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The influence of family and pyramidal ownership on corporate diversification in Chile

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ABSTRACT

In this paper we analyse the moderating effects of family nature and pyramidal ownership on the relationship between corporate diversification and performance in Chilean companies. Using a sample of 104 companies listed on the Santiago Stock Exchange between 2005 and 2016, we report a diversification discount. Second, we find that when firms are owned by a family, the relationship between performance and diversification is positive. However, when family ownership is pyramidal, the relationship between performance and diversification becomes negative.

1. Introduction

Recent studies on family firms have focused on examining how firms increase their performance (Wagner, Block, Miller, Schwens, & Xi, 2015), analyzing several features inherent of families such as CEO turnover, succession, entrepreneurship and corporate financial policy, among others (González, Guzmán, Pombo, & Trujillo, 2015; Rees & Rodionova, 2015). However, few attention has been given to the pyramidal ownership structures and its impact on the corporate decisions on family firms.

Two arguments can explain the influence of family control and the use of pyramidal ownership. On the one hand, the excess of control rights allows controlling shareholder to take advantage of pyramidal ownership structures and to search for private benefits of control throughout activities such as tunnelling,[1] thus maximizing the value of the base company (Claessens, Djankov, & Lang, 2000; Faccio & Lang, 2002). Alternatively, resources can be transferred to the listed company to boost its performance or to avoid default risk (Peng, Wei, & Yang, 2011). Thus, pyramidal ownership can be used to carry out both tunnelling and propping practices. On the other hand, if both the family firm‘s managers and the controlling shareholders interests converge, managers could be less inclined towards rent-seeking behaviour through financial policies (Kuo & Hung, 2012). This can be explained by stewardship theory, which supports a mutual interest convergence. When goal alignment between family insiders and outsiders is high, a stewardship environment will prevail (Pieper, Klein, & Jaskiewicz, 2008).

In this paper, we study the moderating effect of family ownership and the control enhancing mechanism (pyramidal structures) over the relationship between company performance and multi-segment corporate diversification for a sample of Chilean firms. Chile

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[1] Particularly, Tunnelling refers here to the transfer of resources from a low-level pyramid property structure company to another on a higher level (Johnson, Boone, Breach, & Friedman, 2000) while Propping is the other way around.

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provides a unique environment to test the effects of control-enhancing mechanisms on family. First, Chile has a Civil-Law-based tradition, with lower levels of investor protection than Common Law countries. Second, the use of pyramidal structures is highly characteristic of emerging markets such as Chile (Buchuk, Larrain, Muñoz, & Urzúa, 2014). Third, the most common agency conflict arises between majority and minority shareholders (Santiago-Castro & Brown, 2007). Fourth, ownership concentration is high. Fifth, the relationship between senior management and the family is generally very close and therefore minority shareholders can be expropriated by the administrators or owners using opportunistic means (Prencipe, Markarian, & Pozza, 2008). Finally, by mandatory law, the stock market regulator, *Superintendencia de Valores y Seguros* (*hereinafter SVS*) tracks the composition of business pyramids in the country.

Using a sample of 824 firm-year observations from 104 Chilean non-financial firms listed in the Santiago Stock Exchange for the period 2005–2016, our results show a negative relationship between family ownership and performance. In addition, we find that diversified companies impacts negatively firm's performance. However, when these companies are family owned, their performance turns positive. Finally, we report a negative relationship between performance and diversified companies for pyramidal-family ownership. Therefore, family-owned companies extract private control benefits through corporate diversification.

The article is structured as follows. Section 2 summarizes the theoretical framework and hypotheses; Section 3 presents the sample and methodology; Section 4 describes the results; and Section 5 concludes the paper.

2. Theoretical framework and hypotheses

2.1. Family ownership and performance firm

Globally, it has been widely documented that the most common form of business organization is the family ownership structure. Shleifer and Vishny (1986) find that in 55 per cent of companies, the major shareholder is a family group. Similarly, La Porta, Lopez-de-Silane, and Shleifer (1999) report that families are the controlling shareholders in 30% of large companies and 53% of small companies. Claessens et al. (2000) find that the majority of the large companies in East Asia are controlled by families (over 60% of the sample), and these owners participate in senior management. In Chile, Martínez, Stöhr, and Quiroga (2007) report that 75% of the companies are family owned, and Bonilla, Sepulveda, and Carvajal (2010) find that family-owned businesses makeup 68% of the listed companies.

Studies on family ownership, particularly those on family governance, have tackled the topic primarily through three theoretical perspectives: social capital theory, principle-agent theory (agency theory) and stewardship theory (Suess, 2014). Social capital theory describes the valuable assets and resources embedded in social relations and networks. Principal-agent theory describes the conflicting relationship between the two parties engaged in a contract. Type I agency problems involve the principal and the agent (Jensen & Meckling, 1976), while type II problems focus on conflicts between the minority and majority shareholders. Stewardship theory (ST) adopts a complementary perspective wherein it is assumed that agents (stewards) identify with the business and act in an altruistic, pro-organizational and cooperative way to guarantee benefits for the complete organization. In this context, an important number of research has reported evidence that The Stewardship Perspective (Le Breton-Miller & Miller, 2009; Miller & Le Breton-Miller, 2005) as well as The Principle-Agent Perspectives (Claessens, Djankov, Fan, & Lang, 2002; Morck, Wolfenzon, & Yeung, 2005) can explain the behaviour and performance of a family business. Based on these theories, the relationship between family ownership and business performance is not conclusive. On the one hand, it has been argued that the long-term orientation of family businesses and the alignment of interests from both managers and controlling shareholders can positively impact the business' performance. Accordingly, Maury (2006) reports that family ownership positively relates to the firm's financial performance in thirteen countries of Western Europe. It also shows that when a family has an active participation in the firm's management, financial performance is better than if it had a more passive role. Sraer and Thesmar (2007) find that French family businesses show a better performance than non-family ones. Kortelainen (2007) finds that family-owned businesses show a better financial performance in Norway than businesses not owned by families. Moreover, he reports that this better performance is found amongst *younger* and small companies. In Asia, Abdullah, Shah, Gohar, and Muhammad Iqbal (2011) report that for a sample of 158 firms in Pakistan, financial performance in family-run businesses is economically higher than those not owned by families, although the difference is not statistically significant. An and Naughton (2009) report that for Korea-based firms, family ownership is positively associated with the company's value. On the other hand, it has been argued that a high percentage of family ownership influences the selection of managers and directors by the family and transactions with companies related to the family group-amongst other actions families can carry out. This can lead to the adoption of potentially suboptimal policies that result in a poor performance of the company (Anderson & Reeb, 2003). Additionally, having a family as the controlling shareholder might lead to a poor performance if the family chooses to take advantage of its position and abandons profitable projects (Demsetz, 1983).

In Chile, studies have focused on the comparison between family-owned and non-family-owned companies. For example, Martínez et al. (2007) study the relationship between family ownership and financial performance of Chilean companies listed in the Santiago Stock Exchange between 1995 and 2004 and find that family-owned companies perform better financially than non-family-owned businesses do. Bonilla et al. (2010) find similar results to Chilean companies listed on the Santiago Stock Exchange between 1998 and 2007. In these studies, company performance is measured by the financial measurement of return on assets, ROA. It is noted that financial measurements used to assess company performance may be altered by manipulating accounting practices. In this sense, Jara-Bertin and Sepúlveda (2014) report manipulative accounting practices for a sample of Chilean companies during the same period considered by Bonilla et al. (2010), thus challenging the validity of the results. Moreover, the accounting measurement does not capture market expectations regarding company value. However, considering these expectations could lead to significant