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Diversification and family control as determinants of performance: A study of listed business groups

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ABSTRACT

The study analyses the individual and joint impact of family control and diversification on the performance of major Spanish corporations, considering the nature of the ultimate owner of non-family groups. The study uses a sample of ninety-nine Spanish corporations, each comprising a parent company listed on the stock exchange and a set of subsidiaries. Heckman's two-step correction is used to eliminate selection bias and the endogeneity of family ownership. Different models are contemplated in which we analyse the impact of both diversification and the family nature of a business on performance, established as Tobin's q-value. The results show how family control has a negative impact on Tobin's q-value, and that differences are greater between family groups and non-family groups controlled by banks and/or foreign agents. They also show how diversification does not affect the creation of value either individually or considering the possible moderating effect of family ownership.

1. Introduction

In world economies, families are among the most important shareholders in business organisations (Aguilera & Crespi-Cladera, 2016; La Porta, Lopez-de-Silanes, & Shleifer, 1999). There are multiple definitions of a family business (Mazzi, 2011), although there appears to be consensus in that a firm is a family business when family members own a majority of shares, are involved in management, form part of the board of directors and wish to transmit the firm to subsequent generations (Mazzi, 2011).

The family nature of a business group determines strategies (Aguilera & Crespi-Cladera, 2016; Dawson & Mussolino, 2014), including diversification (Banalieva & Eddleston, 2011; Praet, 2013) and its subsequent impact on performance (Kang, 1999; Muñoz & Sánchez, 2011). Family members not only pursue financial targets, but also aim to maintain socio-emotional wealth (Cennamo, Berrone, Cruz, & Gomez-Mejia, 2012; Deephouse & Jaskiewicz, 2013; Gómez-Mejía, Makri, & Larraza, 2010). Family groups will thus prefer diversification strategies that are compatible with maintaining socio-emotional wealth that do not endanger survival, with an impact on performance.

Initially, the lack of socio-emotional wealth in non-family enterprises means that they aim to maximise performance. However, do all non-family groups act the same? In non-family groups where there is no shareholder of reference (who can exercise effective control), management has more discretionary power and tends to aim to satisfy its own needs instead of creating value for shareholders, with a negative impact on performance (Jensen, 1986). In this respect, managers can use diversification to improve their income and prestige, even if it has a negative impact on business performance (Jensen, 1986). The presence of a shareholder of reference in other non-family groups (banks, foreign firms) facilitates the goal of maximising performance, and thus the use of more appropriate diversification strategies.

Given the above characteristics of family holdings and the differences with non-family groups (primarily with groups "with no effective control", where there is no shareholder of reference), there are two questions that this study attempts to answer. How does family control and degree of diversification affect performance, both individually and together? What are the differences in relation to different non-family businesses, specifically where there is no shareholder of reference?

A family can decide not to participate in new profitable businesses due to the need for new financial, human and material resources, and the possible loss of control derived from new shareholders, which would have a negative effect on socio-emotional

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wealth (Cennamo et al., 2012). In these cases, non-family groups have the advantage of not having to consider socio-emotional wealth in their utility function. The desire for a family firm's survival and transmission, however, generates a greater concern related to new medium and long-term profitable investments, as family members would carefully choose diversification projects that have a real positive impact on performance, thus revealing an advantage relative to non-family enterprises, where there is no desire to transmit ownership to subsequent generations. All these differences between family and non-family corporations would also be greater in relation to groups "with no effective control" due to the lack of a shareholder of reference and the difference between managers' and shareholders' interests.

Both family control and diversification are determinants of business performance, albeit with mixed conclusions in the literature (Benito, Guerras, & Zuñiga, 2012; Miller, Le Breton Miller, & Scholnick, 2008). There are few studies, however, that analyse the joint effect of family control and diversification on business performance, other than Kang (1999) and Muñoz and Sánchez (2011). The lack of homogeneity in the conclusions of previous research and the lack of studies considering the nature of the ultimate owner of non-family groups justify the need to delve deeper into the individual and joint impact of family control and diversification on performance.

This study also aims to advance in the analysis of the impact of diversification and family control on performance. The study has several objectives. The first is to analyse the individual impact on degree of diversification and family control on performance. The second is to establish differences in performance between family and non-family holdings, with the latter including the nature of the ultimate owner. In this case, the differences will be established relative to groups with no shareholder of reference ("without effective control"), rather than to family groups, although also considering groups controlled by banks and foreign agents. The third and final objective consists of determining the joint impact of family control and diversification on performance, thus determining whether family ownership, in which the preservation of socio-emotional wealth is key, can affect the use of more or less successful diversification strategies compared with non-family groups in general, and groups "without effective control" in particular.

We thus analyse a sample of 99 corporations, the parent companies of which were listed on the Spanish stock exchange during the 2000–2005 period. The Heckman two-step correction (1979) is used to test the established hypotheses, as it corrects the selection bias derived from diversification and the possible existence of endogeneity derived from family ownership (Demsetz & Lehn, 1985).

The study makes several contributions to the field of research. Firstly, the analytical unit is a business group, comprising a listed parent company and a set of subsidiaries. The activities of both the listed parent company and its subsidiaries provide a clearer idea of corporate strategy, and the market's evaluation of the parent company shows investor expectations not only regarding the company itself but also in relation to the entire group.

Secondly, when analysing the impact of the nature of the ultimate owner on performance, we compare businesses controlled by family members with non-family groups, with reference to groups with greater managerial discretionality and/or which do not have a shareholder of reference. The aim is to discover whether family ownership has a more positive impact on performance than other corporations with greater managerial discretionality (with a negative impact on performance). Following this analysis, we check for the existence of similarity of performance of family groups and groups controlled by banks and/or foreign agents, as managerial discretionality is more reduced in these cases, with a shareholder of reference.

Finally, we aim to provide new evidence for Spain considering the moderating effect of family ownership on the diversification/creation of value ratio.

This paper is structured as follows: we first establish the theoretical framework in which our hypotheses regarding the impact of diversification and family control on performance are formulated. We then describe the database, the variables and the methodology used to test said hypotheses. Thirdly, we present and analyse the results of the econometric models. Finally, we summarise the study's main conclusions, its limitations and future lines of research.

2. Theoretical framework

The decision to diversify forms a fundamental part of the strategic behaviour of corporations (Hitt, Hoskisson, & Ireland, 1994), and plays a key role in enhancing their performance (Hull & Lee, 1999). Diversification involves participating in new business or markets by launching new products (Ansoff, 1976). By performing new activities, firms can make us of surplus resources and capabilities (Chatterjee & Wernerfelt, 1991), generating synergies between activities and making the most of the opportunities to invest in businesses that favour the creation of value (Martin & Sayrak, 2003). Diversification, however, increases coordination costs and information asymmetries (Denis, Denis, & Yost, 2002), with which the firm's inflexibility costs grow (Porter, 1985) and its ability to react to market changes diminishes. The literature often refers to diversification discount, which anticipates a negative impact of diversification on performance (Villalonga, 2004).

From an agency theory perspective, diversification is the result of greater managerial discretionality; by increasing the size of the company, managers seek higher salaries, a reduction in personal risk, secure job positions and greater power (Amihud & Lev, 1981; Jensen & Murphy, 1990). New investments are not to maximise value for shareholders, but to satisfy managers' particular interests; they have a negative impact on performance and increase agency costs (Jensen & Murphy, 1990). Furthermore, the greater the degree of diversification, the easier it is for managers to access capital by the use of cross subsidies (Meyer, Estrin, Bhaumik, & Peng, 2009), producing inefficient resource allocation that reduces the firm's value (Berger & Ofek, 1995).

The negative impact of diversification on performance, however, is not only due to the conflict between shareholders and managers, but can also derive from conflicts between majority and minority shareholders. If concentration of ownership is high, part of the wealth of minority shareholders can be expropriated by majority shareholders (Lins & Servaes, 2002). Said expropriation is easier through diversification, with tunnelling practices reducing the company's value (Johnson, La Porta, Lopez-de-Silanes, & Shleifer, 2000). Majority shareholders prefer new activities that do not aim to maximise performance, but to favour their own interests (Johnson et al., 2000). Diversification enables tunnelling practices, where assets or results are transferred out of the firm in favour of the majority shareholders, or cash flow is transferred from one firm to another (Johnson et al., 2000; Lins & Servaes, 2002), all of which has a negative impact on the corporation's performance.

Therefore, the first hypothesis is:

H1. Business group's diversification has a negative impact on performance.

The impact of family control on performance is a major line of research in the literature, and there is no consensus regarding the relationship between the two variables (Anderson & Reeb, 2003; Miller et al., 2008; Sacristán, Gómez, & Cabeza, 2011). The impact of family ownership on performance depends on the relationship between pros and cons; if the advantages exceed the disadvantages