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Full Length Article

Banker directors and firm performance: Are family firms different?

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Abstract

Employing data on publicly listed Indian manufacturing firms covering the period 1996–2012, we investigate the impact of the presence of banker-director on the board of family firms. We posit several hypotheses that highlight the pros and cons of the presence of banker-directors. The findings provide support to the industry expertise hypothesis which suggests that bankers are less likely on boards on family firms that operate in industries where the possibilities of knowledge spillovers can significantly influence profits. A disaggregated analysis suggests that the performance of these firms varies depending on the nature of equity and ownership interlocking.

JEL classification: G34; L26; P52

Keywords: Family firms; Banker-director; Corporate governance

1. Introduction

The growth and emergence of family firms has been a widely debated topic in recent years. According to La Porta, Lopez-de-Silanes, and Shleifer (1999), 65% of the 20 largest firms in Argentina had a family stake of at least 20%; in Japan, this was 5%. Anderson and Reeb (2003a, 2003b) document that in the US, 35% of the S&P500 firms are those with family ownership. A research report by Credit Suisse (2011) finds that family-owned companies controlled 50% of the over 3500 publicly listed companies in ten major Asian economies: the share was the highest for India at over 65% and the lowest for China at 13% (See also, Claessens, Djankov & Lang, 2000; Claessens, Djankov, Fan & Lang, 2002).

The presence of family firms has raised important questions as to whether it is an efficient organizational form. On one side of the debate, it has been argued that having a large minority shareholder can ensure effective monitoring and thereby ameliorate agency problems (Shleifer & Vishny, 1986). Following from this argument, several studies adduce evidence in support of this contention (Anderson & Reeb, 2003a, 2003b; Barontini & Caprio, 2005; Villalonga & Amit, 2006; Ghosh, 2010). Focusing on a sample of Western European family firms, Maury (2006) for example find that family firms exhibit better performance than firms controlled by non-family block holders. Critics of this argument contend that by putting their own interests before minority shareholders, family ownership might end up

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aggravating agency problems and impede performance (Faccio, Lang & Young, 2001; Dyer, 2003; Perez-Gonzalez, 2006; Morck & Yeung, 2003).

Another strand of the literature highlights the importance of bankers in enhancing corporate governance in firms. Research based on advanced economies indicate that bankers not only play the role of expertise provider (Booth & Deli, 1999), but in several instances, improve the bank's business opportunities (Dittmann, Maug & Schneider, 2010). Earlier, Kroszner and Strahan (2001) had demonstrated that bankers are less likely to be represented on boards of firms when the monitoring costs overwhelm the benefits.[2] More broadly, using data on non-listed Spanish family firms, Arosa, Iturralde, and Maseda (2010) document a negative impact of outside directors on performance.

In this context, using an extended sample of Indian firms for the period 1996–2012, the article investigates three major hypotheses. First, are family firms more likely to have banker nominee on their boards? In India, 70% of the firms are family-controlled (Piramal, 1996). This lowers the likelihood of principal-agent conflict (Carney, 2005), in turn, reducing the importance of the monitoring role of the board. That being the case, the importance of banker-directors in family firms could actually be much less significant. Second, how does non-bank debt influence firm capital structure? Besides provision of debt, banks have other channels of influence over firms, such as through interlocking directorates. We examine whether this channel matters for firm behaviour. Finally, how important are banker-director in family firms in influencing performance, especially given their varying intensity of involvement?

There are several reasons as to why these are important questions and India presents a compelling laboratory for examining these issues. First, in emerging economies such as India, the presence of family firms spans several industries and product lines. van der Molen (2005) found that Indian families operate in an average of 5.4 industries. A second reason is that although the foundations of the corporate governance model in India are based on the Anglo-Saxon model, the investor base is distinctly at variance with those observed under such a framework. For instance, in the Indian case, investors comprise largely of the company founders, their respective family members and the government. This contrasts with the UK evidence wherein companies are less concentrated towards certain groups, are geographically dispersed and largely held by professional investors. Third, India has a rich longitudinal database on corporates, which permits rigorous statistical analysis. The findings obtained from the analysis may offer useful implications for the role of these firms during periods of financial distress in other emerging markets.

Our study contributes to the literature in three distinct ways. First, this is one of the earliest studies for an emerging economy to systemically investigate the role of banker-director in family firms. Given the limited likelihood of principal-agent conflict in these firms, this raises the question as to what purpose the banker-director serves in such firms.

Second, it is well recognised that banks play an important role in enhancing corporate governance in firms (Booth & Deli, 1999; Kroszner & Strahan, 2001). In the Indian case, based on cross-section data for 2003, Nachane, Ghosh, and Ray (2005) find that banker nominees primarily act as expertise providers. More recently, Dittmann et al. (2010) show that in Germany, banker-directors on the board of non-financial firms help firms tide over funding difficulties. The present analysis augments these findings by exploring the involvement of bankers on boards for family firms across varying degree of equity and ownership interlocks.

Finally and more broadly, our paper is related to the literature that focused on the corporate governance of firms (Shleifer and Vishny, 1997). In the case of Japan, Morck and Nakamura (2007) find that bankers are represented on boards of poorly performing firms to ensure prompt repayment of their debt. In contrast, Dittman et al. (2010) find that bankers represented on boards of German firms also promote their own business interests. Unlike these papers, we focus on an emerging market, where the weak institutions and greater likelihood of cronyism make the role of banks in corporate governance potentially far more critical.

The remainder of this paper continues as follows. In Section 2 we provide an overview of the relevant literature and derives several testable hypotheses. Section 3 discusses the institutional environment, followed by the database (Section 4) and empirical strategy (Section 5), results (Section 6), robustness checks (Section 7 and 8) and the concluding remarks in the final section.

2. Literature and testable hypotheses

The prevalence of family firms is quite pervasive in both developed and emerging economies (Leff, 1976; Caves & Uekusa, 1976; Chang & Choi, 1988; Ghemawat and Khanna, 1998; Khanna & Rivkin, 1999; Morck, 2005; Morck,

[2]We employ the terms bank nominee, banker-director and banker on board interchangeably.