Journal of Family Business Strategy 3 (2012) 106–117

Contents lists available at SciVerse ScienceDirect

Journal of Family Business Strategy

journal homepage: www.elsevier.com/locate/jfbs

The relationship among family business, corporate governance and firm performance: Evidence from the Mexican stock exchange

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ARTICLE INFO

Article history:
Received 8 September 2011
Received in revised form 1 March 2012
Accepted 11 March 2012

Keywords:
Firm performance
Family business
Corporate governance

ABSTRACT

This study aims to examine whether there are differences in performance between family and non-family firms, taking into account the peculiarities of the Mexican corporate governance system. We propose an analysis that allows us to conduct a comprehensive study and comparison between companies with different (i.e., family vs. non-family) ownership structures, distinguished by developed patterns of governance with heterogeneous characteristics. We also analyze the effects on firm performance depending on the degree of ownership concentration. We find that family firms adopt substantially different corporate governance structures to non-family firms. There is some evidence to suggest that these differentials ultimately impact upon firm performance.

1. Introduction

In thinking about family business and firm performance, an important question is, does family ownership per se increase or decrease firm performance? This is not a question easy to answer. With regard to U.S. firms, we can find different answers. Anderson and Reeb (2003) find that family firms have a better performance than non-family firms, although Holderness and Sheehan (1988) find the opposite. These conflicting and ambiguous empirical findings led O'Boyle, Pollack, and Rutherford (2012) to develop a meta-analysis. As a result, they propose to refine measurement of family involvement as a multidimensional construct. Therefore, whether family firms have a better or worse performance is an empirical question that depends on many aspects, including the context of each country and their influence on the ownership structure. La Porta, Lopez de Salinas, Shleifer, and Vishny (1997) argue that the legal system operating in each country determines the ownership structure. They show that civil law countries with low protection granted to shareholders cause a trend toward greater concentration of ownership and consequently, a larger proportion of family firms. On the other hand, common law countries tend to protect shareholders more, leading to a greater degree of ownership dispersion. In summary, the authors show that there is a relationship between the degree of shareholder protection and the degree of ownership concentration.

Considering family companies where it is more difficult to mitigate agency problems, Jensen and Meckling (1976) and Morck, Shleifer, and Vishny (1989, 1990) find empirical evidence of agency problems and the mechanism by which owners are constrained. Fama and Jensen (1983) argue that concentrated companies with overall control tend to exchange benefits for private rents. Demsetz (1983) explains that the owner chooses the consumption of non-pecuniary resources at the expense of resources for profitable projects. Morck, Shleifer, and Vishny (1988) find a nonlinear relationship between ownership concentration and firm value. Some authors show that, on average, the concentration has a negative effect on the value of the company. Shleifer and Vishny (1997) provide evidence that controlling shareholders try to extract benefits from the firm and that this is more accentuated as they have more control of the firm. Morck, Stangeland, and Yeung (2000) and Perez-Gonzales (2001) argue that family firms hire relatives in important positions in the company, although they are less efficient than professional managers available on the market. Sacristan-Navarro, Gomez-Anson, and Cabeza-García (2011) do not find results that support the idea that any shareholders' combination influences significantly family firm performance. Other authors such as Barclay and Holderness (1989), Barclay, Holderness, and Pontiff (1993), Bebchuk (1999), Claessens, Djankov, Fan, and Lang (2002), Faccio and Lang (2001), Johnson and Mitton (2002), Morck et al. (2000), Nenova (2000) and Rajan and Zingales (2001) argue that concentrated ownership causes an exchange of corporate profits for private benefit. Moreover, family business may tend to not maximize profits because they are not able to separate economic preferences of the owner from other interests, thus being at a disadvantage compared to non-family companies.

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doi:10.1016/j.jfbs.2012.03.001

That family business is less efficient is not a widely accepted view. Demsetz and Lehn (1985) show that by ownership concentration and control, managers can mitigate the problems of managerial expropriation. By placing relatives in key positions, there is more possibility of monitoring and controlling the company by the family. Shleifer and Vishny (1986) find a positive relationship between ownership concentration and performance, while Claessens and Djankov (1999), DeAngelo and DeAangelo (2000), Faccio and Lang (2001), Friend and Lang (1988), Johnson, Magee, Nagarajan, and Newman (1985) and Singell (1997) argue that large shareholders can mitigate the managerial expropriation in companies with concentrated ownership and control. This occurs because family firms have relatives inside the company who know the business better, as they have a longer time in the business or are the founders. Also, James (1999) finds that the family firms have a greater efficient investment because they have longer investment horizons that can mitigate the problem of myopic short time investment decisions by managers. Basco and Perez (2011) find that family firms can achieve successful business results by using a combination of family and business orientation in their decisions making. Wang (2006) argues that family firms have no incentive to behave opportunistically as the board is willing to adopt policies to reverse damage to the reputation of the family and improve performance in the long term. Others (Claessens et al., 2002; Gorton & Schmid, 1996; Himmelberg, Hubbart, & Palia, 1999; Holderness, Kroszner, & Sheehan, 1999; La Porta, López de Silanes, & Shleifer, 2002; Lee, 2006; Morck et al., 1988; Shleifer & Vishny, 1997) find evidence that family firms show a better performance than non-family companies. Therefore, the relationship between ownership structure and performance is an empirical question with contrasting results. We can find literature with negative, positive and endogenous relationships across different countries.

There is growing evidence that family firms retain their advantages in more developed economies and in highly codified legal environments. However, the superior performance of family firms is even more evident in emerging markets where they are viewed as the "engines" of the economy (Whyte, 1996). Large family controlled business groups are dynamic and versatile, and they account for a significant proportion of gross national product in high-growth emerging markets (Carney, 2005; Claessens et al., 2002). In Mexico, a majority of firms, as in most developing countries, are considered family businesses. Regardless of size, the most dominant companies are owned and managed by one or more families, either the founders or their descendants. Nevertheless, very few studies refer to Mexican family businesses. The principal reason for the absence of these studies has been the difficulties of gaining access to information on ownership and control structures of the companies.

In this research, we studied the relationship between family ownership and firm performance considering all the companies listed in the Mexican Stock Exchange. We used a data panel model to show the performance differences between family and non-family firms. To measure performance, we used accounting and market data through cross-sectional comparisons between family and non-family companies. We also show whether family members exert active control on the company and the effects of this control. Our main focus is to find the relationship between family ownership and firm performance answering questions like: Does family ownership per se increase performance or decrease it? Does family management per se increase performance or decrease it? While prior research has focused on how different incentives of family members impact on performance, the purpose of this paper is to examine the relationship between family control and other internal control mechanisms on performance. In this way we try to disentangle if they are potentially substitutes or reinforcing components depending on the ownership structure (family and non-family firms).

The remainder of this paper is structured as follows. Section 1 provides an explanation of family companies and the Mexican context, while Section 2 presents the data collection and summary statistics. We continue with Section 3 and describe the methodology used, while Section 4 presents our empirical results. Section 5 discusses government mechanism and ownership structure, and finally, in Section 6, we present the conclusions of our research.

2. Family firms, corporate governance and firm performance

The agency relationship between owners and managers has intrigued researchers for many years. The central premise of agency theory is that managers, as agents of shareholders (principals), can engage in decision making and behaviors that may be inconsistent with maximizing shareholder wealth (Daily, Dalton, & Rajagopalan, 2003). This delegation of authority exposes agents to risks for which they are not fully compensated, giving them incentive to seek additional compensation through non-compensatory means such as free-riding or shirking (Jensen & Meckling, 1976). It also creates information asymmetries that make it possible for agents to engage in activities that, if left unchecked, would threaten firm performance and may ultimately harm the welfare of owners and agents alike. Information asymmetries and incentives therefore combine and pose a moral hazard to agents, which owners can reduce by monitoring agents conduct, gaining access to their firms' internal information flows, and providing incentives that encourage agents to act in the owners' best interests (Schulze, Lubatkin, Dino, & Buchholtz, 2001).

Accordingly, Jensen and Meckling (1976) conclude that the cost of reducing information asymmetries and the accompanying moral hazard are lowest when owners directly participate in the management of the firm. Owner managed firms thus have little need to guard against this agency threat. Thus, according to agency theory, one could argue that family involvement in ownership and management of the business should be more efficient than in firms where there is a separation between ownership and control, given the problems of opportunistic behavior of the agent with respect to the principal and the costs associated with supervision (Cabrera, De Saá, & García, 2000).

2.1. Family firms

As an indication of the relatively undeveloped state of research in family business management, there is still no consensus on how to define a family business (Chua, Chrisman, & Sharma, 1999; Steier, Chrisman, & Chua, 2004). The family business classification into "wide", "intermediate" and "restrictive", proposed by Shanker and Astrachan (1996) provides a way to overcome this ambiguity. The wide definition considers a company as a family business when the family members approve the main corporate strategies, even though they do not participate in their formulation. The intermediate definition of family firms considers those businesses where founders or their descendants control the company and strategic decisions, and have some direct involvement in the implementation of these strategies. The family is directly involved in management but not exclusively. Finally, the restrictive definition regards a family business as a company where several generations of a family have control and an active presence in the management. Therefore, family involvement at different levels of management and execution is very intense. The family monopolizes the ownership and management of the company. Le Breton-Miller, Miller, and Steier (2004) do not explicitly define a family firm, but they assume that in this type of firm leadership will pass from one family member to another during the succession