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Family Firms, Do They Grow Slower Than Non-Family Firms?

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Introduction

Family firms account for a large bulk of total firms all over the world (Burkart et. al. 2003). A great amount of big famous international companies is family controlled, such as Audi, Walmart, Ford motors amongst others. The culture of family firms is especially strong in Western-Europe where the majority of firms are family controlled (Faccio et. al. 2002). With access to CCGR database, we want to conduct our studies in Norway, where it has a percentage (38,55%) of family owners. In recent years there has been an increasing interest of family firms compared to non family firms, comparing the differences between family firms and non family firms in many aspects.

Main aspects previously studied has been: the capital structure of the firm and the effect on agency problems (Jensen & Meckling 1976); The dividend policy of family firms, and their desire to remain in control (Villalonga and Amit, 2006). Much less research was found to compare the actual growth rate of the family and non-family firms. What we found was that most researchers addressed the growth, and possible reasons to why they think family firms grow slower. Actual testing and comparing the growth rate of both family and non-family firms was not performed (Jensen & Meckling 1976, Gallo 1995, berger & udell 1998, Mishra and McConaughy 1999, Thomsen & Pedersen 2000, Aldrich & Cliff 2003, Carney 2005, Villalonga and Amit 2006). Hence, in our article, we want to test the growth rate of family and non family firms and see if family firms grow slower than non family firms.

This study aims to investigate the growth rate of both family firms and non family firms in Norway. More specifically, the growth path between the two types of companies will be compared. As implied by previous research, family firms should grow slower than non family firms, it will be highly interesting to see whether this is indeed true. In addition, we are also interested in analysing and finding out what possible reasons might cause the different growth rate between the two types of companies, such as capital structure, governance and implied risk aversion. Capital structure will in this article be based upon level of leverage and external financing. Governance will be measured by level of ownership, where high ownership implies large proportion of wealth invested in the company and thereby higher risk aversion (Nordqvist et al. 2007). We also want to compare as

well as test whether the reasons that we believe may make family firms grow slower are consistent with those suggested by previous studies, lower leverage (Mishra and McConaughy, 1999), lower rate of external financing (Gallo, 1995). Moreover, we want to make a contribution to the missing area of growth between family firms and nonfamily firms and provide implications to future research in this field.

Growth rate is very important for a firm, especially in the beginning years, as it determines the firm's future success or failure. Considering that there is a lot of cross sectional analysis of family firms and non-family firms, it is our motivation to uncover how the two types of companies grow, which will bring a greater knowledge of their risk aversion and resource management through time. Studies have suggested that family firms grow slower, due to the assumption of higher risk aversion for such companies (Nordqvist et al. 2007). Since managers in family firms tend to have a large proportion of their personal wealth invested in the company, it renders them more affected by the company's idiosyncratic risk. Managers in non-family firms however, are more diversified with their personal wealth, thus the nonfamily firm can afford taking on more risk than family firms. With managers also being owners in family firms, it is interesting to see how this organizational structure affect the company compared to non-family firms.

As discussed by Thomsen & Pedersen (2000), organic growth strategy is preferred for family firms, as it poses less risk than acquisitions growth. Therefore, it is more interesting to compare the two types of firms growth in earlier years, i.e. first 10-15 years of its life, where mergers and acquisitions are unlikely due to size and monetary constraints. In this period, we believe they both grow more or less organically. In later years, family firms might want to continue with organic growth, while nonfamily firms might turn to merging and/or acquiring other firms. Comparison in a later period would therefore be uninteresting, since it gives no additional value to this field of research. We would like to assess the two firms when they are faced with similar challenges with respect to growth, thereby deducing what choices are optimal for growth and the company's future.

In this study we will introduce what is meant by family firm and discuss previous research and their findings and implications. we will further point out the wide aspects of growth, and define what type of growth we will focus on and why. Reasoning will be made on why different growth paths are expected, based on capital structure and governance. Hypothesis formed by these differences will then be made, and the methodology on how to test them will be explained. The data sampling from the Norwegian database on firms, and how it is assembled to be correctly tested, are later rationalized. Results will be further discussed in accordance to theory and give conclusions to why the differences exist. Although we aim to bring new knowledge about family and nonfamily firms growth, the knowledge will not be exhausted and needs further aspects to be researched and analysed. Further argumentations for why other aspects must be considered, will be argued for in the section for further research and implications.

Problem formulation

We study the growth of family and nonfamily firms in their early years. By using a Norwegian database on firms, we will run a regression on growth, then look at organic growth, capital structure and governance to address the differences in growth. Due to space and time consideration, the only aspect of governance that will be measured is the level of ownership.

Literature review

Extensive research has been done on the theoretical aspect of family firm growth, and the nonfamily firms. One of the possible reasons that family firms grow slower could be the possible conflict between active family members who cares about the future growth of the firms and non active family members who focus more on their personal interests, such as dividends that might sacrifice the benefits of the company growth (Nordqvist et al., 2008).

There seems to be a common notion that family firms grow slower, due to lower leverage (Mishra and McConaughy,1999), and also the reluctance to give up power by getting external funding (Gallo, 1995). The unwillingness to dilute family ownership (Sirmon & Hitt 2003) by turning to outside investors may result

in inefficient resource management. (Croce & Marti, 2016) looked at the aspect of Private equity(PE) involvement. Most family firms have a socioeconomic point of view, e.g. legacy, the study found that family firms who look to PE usually are in economic distress. In distress, the financial aspect of monetary value creation converges with their socioeconomic wealth aspect. Furthermore, they found that those family firms who used PE grew in the sense of total factor productivity. Berger & Udell (1998) stated that after surviving the infant period of one's business, the principal owner increases their funding substantially, by decreasing debt and increasing equity from other inside owners. For family firms this might be higher than private firms, due to the fact that they want to increase their control, whilst private firms invest money into profitable projects.

As seen by abovementioned studies, external funding provides capital as well as knowledge from private equity and venture capitalists. Including owners outside the family, creates incentives to further analyse certain prospects objectively and thereby one could reason that it creates a more profitable investment strategy. Family firms often rely solely on manager's/owner's own gut-feeling, creating different perspectives towards growth. Thus, it can be stated that private investors function as information producers, and are likely to overlook the growth of the company.

The intuition behind each statement above, can be explained by a simple example: a company has initially 100kr, and the possibility of additional 100kr from external financing or debt with an interest rate or required rate of return equal to 5%.
If the firm then have an investment opportunity yielding a 10% return, then the firm would invest 100kr and after 1 period end up with 110kr without external financing. With financing, the firm would have additional 100kr, and could invest 200kr, ending up with 220kr -105kr =115 which is larger than the non-financing scenario.
However, if the return turns out to be smaller than expected, let's say 2%, then in scenario 1 the firm will end up with 102kr, and scenario 2: 204kr-105kr = 99kr < scenario 1. Furthermore, if the debt or return is not immediately paid back with interest after 1 period, the result would be even worse due to compounded interest. So we see that external finance will cause greater growth if managed properly and

without unexpected changes in return of investments, but also will cause negative growth.

It is found in studies that top executives are selected by family ties rather than professional expertise. Family members and non family members are treated differently, so that it is less likely that family firms can attract top quality external managers, which would indirectly affect the development of the family firms and thus possibly its growth rate (Carney, 2005).

Other studies have gained knowledge in the family firm growth through time, by studying the growth of founding family and their descendants (Croce & Marti 2016). Their findings suggest that founding family are growing faster than descendants. it is then interesting for us to investigate how family growth differs from nonfamily growth, in this high growth (founding family) period. In a company's early age, it is often referred to a high growth company, and Jensen (1986) states that in the high growth periods, the level of free cash flows is low as they are invested in highly profitable projects. High free cash flows then suggests that the otherwise profitable projects are forfeited or not available. Furthermore, Jensen (1986) research suggests that altering the capital structure to less leverage creates less demands for that stock in the market. Within reason, this might suggest that there are less profitable projects available to invest in, hence the company will grow slower.

On the other hand, there are also some study suggesting that family firms might grow faster than non-family firms. In one of those studies, researchers found a positive relation between entrepreneurial orientation and growth of family firms. Firstly, special traits of family firms prompt them to develop entrepreneurial orientation behaviour (Aldrich & Cliff, 2003). Further, orientational behaviour would promote proactive and innovative behaviour, which helps the firm to perform better and grow quicker.

Studies have been performed on family businesses and their growth opportunities are explained by governance aspects as well as their capital structure. Family firms and non-family firms do have certain aspects which defines them, such as their capital structure and family's unwillingness to turn to external investors.

Some researchers even state that family firms use less leverage (Mishra and McConaughy,1999). Due to these differences most research seems to conclude that family firms grow slower, without actually researching if this is the case. Our study will therefore try to unveil the growth of family firms, and if it is in fact growing slower than non-family firms.

Thomsen and Pedersen (2000) found in an empirical study that ownership share is not correlated with growth(sales). ROA is significantly negatively correlated with ownership share. Further controlling for ownership status, such as family, nonfinancial company, banks and institutions, they found that family firms and (nonfinancial) company owners have higher sales growth than institutional and banks and government owners. This seems to be in line with the interpretation that nonfamily firms tend to have more emphasis on shareholder value, as for family firms they tend to be more concerned about the growth and survival of the firm. Their findings then suggest that family firms will actually grow faster than nonfamily firms. The idea is further strengthened by the agency problem theory, where managers have incentive to grow beyond what is profitable (Jensen, 1986) since this gives them more resources under their control. With family firms, the manager is also the owner and their is therefore no conflict of interest on the matter. One might deduce that this desire to grow is not hindered by owners wanting to maximize profits.

Hypothesis:

1. Family firms grow slower than non family firms

Based on what most previous research found, there are many reasons that might hinder family firms to grow as discussed above. Hence, we believe that it is most likely that family firms grow slower than nonfamily firms.

2. Family firms has less debt and thus more control than non family firms.

As argued by many researchers, family owners want to take more control of the firms and thus unwilling to borrow money from outsiders that is at the cost of losing ownership. Thus, we want to test ourselves to see if this is true differences between family firms and nonfamily firms, which might further affect respective growth rate.

3. Less debt and risk are negatively related with firm's' growth rate.

We believe that less debt might be one of the reasons that affect the growth rate of firms. Together with hypothesis 1 and 2, if both are true, we can reach one possible explanation to the reason why family firms glow slower than nonfamily firms.

Theory

Firstly, we need to define family firm. Up to date, there has not been a widely accepted definition for family firm. But there are various beliefs of family business discussed in previous research, most of which suggest three ways to consider the definition: content (Handler, 1989; Heck & Trent, 1999), family ownership (Barry, 1975; Lansberg, Perrow, & Rogolsky, 1988), family business culture (Dreux IV & Brown, 1994). For content and family business culture without quantitative level, it is difficult to differentiate family firms from all the other firms. Hence, we prefer to choose ownership to define family firms, which is also suggested by Litz (1995). A business firm can be considered as a family business to the extent that its ownership is concentrated within a family unit.

Further, as it is defined by Villalonga and Amit (2006) that 'a minimum control threshold of 20% of the votes, being the largest shareholder or vote holder, having family officers or directors, or being in second or later generation'. We, therefore, adopt this definition to distinguish family firms from all the other firms, that is 20% of total ownership is controlled by family members.

In addition, we need to define the growth rate of a company. There are several ways to assess a company's growth: total factor productivity, operational profits, return on assets, return on equity amongst several other factors. Delmar et. al. (2003) used 19 different ways of measuring growth of firms. Thus, when growth is explained by capital structure, it may not give the full perspective and understanding of the differences between family firms and non-family firms.

Organic revenue growth is defined as overall expansion of the market share of the company, whereas inorganic growth arises when one company merges or acquires other firms (Koller, Goedhart & Wessels, 2010). Therefore, we should define two

type of growth rate before we compare the growth rate of family and non-family firms.

We expect, like other practitioners that non-family firms are more open to merge and acquire whereas family firms are less likely to be acquired or merged as this will render the persistence of control for the family. So it is likely that the growth rate of family firms is organic, meaning that we should also look at the organic growth rate of nonfamily firms excluding the effect of merge or acquisition, otherwise they will not be comparable. Moreover, sales and employment are two factors most researcher explore and therefore might be a good way of measuring growth, as it yields the opportunity of comparison between studies.

Methodology

Our research will examine the growth rate of employment and sales growth, further defined by organic growth for comparability reasons. The period of which we will look upon will be 10 years as this will deflect the companies arbitrary increase due to possible industry change or other macroeconomic factors. The regression will be time series panel data, comparing nonfamily firms to family firms across time. An important aspect to remember is that companies differ in growth with size and age (Delmar et. al. 2003). Thus certain classifications and requirements must be made, within the data sample range of possibilities. The most interesting aspect of growth is at a firm's relatively young age, since older companies usually are bigger and are also mostly confined to acquisition growth. Thus we would like to confine or span to companies formed within the 10 years prior to our subsequent examining period. furthermore, small companies tend to grow at a faster pace, consequently we follow the article by Delmar et al (2003) and make a criterion that the firm has been operational for at least three years.
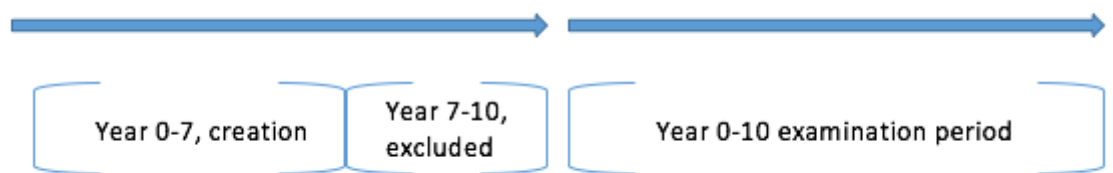
otherwise we could specify that the company's size is no bigger than 100 employees by the starting point of our examination period.

According to Coad, A. (2010), growth rate of a firm is calculated by taking the differences of natural log of its sales and employment.

$$\text{Growth}_{i,t} = \log(X_{i,t}) - \log(X_{i,t-1})$$

Where X is measured in terms of sales and employment for firm i, from time t to t-1.

The regression we will run will be:

$$Y_i = \alpha + \beta X_{1,i} + \gamma_1 Z_{1,i} + \gamma_2 Z_{2,i} + \gamma_3 Z_{3,i} + \varepsilon$$

Where Y_i are the growth rate of firms that we obtained from the regression above. $X_{1,i}$ is a dummy variable, with value 1 stands for family firms and 0 for nonfamily firms. Z_s are controlled variables, specifically Z_1 represents firms' sizes, Z_2 firms' age and Z_3 represents industries.

The reasons why firms' size is a controll variable is that firm size affects growth rate a lot, according to plenty of researches (Hymer & Pashigian,1962; Evans, 1987; Beck, 2005; Hall,1986). Smaller firms usually grow faster than large firms. That is the same for firm age. The growth rate of younger firms is found to be significantly faster than that of older firms in a given age period (Evans,1987; Samuelson,1989; Huynh & Petrunia, 2010). As for industries, the growth rates of industries can be very different from each other, which greatly affect the firms in respect industries. The firms in a fast-grow industry can grow much quicker than the other industries, which is not because the firms outperform the other firms but only because they are in this industry. In all, our results would be biased when comparing the growth rate of family firms and nonfamily firms, if those above three variables are not controlled.

Endogeneity must be controlled for. if not we may reach a conclusion based on wrongly specifying the model. we will most likely have a problem when growth is not only based on the two variables specified.

Data

We will use Norwegian firm data provided by CCGR database, which includes all types of firms. The database gives us access to a range of firms which is not publicly listed, and may give a better understanding of the two different types of firms, when they are unaffected by the public market. We will then differentiate family firms from all the firms, according to the theory of family firms discussed above (more than 20% of ownership is controlled by family members).
We will analyse panel data, meaning that we will access the sales and employment figures of all the firms within 10 years, in order to overcome endogeneity problems.

We intend to use two studied subjects to correctly specify and sort our data. Research Methodology, which helps us to make up regression as well as Multivariate Statistics and Econometrics. Furthermore, in order to address and use the right variables according to theory, Applied Valuation, Multinational Corporate Finance and Asset Pricing will be used to further follow what theory suggests variables effecting growth.

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