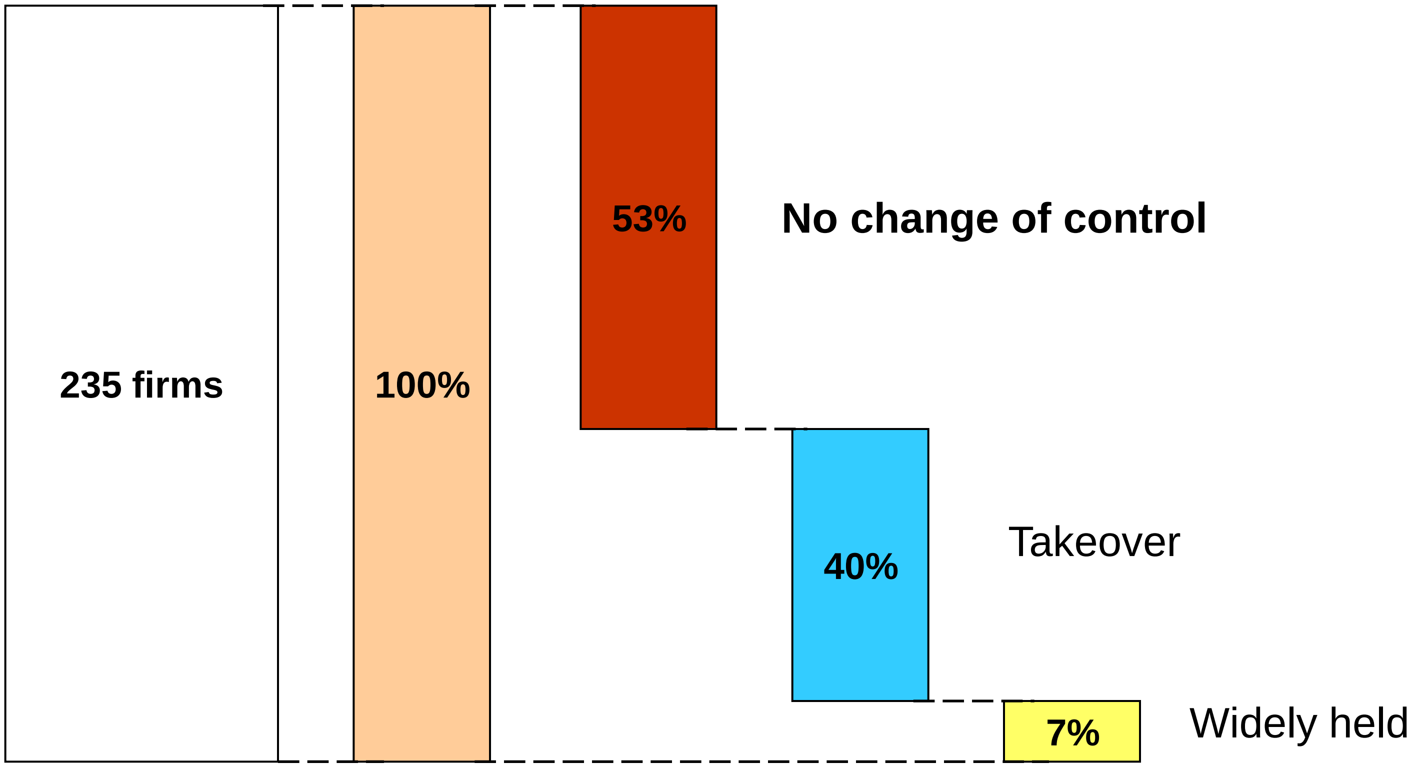
Sample of 27 countries: in outsider countries, family firms follow life cycle, esp. in industries w/high external financing and M&A.

Probit regressions

Dependent variable:	Firm is family controlled (1) or not (0)			
	(1)	(2)	(3)	(4)
Firm age	0.012	-0.012	-0.013	0.012
	[0.012]	[0.018]	[0.019]	[0.014]
Listed firm	0.041	0.042	0.041	0.041
	[0.039]	[0.038]	[0.039]	[0.039]
Size	-0.044***	-0.044***	-0.044***	-0.044***
	[0.008]	[0.008]	[0.008]	[0.009]
(*OUT*) x (Firm age)	-0.063***			-0.069**
	[0.024]			[0.027]
(*OUT*) x (*Ext Dep*)		-0.016***		-0.013***
		[0.002]		[0.004]
(*OUT*) x (*M&A Act*)			-0.022*	-0.023**
			[0.012]	[0.011]
Observations	27684	27684	27684	27684
Pseudo R^2	0.102	0.102	0.102	0.104
Country and industry fixed effects	YES	YES	YES	YES

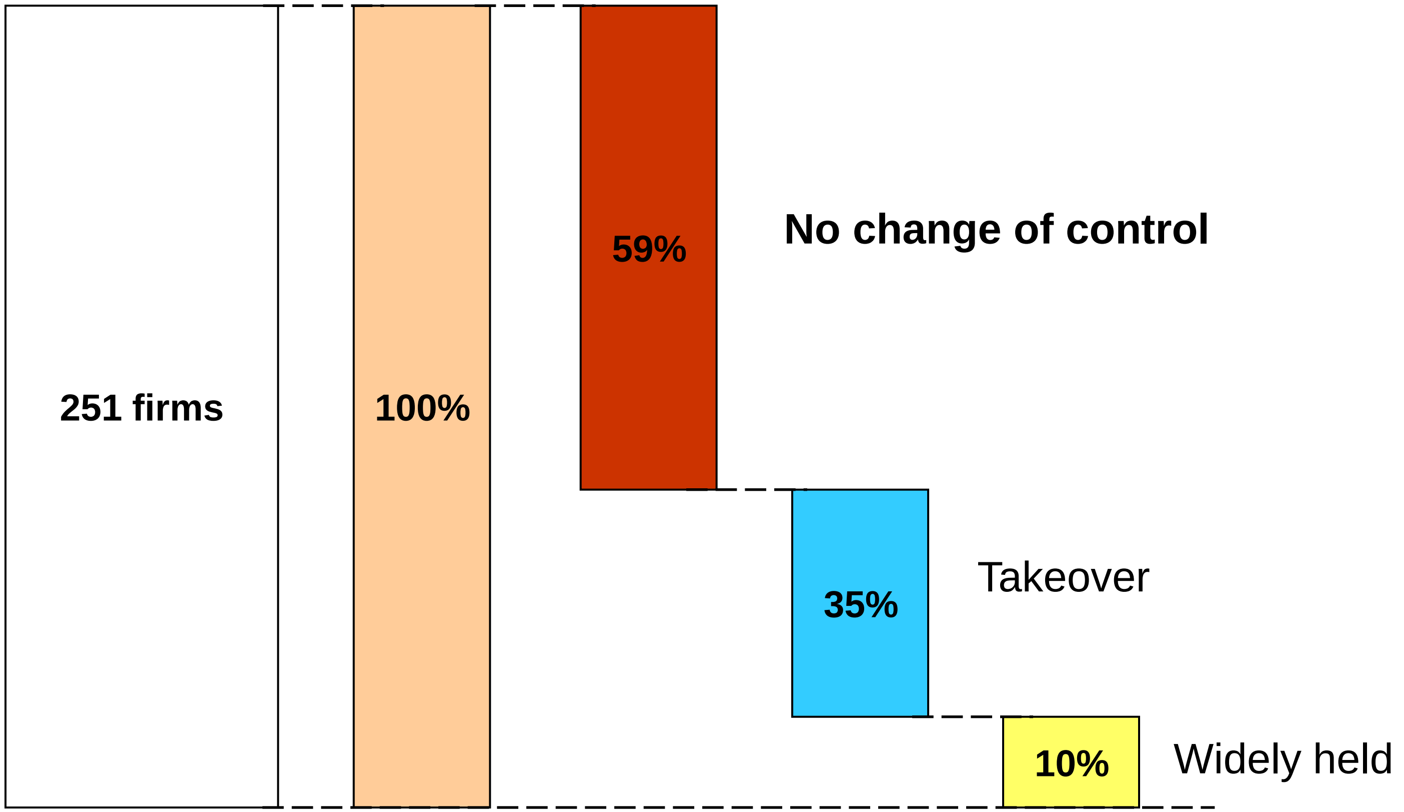
Evolution of Listed Family Firms 1

Germany



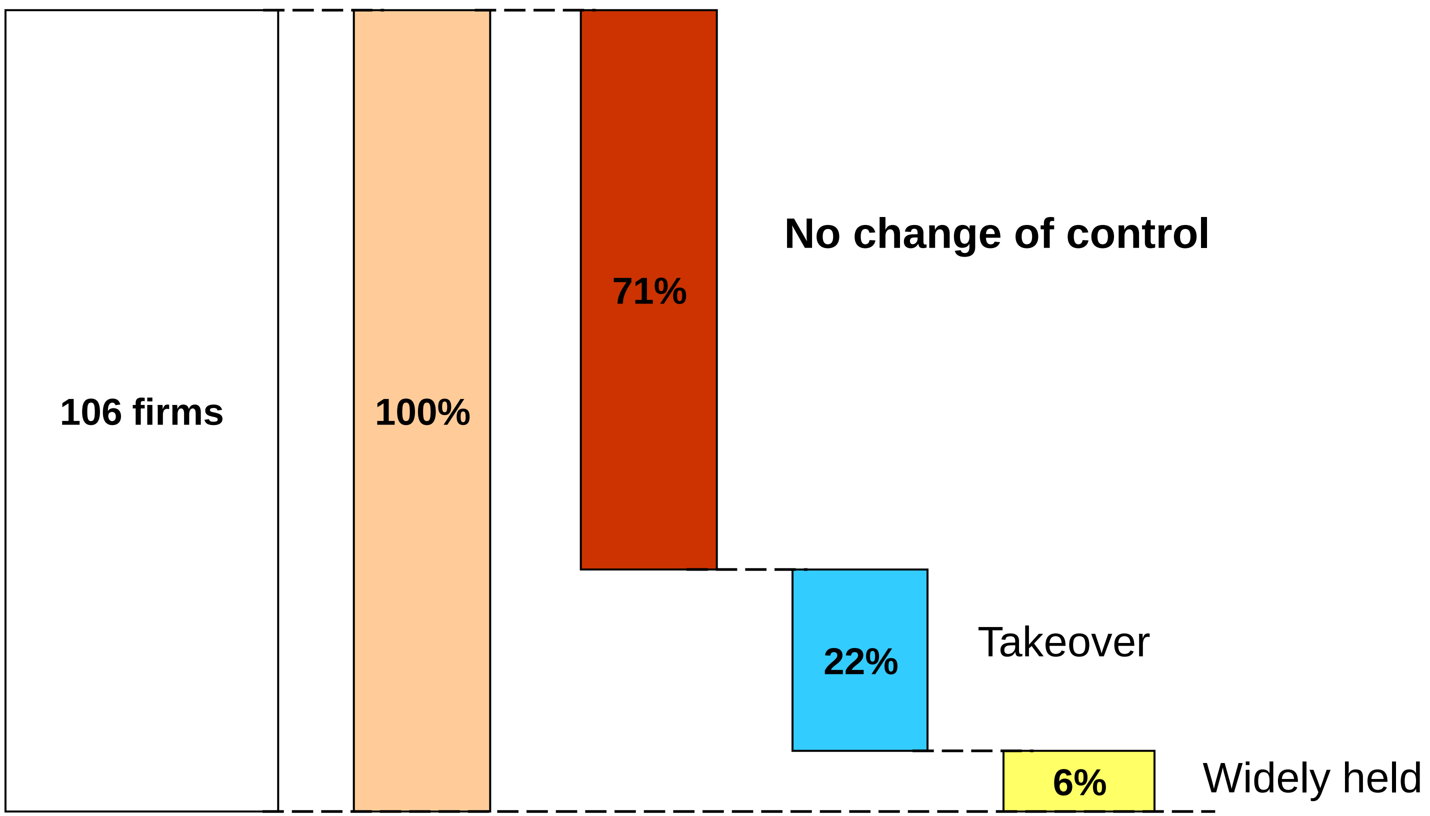
Evolution of Listed Family Firms 2

France



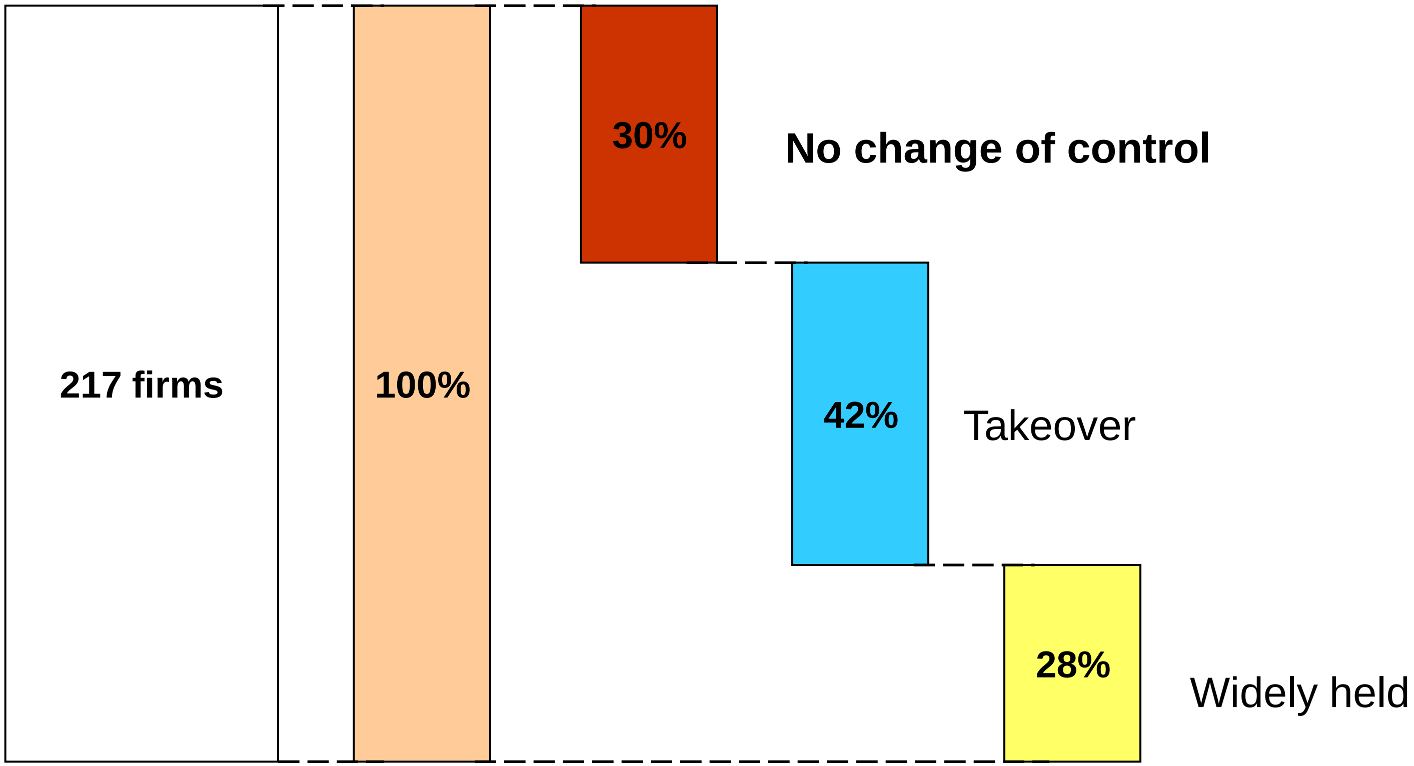
Evolution of Listed Family Firms 3

Italy



Evolution of Listed Family Firms 4

UK



Wider ownership within a family causes more control changes

Dependent variable: Change of control from 1996 to 2006				
	(1)	(2)	(3)	(4)
Founding family in control in 1996	-0.580***	-0.644***	-1.060***	-1.078***
	[0.118]	[0.122]	[0.172]	[0.181]
Control divided among family members	0.192*	0.195*	0.491***	0.466***
	[0.105]	[0.109]	[0.146]	[0.155]
Voting rights (%)	-0.018***	-0.018***	-0.009**	-0.007*
	[0.003]	[0.003]	[0.004]	[0.004]
1st generation (founder) in control	-0.104	-0.123	-0.042	-0.014
	[0.119]	[0.126]	[0.160]	[0.173]
3rd generation in control	-0.149	-0.142	-0.067	-0.015
	[0.129]	[0.135]	[0.172]	[0.185]
U.K.			1.215***	1.192***
			[0.191]	[0.205]
Log(sales)			-0.079**	-0.071*
			[0.039]	[0.042]
Industry fixed effects	NO	YES	NO	YES
Pseudo R^2	0.074	0.094	0.192	0.219
Observations	742	718	443	424

Conclusions

- In the UK, family firms naturally evolve into widely-held firms as they grow bigger and older. This does not happen in Continental Europe (CE).
- Generally, high turnover of control in the UK. Low turnover in CE.
- Why these differences?
  - Insider versus outsider systems
  - Two mechanisms may lead to dilution of family ownership:
    1. The need to raise external capital to finance growth
    2. The activity of the market for corporate control.

Some issues

- How should family dominated capital markets evolve? What should governments do?
- Should we be worried in the UK about the low proportion of companies with family control?
- Is the level of family businesses in the UK a reflection of our culture, opportunities in our capital market and low levels of private benefits?
- Are our institutions such as banks, stock exchanges and takeover codes biased towards the public company with widely dispersed ownership? Is there a bias against companies with large stockholders, where [family] kinship and succession is valued.
- Can we do much about this? Are we stuck with the marriage of our capital markets and landscape of ownership?
- Will other countries follow us when their capital markets move to outsider system?