Family Ownership and Firm Performance: Further Evidence from Sri Lanka and Japan

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ABSTRACT

Numerous studies have focused on ownership structure and firm performance. In recent years, a growing amount of research has recognized the importance of family-controlled firms (FCFs) where ownership concentrates on single individual or family. Despite many important insights, however, significant gaps in the literature remain. Studies have produced divergent findings about the performance of FCFs, leading to calls for further research. Utilizing 151 and 753 firm-years of FCFs drawn from the Colombo Stock Exchange, Sri Lanka, and the Tokyo Stock Exchange, Japan, respectively during 2011-2013, this study examines the relationship between family ownership and firm performance. Regression results show conflicting findings in that family ownership has a positive relationship with firm performance in Japan whereas a negative relationship is found in Sri Lanka. In sum, finding supports that view of the extant studies that family ownership and firm performance have a curvilinear relationship meaning that ownership concentration beyond a certain point likely creates entrenchment and consequently negative effects on performance.

Keywords: Agency Theory, Family Ownership Concentration, Family-Controlled Firms, Firm Performance, Herfindahl Index, Japan, Sri Lanka

1. INTRODUCTION

Family-controlled firms (FCFs) are the oldest form of business in the world. The study of FCFs has attracted significant attention in recent times because of FCFs prevalence in the global economic and business landscape (Gomez-Mejia, Haynes, Nunez-Nickel, Jacobson, & Moyano-Fuentes, 2007; Moores & Mula, 2000; Morck & Yeung, 2004). Their role in the economy is significant in terms of employment generation, wealth creation and industrialisation. Researchers have suggested, based on conservative estimates, that more than 75% of all businesses in most economies are family-controlled (Miller, Steier, & Le Breton-Miller, 2003). According to Carlson, Upton and Seamen (2006), 60% of all employment, 78% of all new jobs, more than 50% of GDP and about 65% of all wages paid in the US are from family businesses. Mishra and McConaugh (1999) reported that a majority of privately owned Indian, Korean and Canadian firms, and a lion share of small and medium-sized firms in Germany and

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Austria, are FCFs. Moreover, on the basis of statistics from the Business Longitudinal Survey (BLS), Moores and Mula (2000) estimated that at least half of all businesses in Australia are family-controlled. Khan (2003) highlighted that large-and medium-scale enterprises in developing Asia are predominantly family-controlled or family-owned. It was reported that 59% of firms in the Pakistani capital market were family-owned (Shahab-u-Din & Javid 2001).

In Sri Lanka, dominant family holdings exist in many listed firms (Wellalage, Locke, & Scrimgeour, 2012). Senaratne and Gunaratne (2007) stressed that the ownership structure of Sri Lankan firms was largely characterized by family-controlled, pyramid cross-holdings, with the controlling shareholder usually being another corporate entity. Moreover, using data from listed firms in 45 countries, Masulis, Pham, and Zein (2011) found that Sri Lanka had the highest percentage of listed firms belonging to a family group (67%) with their market capitalization being about 44%. Oi (2012) reported that in Japan there are more than 90% of firms that are considered to be family businesses. Highlighting their longevity, Kurokawa and Ogawa (2011) asserted that out of 7,212 two-century-old firms in 58 nations (mostly known to be family-owned/managed), 44.6% were in Japan. For example, the Zengoro Hoshi hotel, founded by a Buddhist monk in 718 AD, is in its 46th generation; Toraya Confectionery was founded in 1520; the Brooks Group was founded in 1830; and Kongo Gumi, a Japanese temple builder, had been operating for 14 centuries, since 578, under the founders’ descendants when it closed in 2006. Moreover, Goto (2005, as cited in 2006) highlighted that the average age of family firms in Japan was 52 years, more than double that of the US, where the average age of a family firm was 24 years.

Despite this worldwide prevalence of FCFs, the literature has produced inconsistent and equivocal findings concerning their performance. Some scholars have found the performance of FCFs to be superior (Anderson & Reeb, 2003; Mao-Feng, Lynn, & Aziz, 2013; McConaughy, Walker, Henderson, & Mishra, 1998; Miller & Le Breton-Miller, 2005; Villalonga & Amit, 2004), yet others have revealed superiority of non-family-controlled firms (NFCFs) (Claessens, Djankov, Fan, & Lang, 2002; Schulze, Lubatkin, & Dino, 2003) and, still others, have found no such performance difference between the two groups (Barontini & Caprio, 2006; Jayaraman, Khorana, Nelling, & Covin, 2000; Miller, Le Breton-Miller, Lester, & Cannella, 2007; Sacristán-Navarro, Gómez-Ansón, & Cabeza-García, 2011; Smith, 2008). In addition, some scholars have found a curvilinear relationship between family shareholdings and firm performance (De Miguel, Pindado, & De la Torre, 2004; Kowalewski, Talavera, & Stetsyuk, 2010; Nickell, Nicolitsas, & Dryden, 1997). Moreover, the vast majority of studies in FCFs have focused on the US and Western economies, with few focusing on other economies. Given these observations, the central objective of this study was to investigate the performance of FCFs to reconcile the controversy about their performance with further evidence from Asia, using an emerging market, Sri Lanka, and a developed market, Japan. The overarching theoretical argument in this study is that FCFs have a performance advantage owing to their agency benefits, whereas the opposite is true for NFCFs because of their agency costs.

The remainder of this paper is organized as follows. Section two briefly reviews the literature pertaining to FCFs and their performance. In section three, the research method is outlined. Section four presents the study’s empirical results. The last section presents a discussion of the research findings, followed by a presentation of the research limitations and directions for future research.

2. LITERATURE REVIEW

The type of ownership in a firm is a most significant variable affecting firm performance (Khan & Rocha, 1982). Research investigating ownership and firm performance dates back to 1932 with Berle and Means’ seminal book, The Modern Corporation and Private Property...
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