Global Connectivity, Knowledge and Innovation for Sustainability and Growth: New Paradigms of Theory and Practice

Editors

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ISBN: 978-0-9797659-9-5

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Family Business Groups In Mexico And Their Financial Performance

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Abstact

The purpose of this research is to analyze the effect that family business groups have on business performance. Therefore, multiple regression models were developed to examine the effects that the independent variables cause (family owned companies which also belong to a business group) on the dependent variable (Log of ROA) in a sample that had 128 companies from the Mexican Stock Exchange Securities. The findings have shown that family ownership is significant and positive for the performance of the companies, but when analyzing those belonging to a business groups it was found that this results in a significantly worse performance for the companies.

Keywords
Corporate Governance, family business groups, agency theory, institutional theory.

Introduction

This research seeks to analyze family business groups in Mexico and their effect when generating a good performance in companies. A business group can be defined as "a group of companies that are controlled by a small group of controlling shareholders, usually family members or group(s) associated with(by) social or ethnic ties" (Chavarin Rodriguez, 2011). Families having ownership or shareholding of companies involve having authority or control to set the policies of the organization (Cheffins and Bank, 2009). In Mexico there is no precise data about when family groups started but for business groups it is mentioned that this type of organization may have begun with the industrial revolution in the late nineteenth century (Chavarin Rodriguez, 2011).

Therefore, this document was developed based on the 136 companies that are listed on the Mexican Stock Exchange (Bolsa Mexicana de Valores – BMV, 2013), which according to the Corporate Governance Forum (2012) regulations on corporate governance have evolved as the development of the stock market, today companies are required to comply with certain aspects of good practice which is covered by the new Securities Market Law (Ley de Mercado de Valores), which entered into force in December 2005 and revoked the one from 1975.

To achieve what is proposed in this document we are using both institutional and agency theory to support the hypothesis that is to be tested, for this purpose the following topics are developed: first the theoretical framework is proposed, and then the existing literature on the theme is analyzed, afterwards the methodology is proposed to pass the data analysis to reach the conclusion.

Theoretical framework

This research is based on institutional and agency theory, these theories are used today because the society and the economy can not be studied without the advances in institutional economics (Miuguez Caballero, 2011); Douglas North sees institutions as the rules of the game. Within this scope, the Business Coordinating Council in

2010 relaunched a new version of the Code of Best Practice (Código de Mejoras Prácticas Corporativas - CMPC) for companies listed on the BMV in which companies have to report annually their affinity with the corporate governance practices that appear here and the addition of a new code to publish reports under the IFRS (International Financial Reporting Standard). Also for the year 2010, it allows pension funds to invest directly in stocks, which has led to greater dynamism in the market (Corporate Governance Forum, 2012). It is also recommended for the board size to be between 5 and 15 directors, and in turn the incorporation of independent directors, which are selected because of "their experience, capacity and professional prestige and also not found in one of the following situations: 1) employees or officers; 2) be shareholders; 3) be consultants or employees of a company advising the organization; 4) be customers, suppliers, debtors or creditors; 5) employees of an organization that receives significant donations; and 6) be CEO or senior manager of a company where the board of directors involves the CEO or senior manager of the company in question. Besides the above it is suggested to have patrimonial directors, which are significant shareholders (at least 2% of the shares) and the last type of directors are the relatives who are not in the above situations. With the previous it is strived to be consistent with the definition of corporate governance, which we can say that is the set of relationships through which the different stakeholders of the company (shareholders, officers and directors) establish mechanisms to control and decide the strategic direction and therefore performance (Eiteman, Stonehill and Moffet, 2007). Control mechanisms are used to generate order and ensure that decisions are developed representing collective interests.

In the theory of the agency it is mentioned that the ownership of a large business is diversified into multiple shareholders (principal) who transfer authority in decision-making to managers (agent) in order to achieve optimum performance, but this in turn causes the control mechanisms to be expensive because information is difficult to obtain especially for small shareholders (Jensen and Meckling, 1976). Therefore, we have what is known as agency problems, where managers behave in an opportunistic way to pursue their own goals, even at the expense of the interests of shareholders (Jensen and Meckling, 1976).

Literature review

Speaking of corporate governance in Mexico it cannot be ignored that most large companies in this country are family owned which means that such families have continued a strategy ever since the nineteenth century, the strategy has been to develop a business network where everyone complements each other, this structure is known as a family business group which causes market concentration and in turn tunneling, which is the diversion of company resources for personal or family use (Chavarín Rodriguez, 2012; Shleifer, Vishny , La Porta and Lopez de Silanes, 2000). This is not just something that happens in Mexico, it is common around the world, where studies have found that 19% of companies listed are controlled by family business groups, which seek to obtain the profits of subsidiaries and in turn have control without capital contribution (Almeida and Wolfezon, 2006; La Porta, Lopez de Silanes and Shleifer, 1999). Although theoretically there may be disadvantages in the homestead, there are studies that argue that in the absence of this type of structures, managers will seek long-term strategies to ensure the wealth of their family (Breton Miller and Scholnick, 2008; Corbetta and MacMillan, 2010). In the business group it is possible to find a conflict between the shareholder and the people that controls the company; Castillo Ponce (2007) developed a Nash equilibrium where theoretically demonstrates when the legal system does not protect the shareholder, then the best option will be choose the family as risk investors to maximize profits from it.

Nevertheless, there are studies which analyze the erosion of the company's reputation by having a concentrated ownership in a majority of shareholders (Delgado García, Quevedo Puente and Source Sabate, 2010), however, for Masulis, Pham and Zein (2011), a company that has concentrated ownership and which in turn follows the practice of developing a business group has certain advantages, especially when seeking financing, also mentioned in emerging economies such strategy has generated competitiveness when making the decision to expand advantages internationally, such as Tata Motors (Indian multinational automotive), which has seen revenues outside their country of origin account for 59% of total consolidated financial statements Singh (201

Meanwhile Chun and Chan (2012), who analyzed the ownership structure of Chinese business groups in Taiwan, examined the performance of subsidiaries and Thievy found that if the property of the subsidiary company belongs mostly to a family founder it is likely that a family member will be appointed as CEO, and this in turn has a positive effect on the performance of the subsidiary.

It should be noted that family ownership is not in itself something that can generate a good performance, it must have good corporate governance in order to meet the goals, it should institutionalize the process of decision making, as it should have a board where independent directors are integrated in family businesses in order for them to provide the experience, expertise, objectivity, neutrality and strategic contribution; this allows to enrich the views of the council as a whole, when monitoring the compliance and responsibility of the board and thereby achieving the institutionalization of the organization; which is important to both independent directors as equity and related services that meet the profile and knowledge appropriate to the organization (Deloitte, 2013). The suggestions above have been both national and international agencies in Mexico, as already mentioned before, and in order to increase the independent directors a control mechanism is generated from related directors to CEO's to align the interests of the principal (Boyd, 1994), helping to improve governance practices and thereby reduce the costs of monitoring (Selekler Gokse and Öktem, 2009).

Therefore, presented below is an analysis of the evidence on how having an independent board can raise the competitiveness of the company; a research presented by Bertoni, Meoli and Vismar (2014), which found that board independence positively impacts both value creation and its protection at the time of the first public offering, however, for Saibaba (2013) board independence is not a significant variable, but it is the size of the board and mentioned that the more you can avoid duplication of functions and the CEO duality will lead to improved financial performance, but it also has been noted that this duality generates high costs and poor quality external audits (Bliss, 2011).

Returning to the financial performance there is a study carried out in Portugal by Alves (2014), who found that independent advice usually does a good monitoring to management, thereby helps protecting the interests of shareholders and thus improving the quality of the earnings; it does happen that this increased control can make the CEO feel less identified with the elite group of the company (McDonald, 2012). Despite all of this, studies have not found a connection to the independence of the board and in turn mentioned that the size of the board is important to generate a good financial performance (Kumari and Pattanayak, 2014).

For all the above, we can conclude that family ownership is common in companies around the world and in turn these seek to generate related businesses thus conforming what is known as family economic groups, on one hand evidence shows that family property generates good economic performance, but in the same time, companies that belong to a group can be victims of what is known as tunneling (Chavarín Rodriguez, 2012; La Porta, Lopez-de-Silanes, Shleifer , Vishny, 2000; Almeida, wolfezon, 2006; La Porta, Lopez-de-Silanes, Shleifer, 1999; Delgado-García, Quevedo-Puente, Source-Sabate, 2010; Masulis, Pham, Zein, 2011; Singh, 2011; Chung, Chan, 2012). It can also be mentioned that in most cases it has been seen that having a good structure on the board as well as a good size does improve the performance of the company (Boyd, 1994; Selekler-Gokse, Öktem, 2009, Bertoni, Meoli, Vismar, 2014; Alves, 2014; McDonald, 2012; Kumari, Pattanayak, 2014). So the following hypothesis can be generated:

H: The performance of the company depends positively in family but also in the refusal to belong to an economic property group.

Methodology

To test the hypothesis formerly a multiple regression analysis with ordinary least squares is developed, for which the reports filed by companies listed on the Mexican Stock Exchange in 2013 are used, which are in total 136 companies, from which 8 companies had to be eliminated because their reports were incomplete or were not published.

Measurement variables

Dependent variable. The natural logarithm of ROA is used to measure the performance of the company.

Independent variables. Family property: binary variable is used as 1 being a company that is owned by one person or family in more than 10% and 0 in other cases; belonging to an economic group, where 1 means that the company belongs to an economic group and 0 in other cases.

Control variables. Patrimonial directors: percentage of such counselors; related directors: percentage of such counselors; Board independence: the percentage of independent directors is taken; board size: total number of directors. It should be noted that the control variables are applied to soften the natural logarithm series in each. The importance of adding these variables is the need to have within the highest governing body of the company a balance in the integration of members to function properly (CMPC, 2010).

From the above, the following model emerges:

$$LnROA = b_0 + b_1 GE + b_2 Pr + e \quad (1)$$

Where:

LnROA is the natural logarithm of ROA; *GE* binary variable business group; *Pr* is family owned company.

Results

This section analyzes statistical data results, where a multiple regression is developed with the method of OLS, previous to this, first a correlation matrix was developed where all the variables included in the study can be seen. It is appreciated that the performance of the company (LnROA) has a significant correlation with family ownership (Pr) and the correlation between the performance of the company and belonging to a business group is negative. Besides there is a positive and significant correlation between the Patrimonial directors and Board independence; additionally the size of the board has a positive and significant correlation with belonging to a business group (Table 1

TABLE 1. CORRELATIONS MATRIX

	LnROA	Pr	GE	Board independence	Patrimonial directors	Related directors	Board size
LnROA	1	0.223*	-0.147	-0.053	-0.143	0.125	0.021
Pr		1	0.127	0.182	-0.047	-0.058	-0.080
GE			1	0.028	-0.023	0.128	0.222*
LnCI				1	0.350**	0.182	.0113
LnCP					1	-0.378*	-0.113
LnCR						1	0.005
LnT							1

Source: Made by myself. Note: One and two asterisks indicate significance levels of 5 and 1% respectively.

The following analysis is the model to test the hypothesis, as can be seen in Table 2, it is shown that family ownership has a positive and significant relationship to the performance of the company, and development while belonging to a business group causes a negative relationship with firm performance. When analyzing the different models, each one of them corresponding to the control variables (patrimonial directors, related directors, and board size), it can be seen that both the patrimonial directors as well as the size of the board have the same trend, but with the variable of related directors the model becomes practically non-significant and analyzing the model with independent directors that must be family property becomes insignificant, but to belonging to an economic group has to be negative and significant at 1%.

TABLE 2. REGRESSION MODELS

		Patrimonial directors	Related directors	Board independence	Board size
Variable	Coefficient	Coefficient	Coefficient	Coefficient	Coefficient
Intercepto	-0.894***	-1.054***	-0.495	-0.492	-1.250*
Pr	.0591*	0.98*	0.260	0.388	0.614*
GE	-0.370*	0.598*	-0.148	-0.528*	-0.412*
R	0.285	0.323	0.177	0.310	0.297
Valor F	4.282*	3.579*	0.356	2.880*	3.088*

Source: Made by myself. Note: One, two and three asterisks indicate significance levels of 10, 5 and 1%, respectively.

Conclusions

This study analyzes how the family property in the economic groups can affect the performance of companies listed on the Mexican Stock Exchange; the findings are consistent with what some authors mention that family property is relevant to the performance of companies (Breton - Miller, Scholnick, 2008; Corbetta, MacMillan, 2010; Masulis, Pham, Zein, 2011; Chung, Chan, 2012). Researching the belonging to a business group we see that performance is negative so we can assume that it is because of tunneling, which generates the diversion of resources for the owning family; with the above they come to similar conclusions to those of Chavarín Rodriguez (2012) and La Porta, Lopez-de-Silanes, Shleifer, Vishny (2000).

The findings are important for managers in this type of family business, taking the decision is important to further develop their corporate form of economic groups even though this will cause a decrease in the financial performance of the subsidiaries and this may cause a conflict of interest with small shareholders and despite following the recommendations of national organizations such as the admission of having independent directors apparently has no effect in protecting the interests of minority shareholders. Possible limitations that exist in this document are that not all of the companies listed on the Mexican Stock Exchange were included. For future research it is proposed to extend the sample to other emerging countries to analyze whether the adoption of independent directors improves control of the ownership family in economic groups.

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