The Significance of Business Ownership and Governance: Contribution and Profitability of Family Businesses in Finland

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Abstract

It has been argued that the contribution of family businesses to national economies is considerable on a world-wide basis. The estimates of the contribution of family businesses to total production and employment vary internationally between 35 and 60 per cent (Astrachan & Shanker, 2003; IFERA, 2003). The variation depends on the country, indicator, calculation method and the definition of what constitutes a family business. However, the exact extent of the impact of family businesses has remained unknown. One reason for this uncertainty is the fact that there are neither official statistics nor representative data available of family businesses at the national economic level. The Family Entrepreneurship Working Group set up by the Ministry of Trade and Industry of Finland made a proposal in 2006 for a definition of a family firm to help researchers find out the number and size of family enterprises and to analyze their industrial structure and significance for the Finnish economy. This study is based on that proposal.

First we estimate the contribution of all family businesses to the Finnish economy based on our population level data of middle-sized and large-sized firms and evaluation made of the significance of small-sized family businesses. Then we concentrate on profitability comparisons between family and non family firms. The data of this study covers the years 2000-2005 and it has been built in co-operation with Statistics Finland. For the first time there is a population level income statement and balance sheet data of family businesses available in focused size groups. All middle-sized and large-sized family businesses were screened from the annual statistics of the Finnish business register and then identified by family ownership. Finally the modified register statistics was linked with the income statement and balance sheet statistics of the same firms.

According to the results 46 per cent of Finnish middle-sized companies and 30 per cent of large-sized companies are family businesses. Typically family businesses are smaller by size than non family or widely held businesses. Only 20 per cent of the 150 largest Finnish companies are family businesses. Almost all of the middle-sized and large-sized family businesses operate in manufacturing, construction, trade, transportation, communication and business services. In these industries middle-sized family businesses contributed 41 % and large-sized family businesses 16 % to the total net sales of the corresponding size group. The personnel figures were 49 % and 22 % respectively. Results linked with estimates regarding ownership and control of small-sized businesses indicate that family businesses as a total contributed some 21–25 per cent to total production and 26–30 per cent to employment in Finland in 2005.

Family business definition and views of the family influence on firm performance offer background for the model on which our profitability comparisons are based. Multiple regression analysis showed that first generation middle- and large-sized family businesses were slightly more profitable than other businesses including family firms that had completed one or more generation transfers. Additionally we found that publicly held Finnish family firms financially outperformed their non family counterparts.

Keywords: Family business, family influence, contribution, profitability

JEL Classification M20/ M21/ D21

I Definition of the family business

Family ownership, governance, management and succession of the firm offer arguments for family business definition (Donnelley, 1988; Handler, 1989). Litz (1995) suggests that "a business firm may be considered a family business to the extent that its ownership and management are concentrated within a family unit, and to the extent its members strive to achieve, maintain and or increase intra-organisational family-based relatedness". According to Tagiuri and Davis (1996) family firms are "organizations where two or more extended family members influence the direction of the business through the exercise of kinship ties, management roles, or ownership rights". Shanker and Astrachan (1996) note that family firms could be classified as a continuum of how much there is different types of family influence and suggest narrow, middle and broad definition. Further Astrachan, Klein and Smyrnios (2006) define family business in three latent dimensions consisting of power, experience and culture. According to their definition, for example, ownership indicates power and is observed as cash flow and voting rights.

The size of the firm and family ownership and governance are related, the larger the firm the less likely it is a family firm even though there are international examples of very large-sized family firms (Wal-Mart, Samsung, Fiat). Family characteristics of the firm could be analyzed also from psychological and motivational point of views (Hall, 2005; Ikävalko & Jussila, 2006). However, any joint definition for the concept of a family firm has not been achieved.

Following arguments of this discussion the Family Entrepreneurship Working Group set up by the Ministry of Trade and Industry of Finland (2006) suggested a definition for the family firm to be used for statistical purposes. This definition has later been adopted, modified and presented by GEEF (Groupement Européen des Enterprises Familiales - European Group of Owner Managed and Family Enterprises) to the Commission of European Union as developmental initiative for the firm statistics agenda. The definition states that a firm is a family enterprise if:

1 The majority of votes are in the possession of the natural person(s) who established the firm, in the possession of the natural person(s) who has/have acquired the share capital of the firm or in the possession of their spouses, parents, child or child's direct heirs.

2 The majority of votes may be indirect or direct.

3 At least one representative of the family or kin is involved in the management or administration of the firm.

4 Listed companies meet the definition of a family enterprise if the person who established or acquired the firm (share capital) or their families or descendants possess 25 per cent or more of the right to vote mandated by their share capital.

II Discussion of the significance of family businesses

It is obvious that there is no theory determining the optimal number or contribution of family businesses or any ownership structure in the economy. These issues need empirical evidence in the first hand. Business ownership and governance are still continuously in the spotlight of both empirical and theoretical economic discussion. As one ramification of this debate it can be asked do family businesses support employment or otherwise act as buffers against negative effects of globalization.

It has been frequently stated, especially in studies published in Family Business Review that family businesses are key contributors to economies. However, the exact extent of their impact has been unknown (Shanker & Astrachan, 1996; La Porta et al. 1999). Further it has been noted that the succession of ownership, governance and management are central challenges for family business survival (Sharma, 2004). The population aging problem concerns business continuity as the retiring process of business owners accelerates. Employment and welfare will partly depend on the nature and success of the transfer of family businesses, be it transfer of generation, management buy-out, or merger or sale to an outside domestic or foreign venture (Tourunen, 2009).

One reason for the problem concerning the exact significance of family businesses is the fact that there are neither official statistics nor representative performance data of these firms at the economy level. However, some approximations of the significance of family businesses have been conducted (Shanker & Astrachan, 1996; Faccio & Lang, 2002; Astrachan & Shanker 2003).The number and contribution of family businesses vary significantly, depending on the country, indicator, calculation method and the definition of what constitutes a family business. According to available knowledge, contributions of family businesses to total production and employment vary internationally between 35 to 60 per cent (IFERA 2003/ questimates from 24 countries). As far as our knowledge none of these approximations are based on data that combines single and reliable family business identification with business performance micro data.

Our study first presents estimates of the family business contribution to the Finnish economy. These estimates are based on population level micro data (income statement and balance sheet statistics of all middle-sized and large-sized firms) and an absolute upper limit estimate of the significance of small-sized family firms. Later this year we are also able to offer more precise estimates of the contribution of small-sized family firms (‘lower limit’) based on sample study and otherwise similar data as used here.

III Family influence on firm performance

Family relations influence how the family firm is governed and managed (Hoffman et al. 2006). Business governance and management then affect the competitive edge that transmits to firm performance (Neubauer & Lank, 1998). Performance broadly defining means efficient use of productive resources and accomplishment of organizational goals, including profitability and the value of the firm (Grant, 1991). It has been suggested that family involvement contributes positively to family firm’s competitive advantage, the factor determining the performance of the firm (Hoffman et. al., 2006). Competitive advantage refers to quality of products and services, innovativeness and reputation of the firm, responsibility, employee, customer and stakeholder loyalty, networks and financing (Arregle et al. 2007).

Habbershon and Williams (1999) define family influence as *familiness* and Dyer (2006) as *family effect*. These concepts refer to the combination and use of human, social and other resources that are characteristic to family firms. As noted, resources improving competitive advantage in family firms comprise but do not limit to family specific governance, management and leadership as well as work environment that inspires employee loyalty (Hoffman et al. 2006).

Human and social resources of the first generation family firms weigh on founder effect which means that the founder of the firm serves as a CEO, speaker of the board or in any other influential position of the firm (Kelly et al. 2000). The founder controlled firms are those who discover and exploit business opportunities and introduce new ideas, technologies and products through specific investments. More generally, founder effect relates to the theory and empirics of entrepreneurship (Shane & Venkataraman, 2000; Behrens & Davis, 2008). This means that especially founder CEOs are persons possessing special technical and managerial skills (McConaughy &Phillips, 1999). Founder effect may also mean that the heritage of the founder influences for example in the form of patents or entrepreneurial spirit even though the firm has gone through generation transfer(s) and the original founder is no longer in the service of the firm. In addition, family members provide physical and financial assets for their businesses (Neubauer and Lank, 1998). Resources en bloc and the way they are used are intertwined and they are usually nurtured during the interaction between the family and the firm (Ward, 1988; Tokarczyk et al. 2007).

According to the resource based view the competitive advantage of the firm depends on all of its resources and its capability to take advantage and leverage them (Teece et al. 1997). The capability to take the best out of resources depends on ownership, governance and management of the firm. At the bottom line the competitive advantage of the firm depends on its unique resourcing that is hard if not impossible competitors to furnish. To gain competitive advantage family businesses combine their family specific resources with other productive resources (staff, technology, customer relations, supplier chains, financing) in a way competitors cannot imitate (Dyer, 2006).

Further Dyer (2006) argues that “certain family factors can lead to various agency benefits and important assets, while other family factors impose costs and liabilities to firm performance”. The first part of this argument means that family firms have the potential to monitor and control management with lower agency costs or even avoid the principal agent conflict of interests. According to Miller and Le-Breton-Miller (2006) and Mustakallio et al. (2002) lower agency costs in family firms are caused by stewardship attitudes, trust, commitment and relational governance.

Factors influencing negatively on family firm performance refer to family conflicts, opportunism, nepotism and selfish misuse of firm assets (Schulze et al. 2001). Negative factors also include free riding, shirking and hold-up by some family members and problems that may arise from the relationship between minority and majority family owners (Chua, Chrisman and Steier, 2003). Tagiuri and Davis (1996) suggest that family influence on firm performance would need to be seen as a net effect stemming from positive and negative family factors.

IV Profitability comparisons: building of proposition

Agency, stewardship and lifecycle theories and resource based view conventionally explain the manner in which different aspects of family involvement influence the governance, managerial practices, resources and performance of family firms (Davis et al., 1997; McConaughy & Phillips, 1999; Dyer, 2006; Chrisman et al., 2007). To organize different aspects, regarding the influence of family involvement on firm performance *family capital* theory (Hoffman et al. 2006) has been suggested. Arregle et al. (2007) propose the concept *family social capital* to be used of this relationship. Here we adopt the concept family social capital which consists of factors such as close relationships, effective information channels, tacit and explicit knowledge, effective networks, honorable norms and values, and trust. As noted, these resources are assumed to complete other resources of the family firm and improve its performance. For example the capacity to transfer the corporate entrepreneurship, entrepreneurial spirit, and expertise from one generation to another may affect to the continuity of competitive advantage of family firms (Koiranen, 2002).

Nahapiet and Ghoshal (1998) categorize *social capital* in three dimensions: structural, relational and cognitive. Hoffman et al. (2006) and Arregle et al. (2007) follow this pattern and define attributes of family (social) capital reflecting this classification (Figure 1). Observing the model similarities, family social capital could be seen as an application of social capital theory in the family business context.

STRUCTURAL FAMILY CAPITAL
Enduring, strong and intense family bonds, experiences, information channels. Channels in conflict settlement. Forms, hierarchies and rationale of family relations
RELATIONAL FAMILY CAPITAL
Shared Values, Norms, Roles, Beliefs, Trust Responsibilities, Identity, Commitment, Co-operation
COGNITIVE FAMILY CAPITAL
Common language, tacit and exact knowledge, shared ways of action

Figure 1 Categorization of family social capital (modification from Nahapiet and Ghoshal 1998; Hoffman et al. 2006 and Arregle et al. 2007).

Family social capital is assumed to generate mutual understanding towards common goals and long term strategy of the family firm that give the potential to improve its operational performance (Arregle et al. 2007). One of the key concepts in family social capital theory is *trust* which is the intermediating factor between the sources and outcomes of social capital (Coleman, 1988). Further Coleman defines norms, group identity, enlightened rationality as sources of social capital. Outcomes of social capital are better communication, coordinated co-operation and fulfillment of group members’ goals.

Based on concepts familiness, family effect and family social capital we analyze the proposition: family influence defined as family ownership and governance improves the competitive edge of the family firm in such a way that family firms financially outperform their non family counterparts.

Using descriptive statistics, regression analysis and GLS estimation we estimate the above proposition by comparing potential profitability differences between first generation family firms, second/ elder generation family firms and non family firms.

V Data and methodology

The income statement and balance sheet data of this study include classification variable indicating family business status of the firm. The data covers all middle-sized and large-sized Finnish firms in 2000-2005 and it is based on annual statistics of Finnish business register. On the ownership recognition phase the observation unit was an enterprise group or an independent firm when the firm did not belong to an enterprise group. Family business status was identified according to the family business definition presented above. The identification of family businesses was made during 2005–2007 by phone interviews among the population of pre-screened potential family firms (for example public utilities could be classified as non family businesses without interviews). The owner(s) or the CEO(s) were asked: Do you classify your company as a family business? If so, has generation transfer(s) taken place in the history of your company? Accordingly, the data can be divided and the results analyzed in three 'family business' groups: first generation family businesses, second or elder generation family businesses and non family businesses.

Middle-sized businesses comprise firms that employ at least 50 persons and less than 250 persons. Large-sized businesses include firms that employ 250 persons or more. The register statistics of firms was first supplemented by family business status variable. Finally the modified register statistics was combined with official income statement and balance sheet -statistics of the same companies. The data matrix contains about 150 income statement, balance sheet and accounting indicator variables. On yearly basis the data of this study covers about 1670 middle-sized firms once an enterprise group was set as an observation unit and 3000 firms including group's parents and affiliates. The population of large-sized firms covers yearly about 530 and 2785 companies respectively.

Return on investment is dependent variable in the model which is based on the proposition set out in the previous chapter. Family influence is operationalized by family dummy variables indicating the firm ownership and governance according to the family business definition. Following referenced empirical studies we use industry, personnel, indebtedness, total assets, immaterial investments and year dummy as control variables. Results are presented using descriptive statistics and generalized least squares method in regression estimation.

VI Results

A The economic contribution of family businesses

The calculations of employment and production contributions of family businesses are based on our data and estimates made of the significance of small-sized family firms. According to these calculations all family businesses contributed at most 30 % to total employment and 25 % to total production in Finland in 2005. These estimates are based on the assumption that *all* small-sized businesses are family businesses which is not true. If we assume that 80 per cent of all small-sized businesses are family businesses, the contribution estimate of the employment of family firms falls to 26 % and the estimate of total production to 21 % respectively. [1]

In the light of these observations the contribution of family businesses to the Finnish total production is far less than previously estimated (40-45 %; IFERA, 2003). It seems that it is necessary first to identify family business status of individual firms instead of for example to estimate contributions on the basis of family business frequency and using aggregate data. One reason for the difference of family business contribution to the economy between for example Finland and the USA is the fact that business sector as a total makes about 64 % of the total production (value addition / Gdp) in Finland and is likely much more in the USA where the estimate of family firms' contribution to total production is about 60 % (Astrachan & Shanker, 2003).

[1] An ongoing continued sample study by the authors confirms that these last figures represent more reliable estimates at the moment. The preliminary results of this sample study of 2000 small-sized firms show that about 78 per cent of all small-sized Finnish firms are family firms. Small-sized firm in this continued study is defined as a firm that employs at least one person on yearly basis and less than 50 persons. It needs to be noted that these sample figures are yet neither combined with income statement and balance sheet statistics nor adjusted to population level. This means that the "lower level" estimates presented above include bias that will be corrected later.

B The profitability of family businesses compared to non family businesses

The figures shown in table 1 indicate that middle-sized and large-sized family firms as a total seem to have been at least as profitable as non family firms in Finland in 2000 – 2005 even though non family firms seem to have been slightly more profitable than family firms that have completed one or more generation transfers. These observations are compatible with the research made by Anderson & Reeb (2003), Jaskiewicz (2005), Lee (2006) and Menendez-Requejo (2006). However, it is noteworthy to observe that first generation family firms seem to have been most profitable. This result supports the observations made by Anderson & Reeb (2003), Villalonga & Amit (2006) and Yong et al. (2007).

TABLE 1: Return on investment, median, %.
Middle-sized and large-sized businesses in Finland in 2000-2005

	First generation family businesses	Second or elder generation family businesses	Non family businesses
2000	17,1	12,3	12,6
2001	16,9	11,8	12,4
2002	14,4	11,1	11,4
2003	12,3	10,6	11,2
2004	14,0	10,4	11,8
2005	12,9	9,3	10,7

The result of the regression estimation is presented in table 2. Profitability is again measured as return on investment which is defined as net result + financial expenses + taxes and divided by average invested capital for the fiscal period. Family influence is presented as family business dummies. Non family dummy is fixed which means that the coefficients of family business dummy variables define directly how much the return on investment of the family firms is bigger or smaller than the return on investment of non family firms. In accordance with the figures shown in table 1 the signs of the coefficients are as expected. The personnel of the firm represent the size variable and it has positive coefficient as could be expected. This means that the larger the firm the better the return on investment or it can be interpreted as support of scale effect. We also made estimations including size (personnel) variable raised to exponent two. The corresponding coefficient was expectedly negative which means that the scale effect starts to dilute eventually.

Opening the family dummy coefficients from logarithm, it showed up that first generation family businesses made 1.0 %-units better return on investment in 2000-2005 than non family businesses in the midpoint of the model. The result supports the proposition regarding family influence on firm performance. It is also in line with the observations made in table 1. However, the proposition did not get support concerning family firms that had completed one or more generation transfers. Opening the corresponding coefficient (-0.15) from logarithm, it showed up, that non family firms made 1.7 % higher return on investment than second or elder generation family firms in the midpoint of the model. It was found in more detailed balance sheet analysis that family firms that had completed one or more generation transfers had still best financial standing measured by equity ratio.

We didn’t make assumptions of the signs of other variables in the regression equation. The control variables were selected following the design of referenced studies. We also estimated other profitable measures and changed the number and composition of explanatory variables but did not find any new insight that is not included in the estimation result presented in table 2.

TABLE 2: Return on investment, GLS estimation
Middle-sized and large-sized firms in Finland in 2000–2005

Dependent variable: ROI = Return on investment
Independent variables:
CON= Constant
F1 = Second or elder generation family business
F2 = First generation family business
NF = Non family business
SIZE = Personnel
ASSETS = Balance sheet, total
DEBT = Long term debt per sales
IMM = Intangible assets per sales
MAN = Manufacturing
TRADE = Trade
CONS= Construction
TRANS = Transportation and storage
OTHER = Other services
YEAR =Year dummy

The model Log ROI = reg (CON, F1, F2, NF,
Log SIZE, Log ASSETS, DEBT,
Log IMM, MAN, TRADE, CONS, TRANS, OTHER, YEAR)

$R2 = 0,144$; F = 216, 56; N = 19 351

Independent variable	Estimate	t-value of the estimate	Standard error of the estimate	p-value
CON	3,89	77,31	0,050	<0,0001
F1	-0,15	-7,47	0,020	< 0,0001
F2	0,08	3,39	0,022	0,0002
NF	…			
logSIZE	0,16	22,27	0,007	<0,0001
logASSETS	-0,20	-31,60	0,006	<0,0001
DEBT	-1,52	-31,99	0,047	<0,0001
logIMM	-0,15	-9,63	0,015	<0,0001
MAN	…			
TRADE	-0,05	-2,27	0,021	0,0507
CONS	0,07	1,98	0,035	0,0447
TRANS	-0,06	-2,12	0,030	0,0249
OTHER	0,06	2,32	0,024	0,0882
2000	0,10	3,46	0,029	0,0005
2001	0,12	4,15	0,029	<0,0001
2002	0,05	1,74	0,029	0,0811
2003	-0,00	-0,13	0,029	0,8927
2004	0,04	1,36	0,029	0,1733
2005	…			

We also put attention on performance comparisons between publicly held family and non family firms in Finland and used data extracted from the data of this study (Kansikas, Tourunen & Laaksonen, 2009). It was found that families were present in one in every four publicly quoted companies in Finland in 2000-2005. This data indicated that publicly held Finnish family firms made almost the same output per employee than listed non family firms. The results further showed that listed family firms were less indebted and outperformed financially non family firms. Using similar model estimation as presented above, it showed up that publicly held family firms made 1.5 % -units better return on investment than listed non family firms in Finland in 2000-2005.

VII Conclusions

The contribution of family firms to the Finnish economy is less than previously estimated. One explanation for this might be the economic development in the early 1990's when Finland experienced its worst peacetime recession. Among the losses were many family firms that have remained inactive ever since. The question arises whether these findings are worrying especially in the light of the latest global economic crisis and the fact that a big share of family entrepreneurs is approaching retirement at an accelerating rate. It can be claimed that the success of family business transfers is becoming even more important for employment and welfare in Finland.

However, this study suggests that middle-sized and large-sized family businesses as a total were at least as profitable as their non-family counterparts in the first part of this decade. Additionally we observed that first generation family firms outperformed both elder generation family firms and non family firms measured by return on investment. We also found that publicly quoted Finnish family firms financially outperformed their non family counterparts. It was further observed that the larger the company the better is its profitability even though the size effect eventually dilutes. Concerning first generation or listed family firms it can be concluded that family influence compensates the size effect in explaining the profitability of the firm.

Family influence on business performance is multifaceted resource concept embracing family social capital as a new dimension. We assumed that family influence transmits through competitive advantage to better performance. Then for example family social capital offers one explanation for the competitive edge favoring family firms' performance.

As a limitation of the study it needs to be noted that the measurement of family influence on firm performance could be more sophisticated. In continued study it would be interesting to supplement the research data with more detailed family influence factors like family member as CEO, governance variables and also with examining more in depth the founder effect. Founder effect seems to offer explanations of why family firms perform better than non family firms. There are also holes in the data matrix that cannot be corrected because of lack of data.

More research based knowledge of the economics of family business is needed to service different purposes. These needs vary from fiscal policy aimed at supporting the overall continuity of family businesses to consulting for individual family firms. Especially interesting would be to recognize studies that concentrate on the contribution of family businesses based on micro data. Future research comparing performance of family businesses with that of non family businesses also needs data that are not limited to stock exchange companies.

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