Family Firm Performance: Trusts, Ownership and Governance

Abstract

We explore the influence of ownership and governance on financial performance in a sample of 200 UK family firms. This study is the first to explore the governance role of trusts and indicates that the presence of trusts lead to a significant reduction in the growth and profitability of family firms. Trusts therefore deserve much greater research attention in the future.

Introduction

Governance and ownership configurations and characteristics have been shown to directly influence the financial and strategic decisions made by family firms as well their performance (Chrisman, Sharma, Steier, & Chua, 2013; Miller & Le Breton−Miller, 2006). The board of directors is arguably the most important part of governance structures and can vary considerably among family firms. It can be in the form of 'family board' or a 'professional board' with or without NEDs, small or large, or without appropriate skills/experience (Corbetta & Salvato, 2004). Ownership is equally important in family firms where, in the beginning, the founding family are the main equity holder and main decision makers. As the firm grows, ownership can be transferred to extended family and non-family members, either through succession or through bringing in non-family talent to the organization. Some family members with equity may be involved in the business, some may not (Le Breton−Miller & Miller, 2013).

An interesting and completely unexplored area of family firm governance, however, is the use of *trusts*. Trusts in the UK are established by some family business owners to allow assets (shares) to be transferred to the trustees who are usually the descendants of the owner or the employees (Scholes & Wilson, 2014). Trusts are important from a governance perspective because as significant or majority shareholders the trustees appoint the board of directors of the family company and have a duty to ensure that the assets of the business are managed in a way that provides maximum benefits to the family as beneficiaries (Allcock & Filatotchev, 2010). Trustees in some of the larger family firms can also be regarded as 'quasi directors' as they meet with directors regularly and therefore have significant influence and over the running of the business (Scholes & Wilson, 2014).

The neglect of the phenomenon of family firm trusts represents a problematic gap in our knowledge of family firm performance, their governance, and the effects of that governance. Those family firms with trusts may then operate in quite different ways than might be expected or prescribed in the current literature on family firms and therefore present a challenge to what the literature can currently say about the effects of governance on family firm performance. This article explores the impact of selected aspects of the board of directors, the share ownership, and the presence of trusts on the growth and profitability of a sample of UK family firms.

Boards, Ownership and Trusts

Boards in family firms are importance as they can influence the family firm performance through providing guidance on the mission and goals of the organization, advice on the strategic direction, provide useful contacts, monitor the CEO and company performance (Pearce & Zahra, 1991). However, smaller family firm boards may not have the necessary skills to guide the family business because of dominant role of the CEO and family members within it. Furthermore, due to the insular nature and in-group-out-group perception of many smaller family firms they may exclude the presence of non-family outsiders or at least a larger pool of talent. This can inhibit the important decision making and decision control functions of the board (Bammens, Voordeckers & Gils, 2008; Carney et al., 2014). We hypothesise therefore that:

H1a Larger boards will promote growth of the family firm.

H1b Larger boards will enhance profitability of the family firm.

Trustees can be family members, typically the founder of the business in the first instance, and/or trusted advisers and/or close family friends. Broadly, trustees serve as voting shareholders as well as 'quasi' directors'. These roles involve trustees voting and electing suitable directors and as well as serving as directors themselves with strong relationships with existing board members and influence over firm strategy. Therefore, trustees can be faced with a conflict of interest which can be thought of as multiple agency or double agent conflict (Allcock & Filatotchev, 2010; Arthurs et al., 2008; Bruton et al. 2010; Child & Rodrigues, 2003; Chrisman et al., 2012). In such situations the objectives of the trustees are more aligned with the management of the firm, the directors, their focus may be on wealth maximization resulting in a focus on increasing the firm size (Bruton et al., 2010). This yields the following hypothesis:

H2a The presence of a trust will enhance the growth of the family firm.

Conversely if the trustees objectives are aligned with the other shareholders/beneficiaries their focus will be to enhance shareholder value by enhancing the value of the company by for example increasing the profitability of the firm without taking unnecessary risks associated with growth (Allcock & Filatotchev, 2010).

H2b The presence of a trust will enhance the profitability of the family firm.

Additionally the percentage of shares in a trust will determine the power of the trust. As the percentage increases the effects on the performance may become more prominent. Wherefore we hypothesize that:

H2c As the % shares in the trust increase the effect on the performance will be greater

The effects of ownership have been explored particularly in relation to whether the owner is also the founder of the firm (Anderson & Reeb, 2003) where in general performance of founder firms has been shown to be better than later generation firms (Molly, Laveren & Deloof, 2010). In this study we focus on the extent to which share ownership of the lead owner affects performance and secondly if the lead owner is also a manager whether this has a bearing on performance. The level of equity ownership of the lead owner is expected to have a positive effect on performance as is the case when the lead owner is the manager. This is expressed more formally as follows:

H3a Greater share ownership of lead owner leads to better family firm performance
H3b Owner/manager status of lead owner will lead to better family firm performance

Method

Data comprised of a sample of over 200 family firms selected from the Bureau Van Dyke database FAME. All firms were privately owned, employed between 50 and 100 employees, had an ultimate owner of the family, and half had trusts in place. All firms were individually checked to ensure that one or more shareholder(s) had the same surname.

Measures

Profitability was measured using the return on capital employed in the year 2013 (Return on Capital Employed %2013), while growth was measured using the change in employees between 2010 and 2013 measured as a percentage change (EmpChange10to13). The variable **DirectorNo** measures the number of directors on the board in the year 2013. **Trust,** measures whether a family firm had a trust in place or not. **TotTrust%** is the % of total shares owned by the trust, while **ContShare%** is the % of shares owned by the lead shareholder. **OwnerMan,** indicates whether the owner manager is a lead shareholder or not. Additionally, **Generation** was used as control measure to assess whether the firm is a first or second generation firm. Descriptives for the trust versus no trust group are shown in Tables 1 (continuous variables) and 2 (categorical variables).

Results

In terms of the growth of the firm (Table 3) the model itself is not significant (sig = 0.146), there is no multicollinearity (tolerance/VIF stats) and the model accounts for a small amount of variance in the dependent variable ($R2 = 0.021$). The number of directors (**DirectorNo**), whether the family firm had a trust (**Trust**), and the size of the trust (**TotTrust%**) are all significant. The number of directors is positively related to growth, and weakly significant, which gives some support for H1a on the importance of board size. The presence of a trust is negative and significant (sig = 0.042) so suggests that growth is greater in family firms that do not have trusts. This finding is backed up by the mean % change in employees in Table 1 which is 7.0% for firms without a trust and 2.7% for firms with a trust. This finding does not support our hypothesis H2a. The size of the trust is positive and significant (sig = 0.03) indicating that as the trust becomes larger (in terms of % shares) the influence on performance becomes larger thus providing support for hypothesis H2c.

In terms of the return on capital employed, the measure of profitability (Table 4), the model itself is significant (sig = 0.025), there is no multicollinearity (tolerance/VIF stats), and the model accounts for a small amount of variance in the dependent variable (R2 = 0.038). Whether the family firm has a trust (**Trust**), and the generation of the firm (**Generation**) are significant. The presence of a trust is negative and significant (sig = 0.03) so suggests that profitability is greater in family firms that do not have trusts. This finding is supported by the return on capital employed in Table 1 which is 19.0% for firms without a trust and 10.2% for firms with a trust. This finding does not support our hypothesis H2b but nevertheless indicates that trusts have a significant effect on profitability, albeit not as we predicted, and are therefore important. Generation is negative and significant (sig = 0.042) indicating that profitability is greater in first generation firms. There is no support in either dependent variable model for greater share ownership and owner/manager status H3a or H3b. There is no support for H1b.

Table 1. Descriptives (continuous variables)

Trust		N	Minimum	Maximum	Mean	Std. Deviation
no	EmpChange10to13	71	-86.36	221.74	7.0460	38.14021
	Return on Capital Employed %2013	102	-46.6	147.8	19.030	26.1212
	DirectorNo	106	1	7	3.45	1.339
	TotTrust%	106	.00	.00	.0000	.00000
	ContShare%	106	50.10	100.00	74.7912	16.58422
	OwnerMan	106	.00	1.00	.7075	.45705
	Generation	106	1.0	2.0	1.057	.2322
	TurnoverGBP2013	102	116950.0	98811000.0	14570055.6	16016867.4
	Number of Employees2013	100	4.0	110.0	49.250	27.3508
	Gearing%2013	96	.0	963.4	77.579	148.0798
	Valid N (listwise)	68				
yes	EmpChange10to13	104	-94.29	120.00	2.7221	26.79905

Return on Capital Employed %2013	124	-126.5	107.8	10.170	22.2225
DirectorNo	126	1	9	4.26	1.726
TotTrust%	125	.01	51.00	17.2993	13.99298
ContShare%	126	50.20	100.00	70.3810	15.72421
OwnerMan	125	.00	1.00	.6960	.46183
Generation	126	1.0	2.0	1.254	.4370
TurnoverGBP2013	125	317300.0	75585000.0	13604791.2	13540560.5
Number of Employees2013	125	2.0	145.0	62.416	30.1786
Gearing%2013	112	.0	637.0	66.986	102.9993
Valid N (listwise)	93				

Table 2. Frequencies (categorical variables)

OwnerMan

Trust			Frequency	Percent	Valid Percent	Cumulative Percent
no	Valid	no	31	29.2	29.2	29.2
		yes	75	70.8	70.8	100.0
		Total	106	100.0	100.0	
yes	Valid	no	38	30.2	30.4	30.4
		yes	87	69.0	69.6	100.0
		Total	125	99.2	100.0	
	Missing	System	1	.8		
	Total		126	100.0		

Generation

Trust			Frequency	Percent	Valid Percent	Cumulative Percent
no	Valid	first	100	94.3	94.3	94.3
		second	6	5.7	5.7	100.0
		Total	106	100.0	100.0	
yes	Valid	first	94	74.6	74.6	74.6
		second	32	25.4	25.4	100.0
		Total	126	100.0	100.0	

Table 3. Governance and Ownership vs. Employee Growth in Family Firms

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-8.410	16.708		-.503	.615		
	DirectorNo	**2.879**	**1.549**	**.147**	**1.858**	**.065**	.902	1.109
	Trust	**-13.466**	**6.587**	**-.208**	**-2.044**	**.042**	.547	1.827
	TotTrust%	**.551**	**.252**	**.225**	**2.191**	**.030**	.536	1.865
	ContShare%	.178	.168	.087	1.058	.292	.838	1.193
	OwnerMan	-5.141	5.269	-.074	-.976	.331	.986	1.014
	Generation	-4.501	6.288	-.056	-.716	.475	.923	1.083

a. Dependent Variable: EmpChange10to13

Table 4. Governance and Ownership vs. ROCE in Family Firms

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	39.494	10.973		3.599	.000		
	DirectorNo	-.611	1.066	-.040	-.572	.568	.901	1.110
	Trust	**-9.689**	**4.446**	**-.197**	**-2.179**	**.030**	.526	1.902
	TotTrust%	.156	.167	.087	.936	.350	.505	1.982
	ContShare%	-.115	.110	-.076	-1.046	.297	.824	1.214
	OwnerMan	.031	3.579	.001	.009	.993	.986	1.014
	Generation	**-9.236**	**4.520**	**-.140**	**-2.044**	**.042**	.915	1.093

a. Dependent Variable: Return on Capital Employed %2013

Discussion

Board size and the presence of trusts were found to be most important where higher growth is associated with larger boards and lower growth and profitability is associated with the presence of family firm trusts. The reasons for the effect of trusts have not been explored here but it is possible to speculate that as shareholders the trustees may be risk averse. Trustees are often lawyers with their own reputations and those of their firm at stake so they may advise boards against risky innovative projects or acquisitions. These decisions and influences may ultimately harm the development of the firm. On the other hand although these firms are not developing as fast as the firms without trusts, the impact of trusts on survival in the long term is not yet known. It is possible that survival is enhanced in firms that have trusts. This is the first article to explore the role of trusts in family firms. We join recent calls to in literature to examine the influence of trusts on family firm performance and outcomes (Scholes & Wilson, 2014). Our research suggests that board size and trusts have a financial impact on family businesses and therefore that trusts, in particular, deserve much greater research attention.

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