Don’t bet against the family firms

There is nothing quite like the interplay of relationships between parents and children, or among siblings, to spice up a business story. The internal dynamics of family firms are also frequently the subject of detailed study by academicians, analysts and sticklers for corporate governance. Are they more entrepreneurial than non-family companies? How do they manage succession? Do family companies treat minority investors fairly?

In the past week, a report about family firms by the Center for Governance, Institutions and Organizations (CGIO) under the National University of Singapore (NUS) Business School attracted a surprising amount of attention. The joint authors of the study were Dr Marleen Dieteman, associate director of the CGIO, Associate Professor Yupana Wattanakanzang of NUS Business School and Dr Shin Jungwook, research fellow at CGIO. Their partner in the study was the Family Business Network (FBN) Asia, an advocate for family businesses.

First, the report found that 52% of the 743 companies listed in Singapore were “family firms”. The definition of a family firm used by the report was broad and based on data collected from three different angles. The first angle was whether an individual or several individuals linked by family ties are among the top shareholders. The second angle related to leadership, where profiles of all board members were evaluated. The third angle looked at their family trees and histories.

The report seemed to reinforce some commonly held perceptions of family firms. For instance, they scored lower than non-family firms on the Governance and Transparency Index, which measures corporate governance and disclosure practices. Although family firms account for more than half of all locally listed companies, only three of them were among the 20 highest scores on the GTI in 2010.

Families also tend to be unwilling to code too much control over their firms. According to the study, the positions of chairmanship and CEO were held by the same individual in 44% of family firms. That compares to 16% for non-family firms. Moreover, the chairman was a family member in 82% of family firms, while the CEO was a family member at 90% of family firms.

Family members were also keen to have a strong say over board appointments at their companies. According to the study, they made up 15% of their nominating committees, 8% of the remuneration committee and 6% of the audit committee. “The higher influence of the family members in the nominating committee suggests families have an interest in maintaining control over the firm and its board members,” the authors write.

The result of that seems to be that familiarity trumps qualifications. According to the study, 54% of family board members do not even have a bachelor’s degree. On the other hand, directors at family firms tend to stay longer, with an average tenure of 11 years versus seven at non-family firms. Within family firms, family members have very long tenures averaging 19 years.

Also, the boards of family firms seemed to be a step ahead of others when it comes to gender diversity. The study shows that 42% of the family firms have at least one board member who is female. Only 36% of non-family firms have one or more female directors. Moreover, 54% of female directors at family companies had executive roles, versus only 36% at non-family companies.

More importantly, family firms seem to be better managed when it comes to generating returns on assets. According to the study, family firms generated an average return on assets of 5%, versus 3% by non-family firms. That finding is consistent with the results of most other studies on family-firm performance in developed economies as well as in Asia, the report says.

What does it all mean? Families often choose to maintain tight control over their companies, forgoing some of the advantages of outside expertise and influence on their boards, according to the report. “Nevertheless, by adopting a hands-on approach to family-firm management, families derive benefits such as a long-term orientation and clear decision-making structures.”

What about corporate governance standards and disclosure practices? Do these ideas simply get in the way of companies pursuing growth and profits, and blunt their entrepreneurial zeal?

Not so fast. While family firms account for more than half of the companies listed in Singapore, they make up less than one-third of the total market capitalisation. To be sure, that is partly a reflection of the significant number of government-linked companies in Singapore that were large to start with. Yet, it also suggests that corporate governance and disclosure practices become more important as enterprises grow. It also stands to reason that recruiting talent from beyond the family ranks could be helpful in driving growth as companies expand.

“While the research shows that family firms on average have higher returns on assets, family firms can further improve their corporate governance practices and achieve benefits from more diversified expertise on their boards,” the report notes.

That is not to say that they will not continue to be family firms, of course. Locally listed companies such as United Overseas Bank and City Developments make no pretense of being anything more than that. And, that is precisely what investors like about them.