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Investment policy at family firms: Evidence from Thailand

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ABSTRACT

Using a unique, multi-year sample of publicly traded non-financial companies in Thailand, I find the level of family ownership influences the level of investment. The results are from an emerging market, which features concentrated, family-dominated corporate ownership structures, including ownership pyramids. Firms with higher levels of family ownership show higher investment ratios, whether the ratio is a fixed assets-based measure or a cash flow-based measure. The investment ratios exhibit greater sensitivity to financial slack. However, these two relations are dependent on the level of family ownership. I find evidence of underinvestment at lower levels of family ownership, plus evidence of overinvestment at family firms which employ pyramidal ownership structures. The results have implications for the efficiency of investment at family-owned firms.

1. Introduction

A firm's ownership characteristics can have a significant effect on the company's investment policy. Myers and Majluf (1984) articulate the ways that information asymmetries can affect investment policy. For example, their model shows instances when managers may make sub-optimal decisions and underinvest, forgoing value-creating projects. Their model also explains why financial slack may

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be valuable because financial slack will give managers the flexibility to undertake investments without issuing new shares to secure funds.

The effect of a firm's ownership characteristics on its investment policy may be accentuated for firms in an emerging market such as Thailand. Thai firms, like many companies in most emerging markets, have concentrated ownership structures that are quite often dominated by families. At high levels of family ownership, the degree of information asymmetry between the large family shareholders and the smaller outside shareholders can be quite substantial. However, the high level of family ownership may also temper the effects of the information disparity. Certainly the family owners – who are often the managers as well – are in a position to know more about the investment opportunities facing the firm. Yet the family owners would have an incentive to pursue an optimal investment policy. Should the managers choose to over- or underinvest, their wealth as shareholders would be directly affected. The effect on wealth could be large, as their ownership stake is large. The net effect would be a reduction in the consequences of information symmetries, leading to pursuit of an optimal investment policy.

At firms with lower levels of family ownership, information asymmetries between the family owner-managers and minority shareholders could still be significant. Though the lower level of family ownership means a family's collective ownership stake is smaller, the managers at these firms still control the investment decision. At lower levels of family ownership, the owner-managers may be more prone to deviate from an optimal investment policy in order to enjoy other benefits of control. The family shareholders may be more likely to use their position to expropriate the minority shareholders. This risk of expropriation would be most acute at firms which employ control-enhancing structures like pyramidal ownership. In these instances, the net effect would be an increase in the consequences of information asymmetries, leading to overinvestment.

This paper makes several contributions to the literature. Few studies have examined the extent to which ownership characteristics affect firms' investment policies, especially in emerging markets. Next, I use a unique time series dataset of firm ownership patterns after the 1997 Asian financial crisis. I also examine the effects that growth opportunities and financing constraints have on the investment policy decision for firms with high levels and with low levels of family ownership. Lastly, I assess the relation of firms' ownership characteristics to marginal *q*, a measure of the incremental contribution that a project makes to the overall value of the firm.

I find firms with high family ownership show higher levels of investment than low family ownership firms. However, this distinction depends on the level of family shareholding used to designate high family ownership. The positive relation between high family ownership and investment also depends on the absence of a control-enhancing (pyramidal) ownership structure. These results imply family firms follow an investment policy more close to optimal when their ownership stake is high and control-enhancing structures are absent. Firms with growth opportunities have higher investment ratios, no matter if the level of family ownership is high or low. I find a weak positive association between financial slack and the investment ratio. However, this association does not hold for lower levels of family ownership or firms with a control-enhancing pyramidal ownership structure. I find no relation between marginal *q* and the investment ratio.

2. Motivation and theory

Myers and Majluf (1984) create a model connecting the investment decision and the financing decision, specifically when a firm is contemplating issuing new equity to fund a new investment opportunity. The model makes two important assumptions. First, managers have information that other investors do not have. The second vital assumption is that managers act in the interest of the *old* stockholders, the existing owners of the firm, who own shares *before* a new project is undertaken and before the firm finances the new project with additional equity. Based on these two assumptions, Myers and Majluf (1984) show instances where managers may make a sub-optimal decision and decide not to invest in a value-creating project. The authors make an example of an investment in a positive NPV project. The project lowers the value of the shares held by the old shareholders, since the old shareholders do not capture the increase in value created by the new, positive NPV project. The gains go to the new shareholders. Thus, the old shareholders would not want the firm to undertake the