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Performance vs. family ownership and management: the case of Portuguese wine firms

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Abstract

- Objective is to empirically examine the relationship between family firms' ownership and control structure and their financial performance.

- Focus on the Portuguese wine firms due to their increasing importance in the Portuguese economy and in the promotion of the country's exports and image abroad.

- It is used an unbalanced panel data of 117 firms for the period from 2011 to 2016 and applied a random effects model.

- The degree of family involvement shows a U-shaped relationship with performance, meaning that those firms where the family does not hold the majority in the board should be open to receive external managers with greater knowledge and experience and increase their internal competencies in order to enhance performance. However, the same is not true when the family has already a majority position in the board.

Literature review

Family firms add a dimension to the shareholders vs. managers relation since family members' interests could not be the same as those of their non-family counterparts.

Since often in FF owners are also managers, how those factors would influence performance? FF possess some strengths favoring performance, namely their experience and knowledge of the business, their solid values and group-belonging culture and their long-term perspective. However, some limitations are succession turbulence, weak organizational structure, lack of professionalism and difficulties in financing.

Family firms tend to present higher levels of ownership concentration and thus lower agency conflicts, being that a potentially positive factor for performance.

According to the agency theory perspective, FF will be characterized by underinvestment, centralized and hierarchical organizations, cronyism, thus resulting in inferior growth and returns. In contrast, stewardship theory predicts that the investment in capabilities, staff and long-term relationships, the cohesion values and commitments shared with all the stakeholders, provide superior growth and financial returns.

When family ownership gets dispersed among few family members, performance could deteriorate due to agency and entrenchment problems arising among equity owners (e.g., conflicts between the founder and new family owners), whose interests are not fully aligned with some preferring to pursue private and non-economic returns.

This negative trend on performance is reversed when family ownership is further dispersed among multiple members, that have now only a limited stake in the firm, while fosters an alignment of interests between equity owners and a reduction of agency costs.

The question of whether family presence in the board hinders or facilitates firm performance becomes an empirical issue.

The choice of the wine sector is justified by the fact that the majority of firms in the sector are family and mature firms, where are present relevant emotional values and a strong commitment to preserve family assets, with ownership and control passing between generations. Additionally, the sector is getting increasingly competitive in terms of demand and price, with firms facing a limited domestic market and trying to export.

Hypotheses

H1: FF outperform NFF

- H1a: Family ownership has a positive effect on profitability
- H1b: Family involvement in the board has a positive effect on profitability
- H1c: Those effects are non-linear

H2: The relation between family power and performance differs between younger and older firms, the latter being more profitable

H3: The relation between family power and performance differs between larger and smaller firms, the former being more profitable

H4: The relation between family power and performance differs between export oriented and domestic oriented firms, the former being more profitable

H5: The relation between family power and performance differs between more or less indebted firms, the latter being more profitable.

Data and methodology

The SABI database includes data for 708 wine sector firms (CAE 1102), with a turnover over 1,300M€, total assets around 3,200M€, a mean ROA of 2.66% and more than nine thousand employees (2016).

Applying the criteria for SMEs definition, considering only firms with at least 5 years of complete data from **2011 to 2016** and excluding firms with negative debt ratios or liabilities greater than assets, we obtained an unbalanced panel data of **117 SMEs** distributed by all Portuguese wine producing regions.

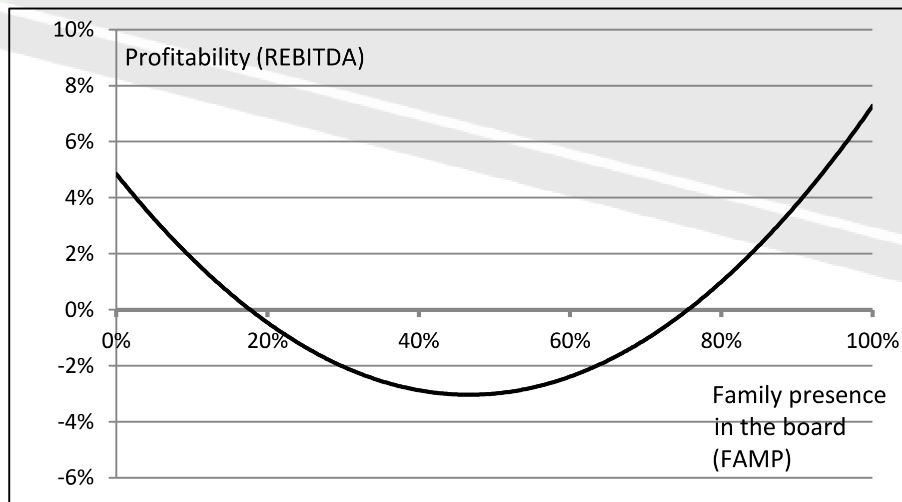
We do not include micro-enterprises with less than 10 employees in order to focus on firms that are large enough to experience and demonstrate some managerial decision making as well as family involvement and influence.

The sample is representative of the sector, accounting for 3,290 employees, a turnover around 460M€ and total assets of 1,125M€ in 2016. The sample only has 11 medium firms and, applying the criteria explained above, 52 firms can be considered FF, of which 42 have a full measure of "family power".

Empirical results/ Discussion

- "family power" (ownership and presence in the board) seems to have a positive impact on performance thus confirming H1a and H1b

- family presence in the board displays a significant U-shaped relation with performance.



The inflection point is found for family presence values slightly lower than 47%, that is, firms where the board is more or less divided between family and non-family members.

This result, which partially confirms H1c, evidences the potential negative influence on performance of conflicts and misalignment of interests within the board.
Beyond a certain point, the advantages coming from decreasing agency costs and stewardship outweigh the disadvantages of conflicts between board members and overlap between family and business interests.

This results evidences that FF owners must acknowledge that family presence in the board brings dysfunctional consequences for firm performance, especially at intermediate levels of family involvement, where members external to the family could eventually have been selected based on personal contacts, disregarding personal managerial capabilities.

So, it seems that in the wine sector family SMEs a robust and cohesive presence of the family in the board is value enhancing and promotes their financial performance.

Regarding the other hypotheses, the interaction terms are broadly significant, showing different impacts of AGE, SIZ, LTD and STD on performance for FF and NFF.

- firm's age seems to have a negative impact on performance. Older firms are more likely to be in the maturity phase, with lower levels of growth opportunities and, consequently, lower financial performance levels.

- larger firms present a better financial performance, possibly a result of the positive relationship between resources and performance. This evidence that bigger firms outperform smaller ones brings an important policy-making implication. Typically, wine firms in Portugal are micro or small firms, so policymakers should create an adequate set of incentives to foster mergers and acquisitions in the sector, as a way to improve the competitiveness of the entire wine sector.

- the performance is not influenced by the degrees of international intensity and diversification.

- more indebted firms are less profitable, independently of the maturity of the debt.

Conclusions

The degree of family ownership and involvement showed a significant positive relationship with performance, meaning that those FF in which the owner family exerts tighter control tend to present higher measures of performance, confirming previous results.

Being that a non-linear relationship, that result indicates that firms willing to attain a better performance should maintain the cohesion in their boards, either primarily composed by external managers, potentially more independent or, preferably, mostly composed by family members, with their interests fully aligned.

One implication for FF owners, when the family does not have the majority in the board, is the need to reduce family presence in it, opening the board to non-family members. That difficult decision could prove more profitable than further increase the presence of family members in the board, possibly lacking the necessary competencies.

However, the same is not true when the family has already a majority position in the board, since a better financial performance is attained when the family totally controls the management team.

Regarding the main questions addressed in this paper, we can answer that:

i) compared to other firms, FF are more profitable;

ii) performance is negatively impacted with intermediate degrees of family presence in the board;

iii) there is a significant positive relation between firm size and performance, a significant negative impact of firm age on performance and the degree of internationalization is irrelevant to explain differences in performance;

iv) there is a significant negative relation between the level of debt and performance.

Our results call for further research, suggesting that firm performance depends heavily on other factors. So, further research should, inter alia:

i) introduce qualitative variables, for instance, consider internal factors such as succession issues, product positioning, marketing and brand management and the firm's specific resources, namely, the impact on performance of the family members' levels of social capital and education;

ii) further research the relationship between performance and the ownership and control structure, covering a longer period and studying the wine sector in other European countries;

iii) analyze in a case by case approach in order to identify the types of management practice currently being implemented by Portuguese wine firms that have a positive impact on performance.

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