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Corporate governance, ownership and firm value: Drivers of ownership as a good corporate governance mechanism

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ABSTRACT

This study analyses the role of ownership as a good corporate governance mechanism. We study cross-national differences between companies with different level of investor protection. In addition, we account for the type of owner (young family vs. non-young family businesses) and the owner's relationship with a second significant shareholder (monitoring vs. collusion). When the main owner has effective control over the firm (i.e., absolute control or less than absolute control but without the control of a second significant shareholder), the relation between ownership concentration and firm value is U-shaped. Our findings also suggest that the conflicts between majority and minority shareholders are weaker for companies with higher investor protection and young family-owned businesses.

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1. Introduction

Practices of corporate governance have been studied as a solution for agency conflicts that appear when a separation exists between the owner and manager roles. According to agency theory, ownership concentration acts as an internal mechanism to alleviate owner–manager conflict. However, this theory was developed in a framework based on companies with diffuse ownership, in which firms are characterized by a large number of investors with a low level of participation in the business. La Porta, López de Silanes, and Shleifer's (1999) seminal work changed the widespread idea of a diffuse ownership structure in countries with high levels of investor protection. In addition, Barontini and Caprio (2006) conclude that one-half of the companies within Continental Europe have a shareholder who holds more than 37% of their firm's ultimate voting rights. In this highly concentrated environment, the conflict between owners and managers becomes less important. However, conflict arises between large and minority shareholders (Renders & Gaeremynck, 2012). In this type of environment, the study of the effect on firm value of the largest shareholder and his or her relation with other shareholders – principal–principal conflicts – has a greater importance (Huyghebaert & Wang, 2012; Pindado, Requejo, & de la Torre, 2012). For this reason, the study of ownership as a corporate governance mechanism should be analysed given the characteristics of this type of environment.

Recent works show that a majority firms are family controlled in Western Europe (Faccio & Lang, 2002), Continental Europe (Barontini & Caprio, 2006), and around the world (Morck, Wolfezon, & Yeung, 2005). The predominance of the family firm model around the world has motivated a large body of research; however, inconsistent results have left many questions unanswered. In fact, Litz, Pearson, and Litchfield (2012) survey and find that 48% of family business scholars have either no or limited understanding of the topic of ownership and governance. Thus, we add to this stream of research to help clarify the effects of ownership on firm value.

Specifically, this study measures the effect of the main shareholder on firm value for different levels of ownership and analyses the negative effect of ownership on firm value for different levels of investor protection. We show that, as noted in recent literature, some types of owners have different behaviour toward the organization (Song, Wang, & Cavusgil, 2015), which

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leads to different impacts on shareholder value (Du & Boateng, 2015). In particular, we consider the case of young family-owned businesses (YFBs) and the main owner's relationship with other shareholders. We define YFBs as companies where the largest shareholder is a family firm that is younger than 30 years old. Our theory is that the amenity potential and involvement in the company by majority shareholders in YFBs discourage their motivation to extract private benefits. Thus, YFBs are a good corporate governance mechanism that favours firm value.

We investigate whether being a YFB mitigates the conflict between majority and minority shareholders. To test this hypothesis we use a sample of 16 European countries for the period 2000–2009. We first measure the effect of the main shareholder's ownership on firm value. This effect is negative for lower levels of ownership and positive for higher levels. In addition, we analyse cross-national differences and find that the negative effect due to the expropriation of minority shareholders is weaker when the company belongs to a country with higher investor protection. Then, we show how this effect is driven by the type of owner and the relationship between different significant shareholders. Finally, we find that this negative effect occurs and is stronger when the main owner is a nonfamily-owned company or an old family-owned company, in which the significant shareholders are motivated to collude rather than to monitor.

This paper makes two main theoretical contributions. First, we extend the agency theory by identifying three factors that influence the role of ownership concentration as a good or bad corporate governance mechanism. In particular, we first study a governance environment with high ownership concentration, in which principal–principal conflicts are high, and find different relations between ownership concentration and firm value for different scenarios. Thus, we contribute by offering a different perspective of agency theory based on the framework that we study. We find the typical inverted U shape in the presence of a main owner who does not have absolute control of the company and is accompanied by a second significant shareholder, that is, when the main owner can be controlled by or who can collude with other shareholders. This finding is in line with prior research, including Anderson and Reeb (2003), who find an inverted U-shaped relation between family ownership and firm value when the companies have a diffusely held ownership structure. However, we find that if the main owner has effective control over the firm (that is, if the ownership of the largest shareholder is large enough to command full control of the company or if the largest shareholder does not hold absolute control but is not controlled by a second large owner), the relation between ownership concentration and firm value is U-shaped. Thus, we provide evidence that shows that generalizations of the effect of ownership on firm value from previous works based on diffusely held samples cannot be made in an environment with high ownership concentration.

The second factor that contributes to explaining the role of ownership as a corporate governance mechanism is the identity of the main owner. In particular, we examine the effect of YFBs. We do not attempt to find the direct effect of family ownership on firm value (such as Anderson & Reeb, 2003; Andres, 2008; Kowalewski, Talavera, & Stetsyuk, 2010; Sciascia & Mazzola, 2008) but rather to determine how this specific type of owner influences the ownership effect. This goal allows us to avoid mixing different effects, such as the impact of family management on firm value (Morck et al., 2005), and focus solely on how young family ownership influences the relation between the family and minority shareholders and, as a result, firm performance. Note that other works, such as Anderson, Duru, and Reeb (2009) and García-Ramos and García-Olalla (2011), use a family definition that includes both ownership and management in its concept, which makes its effect on firm value ambiguous because family ownership and family management have different effects on firm value (Block, Jaskiewicz, & Miller, 2011). By focusing only on family ownership, we show how the motivation for extracting private benefits disappears when the firm is a YFB. The third factor that also influences the effectiveness of ownership as a good corporate governance mechanism, and therefore, complements the agency theory, is the relationship of the second shareholder with the main owner. Depending on the stakes of the main owner, the second shareholder may be motivated to collude with or monitor the main shareholder. Thus, we take into account the trade-off that shareholders face between colluding and monitoring. The presence of a second shareholder alone is not enough to study the impact on firm value; an investigation of how they relate to each other is one contribution of this study.

The second main theoretical contribution is related to the family business literature. We contribute to this stream of research by explaining the positive and/or negative effects of young family firms on firm value from an agency perspective, since we analyse the pros and cons of the young family ownership as a corporate governance mechanism. In fact, we differentiate between young and old family-owned businesses. Thus, we contribute by considering the firm's life cycle as an explanation for previous works that find a non-significant relation between family ownership and performance (Sacristán-Navarro, Gómez-Ansón, & Cabeza-García, 2011a; Sacristán-Navarro, Gómez-Ansón, & Cabeza-García, 2011b; Sciascia & Mazzola, 2008; Tsao, Chen, Lin, & Hyde, 2009). These results may be due to the aggregation of young and old family-owned companies. The distinction between young and old family-owned companies allows us to consider the effect of family firm maturity on firm performance. Young and old family-owned businesses have opposite effects on firm value, which makes the relation nonsignificant. When this result occurs, the moderating effects can help determine whether the nonsignificant relation holds or whether it may be due to other reasons (Tsao et al., 2009). We use the age of the family firm to build our YFB variable. This different approach does not rely on the presence of the founder (Achleitner, Kaserer, & Kauf, 2012; Miller, Le Breton-Miller, & Lester, 2011), which may lead to the consideration of other factors that influence firm value (e.g., the entrepreneurial role of the founder to lead the business). These factors do not explain our main purpose, which is the study of the expropriation effect and its impact on firm value. Instead, the use of the firm's age is used as an indirect approximation to the conflicts inside the family, which is a factor that influences the level of expropriation. With our approach, we are able to consider the conflicts inside the family that appear along the firm's life cycle.

Finally, we also make a methodological contribution with the use of panel data methodology which allows us to overcome two common problems in the ownership structure field. First, the study of the relation between ownership structure and firm value suffers from large problems of endogeneity that can be solved with the use of instrumental variables. Second, some unobservable factors or individual effects are correlated with the independent variables and affect the dependent variable. For instance, family culture, which affects firm value, may influence some firm decisions such as the level of debt and ownership, the length of stay of family members in the company, and other firm characteristics. We use the system generalized method of moments, which allows us to mitigate these two problems and find consistent results that cannot be reached by other methodologies such as ordinary least squares.

The remainder of the paper is structured as follows. We first describe the previous literature on corporate governance, ownership concentration, and firm value. We also analyse the main factors that shape the role of ownership as a good corporate

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