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Family-firm risk-taking: Does religion matter?☆

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ABSTRACT

We propose that family firms with religious founders have less risk than other family firms. Using a sample of 4159 family firms in China, we find that firms founded by religious entrepreneurs have lower leverage and less investment in fixed and intangible assets compared to firms founded by nonreligious entrepreneurs. These findings are consistent with our proposition. However, these findings primarily hold for entrepreneurs who adhere to Western religions but not to Eastern religions. As such, our paper makes important contributions to the literature on family-firms and their risk-taking and the literature on the relation between religion and risk aversion.

1. Introduction

Family firms are often thought to be risk-averse because their founders invest their entire human and financial capital into their firms (e.g., LaPorta et al., 1999). However, recently, some scholars have argued that not all family-firms are risk-averse. Anderson and Reeb (2003a) contend that some family firms care about enhancing their firms' share values and thus adopt risky business policies. Gómez-Mejía et al. (2007) propose that some families of family firms value control rights for socioemotional reasons and will take risks to maintain that control, even if it means forgoing financial gains. Based on the recent literature, therefore, we can conclude that family firm risk-taking varies, and this variation seems to be related to differences in families' personal values. We propose another personal value that may also explain family firm risk-taking. Abundant research shows that religious people are risk-averse (e.g., see Hilary and Hui, 2009 and studies cited therein). Based on this assertion, we propose that family firms founded by religious founders take on less risk than other family firms.

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Our paper's central proposition is primarily motivated by Hilary and Hui's (2009) recent findings. They suggest that CEOs' religious beliefs can affect their decisions at work. Their general contention is consistent with the long-held view that one's religious beliefs can affect and explain her or his economic attitudes, behaviors, and decisions, along with a variety of other everyday attitudes and life decisions (Iannaccone, 1998). In particular, Hilary and Hui point out that prior research finds that religious people are risk-averse. Therefore, they hypothesize and empirically find that publicly traded U.S. firms headquartered in counties with high degrees of religiosity display lower levels of equity risk, investment, and growth. No other paper studies the relation between religion and corporate decision-making. And prior papers that study economic development and religion (e.g., Barro and McClearly, 2003) suffer from sample heterogeneity (i.e., religion, legal environment, and economic structure, are difficult to disentangle). Therefore, by specifically studying religion and corporate decision-making, and by focusing on just one country, Hilary and Hui take a major step in showing how a cultural value, religion, can indirectly affect business risk-taking. However, while their findings are telling, their study has at least two shortcomings. First, they do not determine whether the firm's CEO, who is likely the firm's primary decision-maker, is religious. Second, managers at publicly traded firms, including the CEO, may have only limited influence over firms' major policies given the possible existence of influential outside shareholders and/or active boards. Our study, which examines whether entrepreneurs' religious beliefs can partially explain their firms' risk-taking, overcomes these two shortcomings because we study privately held family firms and we directly identify which founders are religious.[1] Founders are often their firms' key decision-makers, and privately held family-firms do not have outsiders to whom they are beholden.

To test our proposition that entrepreneurs' religious beliefs affect their firms' risk-taking, we study family firms in China. There are several reasons why we use Chinese data. First, China will soon become the world's largest economy. Small firms are well known to be the primary drivers and engines of economic growth. Therefore, it may be relevant to see how entrepreneurs' religious beliefs may affect their decision-making, given that these decisions may also then influence and shape the growth of China's economy. A second reason for using Chinese data is admittedly for practical reasons. It is nearly impossible to obtain a large sample of entrepreneurs and to identify directly their religion. A recent large-scale government-sponsored survey of family firm founders in China, conducted during 2005–2007, allows us to obtain such data. In addition, it is also difficult to obtain data on investments into intangible assets, such as research and development (R&D).[2] Investing in intangible assets is a key measure of firm risk-taking. Our Chinese data set includes not only data on R&D investments but also data on firms' advertising expenditures, which is another potentially important form of intangible investments, as it represents an investment into brand equity. Finally, but just as important, by studying China we are also able to contrast founders who adhere to Western religions with founders who adhere to Eastern religions. Nearly all studies that examine the relation between one's religious beliefs and her or his economic attitudes and behaviors focus on Western religions only.

From regression tests, we find the following. First, family firms founded by religious entrepreneurs have lower levels of leverage and lower levels of investment in fixed and intangible assets, compared to family firms found by nonreligious entrepreneurs. These findings are consistent with our proposition that family firms founded by religious entrepreneurs have less risk than family firms founded by nonreligious founders. To make sure that our religious founders have decision-making power in their firms, we also identify firms where the religious founder owns more than 50% of the firm, and we find that these firms in particular have low leverage and low investments into fixed and intangible assets. We then separately distinguish firms founded by an adherent of a Western religion and firms founded by an adherent of an Eastern religion. We find firms founded by Western religion adherents are primarily the ones with low leverage and low investments into fixed and intangible assets. Firms founded by Eastern religion adherents do not appear to strongly prefer either high or low leverage or investments. Overall, our paper makes several important contributions to both the literature on family-firms and their risk-taking and the literature on the relation between religion and risk-aversion. With regard to the latter literature, based on our unique data, we are able to support but also strengthen Hilary and Hui's story that religious people seem to be risk-averse, and that this seems to affect their corporate decision-making.

The rest of our paper proceeds as follows. The next section reviews the relevant literature and presents our paper's hypotheses. Section 3 describes our data, presents descriptive statistics, and reports results based on univariate tests. Section 4 presents and discusses our main results. The last section concludes.

2. Literature review and hypotheses development

Our study focuses on family firms, the religiosity of the founder, and firms' risk-taking. In this section, we first review the literature on family firms and their risk-taking, and then we review the literature on religiosity and risk-taking. Based on these literatures, we propose our hypotheses.

2.1. Family firms and risk-taking

Family-firms are a prevalent organizational structure found worldwide, including the United States (e.g., see Anderson and Reeb, 2003a,b; LaPorta et al., 1999). Much has been written about the cost and benefits of family firms. For example, many studies find that family firms underperform compared to nonfamily firms (e.g., Claessens et al., 2002; Cronqvist and Nilsson, 2003; Morck et al., 2000). The reason for the underperformance could be that family firms exploit minority shareholders (e.g., Demsetz, 1983; Demsetz and

[1] We use the words “entrepreneur” and “founder” interchangeably.

[2] For example, in the Compustat database, R&D investment is missing for many firms.

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