International Journal of Management, Accounting and Economics
Vol. 4, No. 10, October, 2017
ISSN 2383-2126 (Online)

www.ijmae.com

# Governance of Family Owned Businesses and Firm Performance: Evidence from Sri Lanka

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## Abstract

Following the notions of agency and stewardship theories, this study examined the empirical validity of the relationship between governance of family owned businesses and firm performance, employing a sample of 82 family businesses in 5 main commercial districts in Sri Lanka. Governance variables related to family ownership, involvement in management and experience were examined in order to assess their influence on firm performance, measured in both financial and non-financial terms. Whilst sales growth was used to measure financial performance, 5-point Likert scale, ranging from *much lower* to *much higher*, has been used to assess respondents' views on non-financial performance of their firms, controlling the cultural factors. The results were in favour of family ownership and family involvement in management both of which influence significantly on financial and non-financial performance of the family owned businesses. But, the study did not support to prove the relationship between experience of owner managers and firm performance

**Keywords:** Governance, Family Involvement, Family owned businesses, Firm performance, Sri Lanka.

Cite this article: Ekanayake, A., & HewaKuruppuge, R. (2017). Governance of Family Owned Businesses and Firm Performance: Evidence from Sri Lanka. *International Journal of Management, Accounting and Economics, 4*(10), 1020-1039.

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International Journal of Management, Accounting and Economics
Vol. 4, No. 10, October, 2017
ISSN 2383-2126 (Online)

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## Introduction

Families and businesses are likely to be always existed in a cycle. Morck and Yeung (2002) and Narva (2001) argue that both the family and the business can be benefited by this cyclical existence. Given the importance of family businesses to the economies, it emerged as a separate discipline in the recent times and called for more research (e.g., Dharmadasa, 2009). Although a considerable number of researches have been carried out in the area, generalization of the findings of such studies is a concern. Particularly, the concepts and techniques of family business and management developed in the West seem ethnocentric, and thus, lack universal validity (Nanayakkara 1992). This situation demands more research in the other regions of the world such as Asia. For example, Khana and Yafeh (2007) found that the businesses of Asia are strongly linked with families, and family owned businesses have been popular in many South Asian countries.

Researchers also found that family businesses of a country are culture specific (e.g., Nanayakkara 1992). In particular, many people in developing countries find their primary sources of the meaning of life in socio-cultural values, beliefs and mysteries. For instance, Sri Lankan indigenous management and business practices have been developed in a rich cultural heritage based on Buddhism over centuries (Ranasinghe 2011). These values have influenced the thinking and actions of the people and their participation in collective effort in doing businesses (Nanayakkara 2004). However, this business tradition has been subjected to turbulent changes during the last couple of decades (Kuruppuge 2013). Hence, only a new research study will reveal the current status of the governance of family owned businesses in developing countries such as Sri Lanka.

Family businesses are unlikely to promote professional management, and governance practices are not grounded in management education and competence. Instead, managerial positions, such as the CEO, tend to be reserved largely for those who have family ties, than those who have qualifications and competence (Nanayakkara 2004). On the one hand, this situation has led to develop a merchant capital hegemony due to the dominance of the family businesses in the economies (Nanayakkara, 2004). On the other hand, this could create serious governance problems in the family owned businesses. For example, Salvato and Leif (2008) found that family businesses have to confront with unique challenges to survive and prosper in the long run. Miller et al. (2004) and Anderson & Reeb (2003) also revealed that only a small number of family businesses survive up to the third generation. Hence, undertaking a study on governance of family owned businesses seems to be important given the significance of SMEs and family owned businesses into the economy of a developing country context.

The purpose of the current study is to examine the relationship between governance of family owned businesses and firm performance. For this purpose, it reviews the existing literature to identify the governance variables that influence the achievement of financial as well as non-financial objectives of family owned businesses, and conducts an empirical investigation to test the study phenomenon.

The study aims to provide both theoretical and practical contributions. It documents the results of an under-studied issue in the literature, namely the governance aspects of family owned businesses. At present, many studies have discussed the problems associated with family owned businesses. However, scant attention has been paid on the governance factors contributed to the success or failure of the family owned businesses. Further, the economy of developing countries such as Sri Lanka depends largely from the contributions made by the small and medium scales enterprises, among which a significant proportion is family owned businesses. However, majority of such firms face going concern problems. For instance, Gamage (2004), in his study on the SME sector, found that up to 85 per cent of businesses face significant survival challenges, whilst more than 75 per cent fail within five years of startup of businesses in Sri Lanka. Hence, proper governance of family owned businesses can play an important role in contributing to the GDP of the countries, and uplifting the living standards of the citizens, for example, by providing employment opportunities.

Family owned businesses can take many different forms. This study uses the definition of family owned business by Habbershon, Williams, McMillan (2003). They define family business as “unique, inseparable, synergistic resources and capabilities arising from family involvement and interactions”. For the purpose of the study, family governance can be described as the ways and means of owning and managing the business by the family members (see Kuruppuge and Ekanayake 2016). Also, the concept of “family” includes an extension of nuclear family to include other relatives such as aunts, uncles, grandparents, and cousins.

The remainder of the paper is structured as follows. Section two analyses the existing literature and develops research hypotheses. Section three explains method used in the study. Results of the study are presented in section four. Section five provides discussion and conclusion of the study.

## Theoretical Background and Hypotheses

This study draws notions from agency and stewardship theories in investigating the phenomenon. The agency theory looks at intra-organizational processes from an economic perspective and it generally refers to the various ways that agents of a firm can influence the economic and non-economic outcomes and behaviors of the firm (Fama and Jensen 1983). More specifically, it refers to the conflicts of interest between an agent who act as a representative of a principal (Ross 1973; Eisenhardt 1989). The basic assumption underlying in this theory is that agents tend to be opportunists who, unless monitored effectively, will exploit owner-principals. This is known as agency problem or cost which is particularly common among top managers because they are at the strategic apex of the firm as they are responsible for resource allocation decisions, new market entries, acquisitions and divestitures (Sanders and Carpenter 1998). Agency theory proposes that the contract between principal and agent is the main instrument for decreasing such agency costs. This contract may include the development of a monitoring system to ensure that behaviors and outcomes do not deviate from the owners’ interests. It might also include the establishment of an incentive system that intends to reward the agent for outcomes that are important to the principal (e.g., profitability, share price).

As per the view of the agency theory, agency problem could arise due to two reasons: contrary interests and asymmetric information. If parties, agent and principal, have the same willingness, then there is no conflict of interest and no agency problem (Jensen and Meckling 1976). But most of the time these two parties, the agent and the principal have different motives. The information asymmetries that exist between knowledgeable agents and principals are expected to provide the basis for this opportunism—which the agent will act upon unless controlled or incentivized not to do so. Furthermore, an agent will typically possess more or better information than the owner or the principal about the agent, the decision situation, or the consequences of actions (Ross 1973). On the other hand if the information is perfect and accurate no cost is incurred as an agent cannot engage in opportunistic behavior.

The discussion so far suggested that the agency problem could arise when principal-agent relationships are characterized by different utility functions and informational asymmetries. But, the nature of owner and manager involvement of family business proposes that family business practice the minimization of problems caused by the separation of ownership from control. As such, the control aspects of firm, family ownership and its high levels of control, can lead to agency problem only with the minority owners or dormant owners (Cronqvist and Nilsson 2003). It is also felt that the value or performance enhancing effects of family ownership are experienced when the family actively manages the firm through a family Chief Executive Officer (CEO) or Chairman of the board. Further, agency theory posits that agency-related costs arise from the consequences of agents' behaviors that are not in the interests of principals and from the expenses incurred for the activities and systems set up by principals to control agents' behavior. However, this is also not very obvious in family business as relationships between principal and agent, usually among owners and management, are very close.

In contrast with the agency theory, stewardship theory suggests that agents' (executives) interests are aligned with those of the firm's owners. In other words, interests are directed towards organizational objectives rather than personal objectives (Davis, et al., 1997). Further, this theory advocates that not all agents are created equal. Some executives respond to a higher (less economically pecuniary, more socially driven) calling in which they strive to be effective stewards of their institution and all of its stakeholders in an effort to create a sustainable and strong corporation (Davis, Schoorman and Donaldson 1997). Furthermore, this theory does not assume a specific link between agents' compensation and owners' wealth or operational measurements of the firm's financial performance. This is because agents act as stewards of the firm and pursue organizational goals. As a consequence, it is not necessary to develop additional instruments to achieve interest alignment (Otten 2008).

The views of the stewardship theory propose that managers and owners are motivated by values that are beyond economic or private interest, and often act with selflessness for the welfare of the organization and its stakeholders. For instance, this theory may provide a possible explanation for a weak link between executive remuneration and firm performance. It may apply to CEO behavior in which the CEO takes a long-term perspective on the business as the case in a family business. CEOs in a family business may be highly motivated to preserve the business for the succeeding generation of the family and gain satisfaction from being an effective steward to the business. Moreover, when stewardship theory applies to family firms, it implies that the family owners often have a deep emotional investment in their firms owing to the fact that their fortune, personal happiness, and reputation are tied to success of the firm. This proves that family firms by and large are characterized by an intense relationship between managers and controlling family owners. Based on the themes discussed above from the notions of agency and stewardship theories, this study proposes the following hypotheses in order to evaluate the relationship between the governance of family owned businesses and the firm performance in a developing country.

### *Family ownership*

The growing literature on family businesses identifies family ownership as an important 'governance' element in the family owned businesses. For instance, Arregle et al. (2007) argue that family owners are keen on retaining control of the business and to pass it on to later generations. Thus, family owners are likely to avoid potentially destabilizing acquisitions and build enduring relationships with stakeholders inside and outside the firm to sustain the business and reduce risk (Miller, et al., 2004). Instead, it is likely that family owners will attempt to maintain their control over firms for the long run, and to concentrate their investment. Further, Kang and Sorensen (1999); Fiss and Zajac (2004) claim that it is not ownership concentration per se, but rather who the owners are and their priorities and preferences that most influence corporate conduct. Furthermore, family owners and owner-managers from the same family working together in their business tend to interact very closely (Gersick, et al., 1997; Miller and Le Breton-Miller 2005). As a result, family members often will have a disproportionate impact on one another when acting within a business context, and may share a common familial identity, reinforced by the roles they play (Cruz, Gómez-Mejía and Becerra 2010; Gómez-Mejía et al. 2007). These specific characteristics related to family ownership of businesses are likely to influence their financial as well as non-financial goals. Hence, such relationships lead to the development of the first and the forth hypotheses as follows:

**$H_1$:** *Family ownership has a positive impact on financial goals of the firm.*

**$H_4$:** *Family ownership has a positive impact on non-financial goals of the firm.*

### *Family Involvement in Management*

Family involvement in management reflects family participation in strategic decision making of family owned businesses. The existing literature investigated the effect of family involvement in management on firm performance in different ways, and arrived at different conclusions. For instance, Lee (2006) found that family involvement in management has positive effects on profitability, employment, and revenue growth. Further, McConaughy, Matthews, and Fialko (2001), based on their study of 219 family businesses found that firms managed by the founding family have greater value, are operated more efficiently. Furthermore, Anderson and Reeb (2003) found that when family members serve as CEO, profitability is higher than with a nonfamily member CEO.

On the other hand, Lauterbach and Vaninsky (1999), in a study of 280 large public firms in Israel, indicate that owner-manager firms, including family-owned firms, are less efficient in generating net income than firms run by nonfamily managers. Also, Daily and Dollinger (1992) investigated the effects of family involvement in management in small family-owned firms, and their results were not significant.

The studies on family involvement in management also focus on non-financial goals. Lee (2006) found that family-owned companies tend to experience higher employment growth. Chrisman and Patel (2012) proposed that family firms display higher variations in R&D investments than non-family firms because of the interferences between family goals and the economic goals of the firm. The present study uses these findings for the development of the second and the fifth hypotheses as follows:

**$H_2$**: *Family involvement in management is positively related to financial goals of the firm.*

**$H_5$** *Family involvement in management is positively related to non-financial goals of the firm.*

### *Experience*

The involvement of multiple generations of a family in a business may have some advantages that could influence firm performance. Later generations are likely to strengthen attitudes of stewardship, for example, diligent management of finances, reputation, and alliances with resource providers (Miller Danny and Isabelle Le Breton-Miller 2006). It may also give rise to strategies for passing on tacit knowledge which is a skill or know-how that resides in individuals and working groups and is not easily codified or communicated (Knott, Bryce and Posen, 2003; Naphiet and Ghoshal 1998). In order to support the new generation of leaders, intentionally structured boards with multigenerational members will be formed so that executive apprenticeships, building a strong top team, and fostering a resilient corporate culture will be taken place. These strategies, for example, intensive executive apprenticeship programs, transfer knowledge across the generations of family executives (Miller and Le Breton-Miller 2005) as the older generation is often willing not only to share wisdom but to discuss their own mistakes (Bubolz 2001). Such experience sharing process in the family businesses have positive impact on firm performance.

However, there can also be challenges with the number of family members multiplies (Miller and Le Breton-Miller, 2005). Such problems include conflicts among family factions, succession problems, and a drain on resources, which could have negative impact on firm performance. These arguments in the literature provide the basis for the development of the third and the sixth hypotheses as follows:

**$H_3$**: *Family experience in ownership and management is positively related to financial goals of the firm.*

**$H_6$**: *Family experience in ownership and management is positively related to non-financial goals of the firm.*

## Data and Methodology

Development of the Survey Questionnaire, Sample Selection and Data Collection

The study follows quantitative approach to test the study phenomenon. Data were gathered through a survey questionnaire. The questionnaire included both structured (likert scaled) and open ended questions to gather respondents views and opinions on the factors related to the governance of the family businesses in Sri Lanka. Altogether, twenty-seven five-point likert scale questions, with a value of "1" indicating that the respondent strongly disagrees to any particular factor/statement and the highest number "5" indicating that the respondent strongly agrees to the particular factor/statement, have been included in the survey questionnaire.

Planning the questionnaire survey included several stages such as focus group discussion, pilot survey and the final field study. In the focus group discussion, the draft questionnaire was discussed and revised several times with the presence of the investigators, the coordinator appointed for managing the field study and the four enumerators hired for data collection. Initially, the coordinator and the enumerators were asked to fill the questionnaire and discussed and revised the vague questions and statements. After that the pilot study was conducted to explore further issues in the questionnaire before undertaking the final survey. In this way, the questionnaire was further refined to make the questions and statements more specific and clear to respondents.

Five districts, namely Colombo, Galle, Gampaha, Kandy and Kurunegala in Sri Lanka, were selected purposefully to conduct the questionnaire survey. Those districts include famous commercial cities in the country, and it is plausible that the family businesses established in such districts are representative of the family businesses in the whole country. The field study has been planned in a number of steps. First, the coordinator and the four enumerators have identified the family businesses located in the main cities in each district and prepared lists of family businesses with the names and addresses of the family businesses and the name/s of the contact person/s and the contact number/s. For this purpose, offices of the District Secretariat and the Chamber of Commerce were visited. Second, a simple random sample procedure has been adopted to select the organizations into the sample. The access to the organizations was a real challenge as most of the organizations did not respond positively for providing information to the survey particularly the financial aspect of information. Hence, the selection of organizations into the sample had been revised number of times.

Respondents to the questionnaires were included owner-managers, other owners and the members of the top management of the family businesses taken into the sample. Enumerators were asked to fill the questionnaires through an interview with the respondent. By this way, it was expected to obtain the respondents' views and ideas more accurately than mere filling up of the questionnaire by themselves. The enumerators were spent roughly about 1.5 to 2 hours in a family business to obtain information required to fill the questionnaires. The coordinator ensured that the enumerator visited the family business by giving a courtesy telephone call once she received the completed questionnaire. This was also used to fill up the incomplete information in the survey questionnaire. Altogether, 82 usable questionnaires were collected for data analysis by this way.

*Variables and Measurements*

This study applied Sales Growth (Model One) and Non-Financial Goals (Model Two) being the dependent variables for the two models developed in the study. Sales Growth has been used widely to assess the firm's financial performance in family business research (e.g., Dyer 2006; Mazzi 2011). The study attempted to use multiple financial performance measures, such as net profit margin, return on assets, return on equity and fixed assets turnover, however, most of the respondents denied supplying such information. 5-point likert scale, ranging from *much lower* to *much higher*, has been used to assess respondents' views on the achievement of non-financial goals of their family businesses.

This study has taken majority of firms into the sample with 100 percent family ownership stake. Hence, family ownership was measured being the number of family members contributed to the equity (Minichilli, Corbetta and MacMillan 2010). Further, family involvement in management was identified by three indicators, namely majority of the board comprised of family members, family CEO and majority of the top management team comprised of family members (Minichilli, Corbetta, and MacMillan 2010). Thus, family involvement in management is a binary variable: where a family business with a majority of the board comprised of family members was coded "1" otherwise"0"; a family CEO was coded "1" otherwise "0"; and majority of the top management team comprised of family members was coded "1" otherwise "0". Finally, 5-point likert scale, ranging from *much lower* to *much higher*, has been used to assess respondents' views on the impact of experience of the owner-managers on the performance of family businesses.

This study controlled cultural factors, such as family values on the business, family loyalty to the business and family's way of participating in the business, in order to avoid their influences on the performance of family businesses. Owner managers of family businesses appear to interact very closely in business dealings (Gersick, et al., 1997; Miller and Le Breton-Miller 2005) and are emotionally closed and mutually dependent in such situations (Homans 1950). Thus, owner managers often will have a disproportionate impact on one another when running the business and may share a common familial identity (Cruz, Gómez-Mejía and Becerra 2010; Gómez-Mejía, et al., 2007). Thus, they tend to be influenced by family loyalties and will try often to fulfill the expectations of family members close to them (Schulze et al. 2001). 5-point likert scale, ranging from *much lower* to *much higher*, has been used to assess respondents' views on the cultural factors. The concepts and variables with associated indicators and measures are summarized in Table 1.

International Journal of Management, Accounting and Economics
Vol. 4, No. 10, October, 2017
ISSN 2383-2126 (Online)

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Table 1: Operationalization of Variables

| Variable | Concept | Indicator | Measurement |
|---|---|---|---|
| Dependent Variables | Financial Goals | Sales Growth | $[(Sales_{2014} – Sales_{2013})/ Sales_{2013}] * 100$ |
| | Non- Financial Goals | Respondents' views on the achievement of non-financial goals | Mean Likert Scale |
| Independent Variables | Family Ownership | Ownership Structure | Number of family members contributed to equity |
| | Family Involvement in Management | Majority of the board comprised of family members; family CEO; and majority of the top management team comprised of family members | Binary variable:<br>1= Majority of the board and the top management team comprised of family members and family CEO<br>0= Majority of the board and the top management team comprised of non-family members and non-family CEO |
| | Experience | Respondents' views on the impact of experience | Mean Likert Scale |
| | Culture | Respondents' views on the cultural factors | Mean Likert Scale |

## Analytical Approach

The study used descriptive statistical measures such as mean, median, frequency distribution, percentage, rank, standard deviation and graphical displays to state the degree of governance of family businesses in Sri Lanka based on the Questionnaire Survey. For this purpose, SPSS package has been used.

In order to investigate the relationship between governance of family owned businesses and firm performance in Sri Lanka, two multiple regression models have been run using the questionnaire survey data. For this purpose, STATA package has been used. Two models derived in the regression analysis are as follows.

*Model One*

Sales Growth = α1 + β1 (Family Ownership) + β2 (Family Involvement in Management)

(Financial Goals) + β3 (Experience) +β4 (Culture) + ε1

α1= Constant (intercept) of the model

β1- β3 = Coefficient of independent variables

β4= Coefficient of control variable

$\varepsilon 1$= Error term

*Model Two*

Non-Financial Goals = $\alpha 2$ + $\beta 5$ (Family Ownership) + $\beta 6$ (Family Involvement in Management)

+ $\beta 7$ (Experience) + $\beta 8$ (Culture) + $\varepsilon 2$

$\alpha 1$= Constant (intercept) of the model

$\beta 5$- $\beta 7$ = Coefficient of independent variables

$\beta 8$= Coefficient of control variable

$\varepsilon 2$= Error term

Other tests used in the study in case of data screening, analysis have shown the eligibility to run the model. The multicollinearity of the regression models has been investigated using the Variance Inflation Factors (VIFs). Mostly VIFs below the value of 10 (VIFs<10) are acceptable. The Heteroscedasticity of the regression models has been investigated using White's General Heteroscedasticity Test which is an estimator for heteroscedasticity-consistent standard errors. Null hypothesis Ho: homoscedasticity. Normality of the residuals has been investigated using the Shapiro-Wilk Normality Test. Null hypothesis Ho: Residuals are normally distributed. The model specification of the regression models has been investigated using the Ramsey Regression Equation Specification Error Test (RESET) test which is a general specification test for the linear regression model. Null hypothesis Ho: No omitted variables in the model. The study assumed a 5 percent level of significance to analyze the statistical test results (i.e., a probability or p level of 0.05 or 95 percent confidence level). This indicates that a 95 percent confidence interval can be constructed if the investigator is willing to accept a 5percent chance of making an error (Weisberg, et al., 1996; Cramer, 1998).

## Empirical Results

Table 2 provides a summary of descriptive statistics of the operationalized variables. Descriptive analysis of each of the variable is discussed separately in the following sub sections.

Table 2: Descriptive Statistics

| | N | Range | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|---|
| Family Ownership | 82 | 3 | 1 | 4 | 1.52 | 0.789 |
| Family Management | 82 | 1 | 0 | 1 | 0.55 | 0.501 |
| Experience | 82 | 2.0000 | 3.0000 | 5.0000 | 3.963415 | 0.4087053 |
| Culture | 82 | 2.2500 | 2.7500 | 5.0000 | 3.680894 | 0.4767943 |
| Non-Financial Goals | 82 | 2.3333 | 2.0000 | 4.3333 | 2.947154 | 0.6593623 |
| Sales Growth | 82 | 10.0432 | 10.8198 | 20.8630 | 14.848732 | 2.7965420 |
| Valid N (list wise) | 82 | | | | | |

Frequency distribution of family ownership is shown in Table 3. Accordingly, maximum number of family directors contributed to capital are four while minimum is one. Most (63 percent) of the businesses have one family director. 23, 11 and 2 percent of the businesses have two, three and four family directors, respectively. The average number of family directors contributed to capital remains at two (1.52) members.

Table 3: Frequency Distribution- Family Ownership

| Number of Family Directors | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| 1 | 52 | 63.4 | 63.4 | 63.4 |
| 2 | 19 | 23.2 | 23.2 | 86.6 |
| 3 | 9 | 11.0 | 11.0 | 97.6 |
| 4 | 2 | 2.4 | 2.4 | 100.0 |
| Total | 82 | 100.0 | 100.0 | |

The results of the variables investigated under family involvement in management are provided in Table 4. As per the table, 61 percent of the businesses have a board with majority of family members while 66 percent of the businesses have a family CEO. In 57 percent of businesses, the top management team consists of the majority of family members. Further, as a whole, in 55 percent of businesses, management is carried out by family members.

Table 4: Family Involvement in Management

| | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| Family Involvement in Management-Board with Non-family Members | 32 | 39.0 | 39.0 | 39.0 |
| Board with Family Members | 50 | 61.0 | 61.0 | 100.0 |
| Total | 82 | 100.0 | 100.0 | |
| Family Involvement in Management-CEO Non-family CEO | 28 | 34.1 | 34.1 | 34.1 |
| Family CEO | 54 | 65.9 | 65.9 | 100.0 |
| Total | 82 | 100.0 | 100.0 | |
| Family Involvement in Management-Top Management Team Non-family Members | 38 | 46.3 | 46.3 | 46.3 |
| Family Members | 44 | 53.7 | 53.7 | 100.0 |
| Total | 82 | 100.0 | 100.0 | |
| Family Involvement in Management Done by Non-family Members | 37 | 45.1 | 45.1 | 45.1 |
| Done by Family Members | 45 | 54.9 | 54.9 | 100.0 |
| Total | 82 | 100.0 | 100.0 | |

Descriptive statistics of experience, culture and non-financial goals are based on the frequency of responses towards the statements included in the questionnaire under each heading. The study summarized the responses for the purpose of reporting and analysis, where “strongly disagree” and “disagree” columns have been added to “disagree” and similarly, “strongly agree” and “agree” columns have been added to “agree”.

Analysis of the statements on experience in the survey questionnaire shows that 69.5 percent of the respondents were agreed that the educational qualification possess by ‘owner-managers’ have a great impact on performance of the business. This percent is 62.2 for the professional qualifications possess by the ‘owner-managers’. Further, 76.8 percent and 73.2 percent respondents agreed that, respectively the number of years of related experience and the number of years of managerial experience of ‘owner-managers’ provide a competitive advantage to the business. Finally, majority (87.8 percent) of the respondents agreed that the number of years of service in the current business of the ‘owner- managers’ help them to manage the business effectively.

International Journal of Management, Accounting and Economics
Vol. 4, No. 10, October, 2017
ISSN 2383-2126 (Online)

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Most of the respondents agreed that family has an influence on the business; family members support the family business in discussions with employees and other family members; family members feel loyalty to the family business; the decisions to be involved with the family business have a positive influence on their lives; and family members are willing to put in a great deal of effort beyond their normally involvement if necessary. On the other hand, the survey results revealed that most of the respondents do not agree or neutral that family members share similar values; family and business share similar values; and members really care about the fate of the family business.

One of the criteria used in the study to assess firm performance is the achievement of non-financial goals. Most of the respondents disagreed that family objectives have always priority over business objectives. Also, they suggested that the owner-managers do not place family concerns over business success or growth at all. Moreover, they are neutral on whether family members are more concerned with providing job opportunities to family members than generating higher profits.

The other criterion used in the study to assess firm performance is the achievement of financial goals for which sales growth has been used. The survey results show that the average sales growth is 14.85 percent while the maximum and the minimum sales growths are 20.86 and 10.82 per cents, respectively (see Table 2).

*Regression Analysis*

The Model One investigated the relationship between governance variables and financial performance of family businesses. The regression results are presented in STATA output. The summary of the results is shown in Table 5.

Table 5: Summary of Regression Model One for Factors affecting Financial Goals (i.e., Sales Growth)

| Model Summary | Constant | Family Ownership | Family Management | R Squared | |
|---|---|---|---|---|---|
| | 12.00722 | 0.1807475 | 0.3010815 | 0.8124 | |
| **ANOVA Summary** | F (4, 77) | df1 | | df2 | Significance Prob> F |
| | 83.37 | 4 | | 77 | **0.0000*** ** |
| **Coefficient Summary** | Variable | β (Coefficient) | | t-value | Significance |
| | Family Ownership | 0.1807475 | | 3.38 | **0.000*** ** |
| | Family Management | 0.3010815 | | 3.27 | **0.002*** ** |
| | Experience | 1.015798 | | 1.22 | 0.225 |
| | Culture | -0.546737 | | -0.82 | 0.417 |
| | Constant | 12.00722 | | 3.70 | **0.000*** ** |

***Significance at 1% level, **Significance at 5% level, *Significance at 10% level

International Journal of Management, Accounting and Economics
Vol. 4, No. 10, October, 2017
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Table 5 shows that the Model One is significant ($p<0.05$) and about 81.24 per cent of the variation of sales growth can be explained using the independent variables (R Square is 0.8124). The constant (i.e., intercept), the slope of family ownership and family involvement in management are 12.00722, 0.1807475 and 0.3010815, respectively, and all of them are statistically significant ($p<.05$).

Thus, the regression model is: *Sales Growth = 12.00722+ 0.1807475 (Family Ownership) + 0.3010815 (Family Involvement in Management).*

The model, therefore, explains that the family ownership and family involvement in management have significant positive impact on sales growth. For instance, increase in one family director will result to a sales growth of 18.07 per cent. Further, family involvement in management (i.e., majority of the board and the top management team comprised of family members and family CEO) will result a 30.11 per cent sales growth. These findings are in consistent with Minichilli, Corbetta and MacMillan (2010). Furthermore, the model did not support to claim that the other governance variable tested on the model, namely experience of the family members in governance, has a significant impact on the sales growth. Finally, the cultural factors (e.g., family values on the business, family loyalty to the business and family's way of participating in the business) controlled in the study also found to be insignificant.

The Model Two investigated the relationship between governance variables and non-financial goals of family businesses. The regression results are presented in STATA output (refer Appendix 3). The summary of the results is shown in Table 6.

Table 6: Summary of Regression Model Two for Factors affecting Non-Financial Goals

<table>
<tr><td rowspan="2">Model Summary</td><td>Constant</td><td>Family Ownership</td><td>Family Management</td><td colspan="2">R Squared</td></tr>
<tr><td>1.938208</td><td>0.5093108</td><td>0.2946192</td><td colspan="2">0.8206</td></tr>
<tr><td rowspan="2">ANOVA Summary</td><td>F( 4, 77)</td><td colspan="2">df1</td><td>df2</td><td>Significance Prob> F</td></tr>
<tr><td>88.04</td><td colspan="2">4</td><td>77</td><td>0.0000***</td></tr>
<tr><td rowspan="6">Coefficient Summary</td><td>Variable</td><td colspan="2">β (Coefficient)</td><td>t-value</td><td>Significance</td></tr>
<tr><td>Family Ownership</td><td colspan="2">0.5093108</td><td>3.21</td><td>0.002***</td></tr>
<tr><td>Family Management</td><td colspan="2">0.2946192</td><td>2.02</td><td>0.046**</td></tr>
<tr><td>Experience</td><td colspan="2">-0.1924891</td><td>-0.98</td><td>0.331</td></tr>
<tr><td>Culture</td><td colspan="2">0.038588</td><td>0.44</td><td>0.660</td></tr>
<tr><td>Constant</td><td colspan="2">1.938208</td><td>2.52</td><td>0.014**</td></tr>
</table>

***Significance at 1% level, **Significance at 5% level, *Significance at 10% level

Table 6 shows that the Model Two is significant ($p<0.05$) and about 82.06 percent of the variation of non-financial goals can be explained using the independent variables (R Square is 0.8206). The constant (i.e., intercept), the slope of family ownership and family involvement in management are 1.938208, 0.5093108 and 0.2946192, respectively, and all of them are statistically significant ($p<.05$).

Thus, the regression model is: *Non-financial Goals = 1.938208 + 0.5093108 (Family Ownership) + 0.2946192 (Family Involvement in Management)*

Hence, the model explains that the family ownership and family involvement in management have significant positive impact on non-financial goals such as family objectives, family concerns, and job opportunities. For example, increase in one family director will result to increase non-financial goals by 50.93 per cent. Further, family involvement in management will result in increasing 29.46 per cent of non-financial goals. These findings are in consistent with some of previous studies (e.g., Sacristán-Navarro, Gómez-Ansón and Cabeza-García 2011). Similar to Model One, this model was also not significant for the relationship between the experience of the family members in governance (i.e., the third governance variable tested in the model) and the non-financial objectives of family businesses. Moreover, the cultural factors (e.g., family values on the business, family loyalty to the business and family's way of participating in the business) controlled in the study found to be insignificant.

The Variance Inflation Factors (VIFs) statistics as explained under methodology section have been used to investigate the multicollinearity problem of the regression models. The results (VIFs<10) indicate that both models are reasonably free from any multicollinearity problem. Further, White's Heteroscedasticity Test as also explained under methodology section has been used to investigate the Heteroscedasticity problem of the regression models. The results indicate that both models are free from any Heteroscedasticity problem accepting Ho (p>0.05) (refer Appendix 3). Furthermore, normality of the residuals has been investigated using the Shapiro-Wilk Normality Test. The results indicate that the residuals of both models are normal accepting Ho (p>0.05). Finally, Ramsey Regression Equation Specification Error Test (RESET) has been used to investigate the Model Specification problem of the regression models. The results show that both models are free from any Model Specification problem (or there is no omitted variables in the models) accepting Ho (p>0.05).

## Discussion and Conclusion

The aim of this study was to examine the relationship between the governance of family owned businesses and firm performance following the multi-theoritical (i.e., agency and stewardship) applications of corporate governance. Contradictory arguments in the two theories were explored in the literature in order to identify the governance variables that influence firm performance. The relationship was tested using two multiple regression analyses in the family owned businesses in Sri Lanka selected into the sample. Findings of this study have both theoritical and practical implications.

As hypothesized, this study found a positive significant relationship between family ownership and firm performance measured both in terms of financial and non-financial goals of the firm (hypotheses 1 and 4). This finding supports the notions of agency and stewardship theories as measured by the number of family members contributed to equity. When the number of equity providers increases the performance of the family owned businesses is also likely to be increased. This could be due to the nature of the owners' involvement in family businesses minimizing the problems caused by the separation of ownership from control as the agency theory suggested. Further, consistent with the stewardship theory, this implies that because family owners often have a deep emotional investment in their firms they work hard for the success of the firm. In the Asian region, in particular, there is a high level of family ownership in publicly listed companies allowing family related board members to acquire a significant portion of shareholdings (Claessens, Djankov and Lang 2000), which in turn increases the board's interest toward the growth of the firm.

Following the notions of the agency and stewardship theories this study assumed in the second and the fifth hypotheses that family involvement in management is positively related to financial and non-financial goals of the firm. The findings of this study are in consistent with this proposition. More specifically, the findings of this study suggested that whenever majority of the board comprised of family members, family member holds the CEO position and majority of the top management team comprised of family members the performance of the family business measured both in financial and non-financial terms is likely to increase. In each of these situations, the agency problem between the owners and the managers tends to be decreased and thus the agency cost will be diminished improving the financial performance of the firm. Also, interests of owner-managers seem to be directed towards organizational objectives rather than personal objectives and they strive to be effective stewards of their institution. As a result, the performance of the firm is likely to increase both in financial and non-financial terms. Lee (2006) also found that family involvement in management has positive effects on profitability, employment, and revenue growth. Moreover, Anderson and Reeb (2003) revealed that when family members serve as CEO, profitability is higher than with a nonfamily member CEO.

Finally, this study hypothesized that family experience in ownership and management is positively related to financial and non-financial goals of the firm (hypotheses 3 and 6). The results depict that the level of experience of the owner-mangers has no impact on the firm performance. In other terms, the educational and professional qualifications possessed by the owner-managers, and the related managerial level of experience in the family owned business and elsewhere did not show a positive impact on the firm performance. The function of advice is expected to be relatively more important to family managed businesses than non-family managed businesses. This is because the top management positions are often occupied by family members in a family business. In contrast, non-family businesses often recruit outside professional and experienced managers for important positions. However, the respondents of this study believe in other way. This finding is therefore contradictory with the notions of the theories employed in this study.

Based on these findings, it is reasonable to conclude that the governance in family businesses influences largely on the firm performance in Sri Lanka. These findings are in line with the notions of the agency and the stewardship theories and prior studies which concluded that there is a strong positve relationship between the family ownership and their involvement in management, and the firm performance in financial and non-financial terms. However, this study did not support the propostion that the experience of owner-managers influences performance of family owned businesses. This could be due to the fact that the determination of the extent of governance in firm performance of family businesses largely depnds on contextual factors, particularly in corporate governance application in the Asian region. This also provides doubt over the universal applicability of corporate governance theories and practices. The effectiveness of corporate governance practices in family businesses may vary with contextual factors such as the nature of the socio-cultural and behavioural aspects of societies.

The findings of this study offer useful insights into policy makers in Sri Lanka and other similar developing nations. For example, governance variables examined in this study related to family businesses are highly likely to have implications for the way in which family businesses are performed. These insights in turn would be useful when designing and implementing policies relevant to corporate governance of these countries. Due to the less developed capital markets such countries face greater difficulties in promoting large scale companies with diverse share ownership. Hence, promoting family businesses is likely to have positive impacts on economic development and providing employment in those countries.

## Acknowledgement

Authors of this article are thankful to University of Peradeniya, Sri Lanka for the Research Grants 2014/2015, ‘Governance of Family Businesses in Sri Lanka: Issues and Challenges for Sustain and Growth, for financial support to carry out this research

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