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COMMENTARY

Poorly performing family firms more likely to improve governance

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IT IS common for people to associate family firms with poor governance, with many believing that controlling families like to have maximum discretion and minimum transparency. Yet, we also know that family owners care deeply about their reputation and would avoid anything that harms it, including bad governance practices. This debate on whether family firms are heroes or villains of corporate governance has been a long-running one.

But the time has come to look at things from a different perspective. There is considerable variety among family firms – some have very good governance practices, while others lag behind. We should not discredit or praise all family firms as if they were a single entity, but instead find out what types of family firms have better governance, and why.

In a recent study, my co-researchers and I asked ourselves: Why are some family firms in Singapore more transparent than others? Does performance influence governance quality? The usual assumption is that well-performing family firms have good governance practices. But we found that some Singapore-listed family firms known for their good governance practices were not necessarily the best performing ones.

For instance, Qian Hu, an ornamental fish exporter run by three brothers, has often won awards for its governance and transparency, but recorded a loss in 2012. On the other hand, family firms that were quite profitable have been found in the lower ranks of the Governance and Transparency Index, issued annually by the Centre for Governance, Institutions and Organisations at NUS Business School.

We decided to go beyond such anecdotal evidence to examine a range of disclosures from a 2012 sample of 421 Singapore Exchange-listed family firms.

WHAT WE EXPECTED

We hypothesised that lower financial performance would trigger family firms to disclose more, in order to avoid negative exposure and to preserve the family's reputation. We had also expected that, in general, family firms that performed well would be less likely to disclose their governance practices. We figured that family owners preferred maximum discretion; and better profitability would mean being able to get away with less disclosure.

In addition, it is widely suspected that family firms with patriarchs dominating decision-making and appointing various other family members as directors make lesser disclosures, as families may think that minimal compliance would suffice.

Thus, we had expected that if a family has a stronger grip over the board (a family CEO or higher percentage of family directors), there would be less disclosures. We thought this would apply to both well- and poorly-performing firms.

WHAT WE FOUND

But our results supported only some of our predictions. A key finding was related to poorly performing family firms: they indeed disclosed more as performance dropped.

For instance, among firms that performed more weakly compared to their historical level of profitability, a one per cent decrease in return on assets (ROA) led to a statistically significant 1.8 point increase in their disclosures of board practices on our scale of 0-10.

However, we did not find support for our idea that well-performing family firms would disclose less. The results of our analysis instead suggested that the degree of family influence had a significant effect on firms that performed well.

When there was no tight family control of the board, well-performing firms tended to disclose more as profitability rose. For every 0.5 per cent increase in ROA compared to historical levels, we saw more disclosures, or a jump of three points on our scale, among well-performing firms without family-controlled boards.

But when there was a strong family influence, family firms that performed well tended not to improve their disclosures, even with better performance.

Thus, our analysis seemed to show that, during rough patches, family firms stepped up their disclosures and appeared more motivated to preserve their reputation, regardless of the influence of the family on the board of directors.

PRACTICAL IMPLICATIONS

While family owners in general care about preserving their reputation, they may be more motivated to improve corporate governance in times of poor performance. This is a useful insight for both minority shareholders and regulators. It suggests that an effective moment to stimulate family firms to improve their governance could be in periods of disappointing performance.

Also, our study somewhat confirmed the widely held belief that greater family control over the board is associated with lower transparency, in particular when firms are performing well. Regulators and stock exchanges could use our findings to more effectively monitor compliance of family firms with governance standards.

As with all research, there are many caveats and remaining questions. We hope our study triggers more discussion and more research on the variety of governance practices found in family firms, as we believe a deeper understanding of what drives family governance practices would ultimately help the business community.

The writer is associate professor and associate director of NUS Business School's Centre for Governance, Institutions and Organisations. The views here do not necessarily reflect the governance practices of particular family companies. The full research paper was co-authored with Toru Yoshikawa and Geng Xuesong of SMU