

The Impact of Family Ownership on Firm Value and Corporate Governance: Evidence from the Financial Sector of Bangladesh

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***Abstract:** This study attempts to find family ownership effects in developing the financial sector in Bangladesh. The objective of the study is to find out family control influence on the listed financial companies of Bangladesh. Four alternative variables to measure family control have been used in their study. The study explores a negative relationship between family control and firm value. Moreover, the relation is weaker between firm value and board stock ownership. Family control is found to be valuable for newly established financial companies with more independent and smaller boards in the financial sector in Bangladesh.*

***Keyword:** Founding Family Controlled (FFC) financial companies, Non Founding Family Controlled (NFFC) companies, Breusch-Pagan-Godfrey (BPG) test*

1.0 Introduction

The concept that, founding family controlled firms are privileged and can add value in the long run is not still well established for every industry or every country. One of the reasons for this is that the measure of corporate governance is still ambiguous and more subjective; as a result the output varies based on the uniqueness of different scenarios, such as differences in country, industry, time period or regulation. How family governance adds value or under which scenario it provides better output and how it differs for different industries and even for different countries? These are the key points that are going to be focused in this study. Khan N.(2014) studied founding family effects in US insurance industry and compared the empirical findings especially with the non-financial Norwegian firms. She found a positive relationship between founding family control and firm value in the case of the US insurance industry. However, the relation is weaker between firm value and board stock ownership. Founding family control is found to be valuable for newly established insurance companies with more independent and larger boards in US insurance industry.

The study of Khan N. (2014) provided us the scope to revisit the family controlled firms' performance in Bangladesh following the model suggested by her; taking 30 Banks, 21 Non Bank Financial Institutions (NBFIs) and 34 Insurance companies. In Dhaka Stock Exchange (DSE), one of the leading stock markets of Bangladesh, banks and insurance represent about 22 percent of the market and here owners include sponsors and they are mainly from the founder's family. They often limit the executive management positions to the family members. (43 percent) (DSE and World Bank, 2009). So, in this paper we followed the same methodology for a different country, different industry and for a different sample size to find out whether the effects remain same for dynamic situation.

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Moreover, most of the research that considered this issue has been carried out for developed market countries, most notably the United States. Only a few of the studies have considered emerging market economies, with very few focusing on Bangladesh. There exist huge institutional differences, including the mechanisms of corporate governance, between Bangladesh and the developed economies. However, it is not known whether existing differences in institutional, regulatory and corporate governance practices also translate into differences in the relationship between family ownership, family governance and firms' performance. So the focal point of this paper concerns family governance, family owned firms' performance, and investment propensities and outcomes.

1.1 Objectives of the Study

This paper aims at two objectives. First is to unveil the relationship between founding family control and firm value in banks, NBFIs and insurance companies-representing the financial sector of Bangladesh. Second is to show the relationship under various corporate governance conditions and different business practices.

The remainder of this paper is structured as follows. Section 2 briefly describes what family firms are and the literature that relates founding family control with firm value and performance. Section 3 briefly presents the structure and governance mechanisms applied in Bangladesh focusing especially on the financial sector. Section 4 presents the hypothesis development based on related literatures. Section 5 details the research methodology and data while Section 6 describes the results of empirical testing. Finally, Section 7 provides the conclusions of the paper.

2.0 Are family firms really different?

2.1 Definition of family firm

There are differing definitions with reference to a "family-controlled businesses," some of which disagree over the extent by which ownership and control must be one and the same in order for a business to qualify as such. It is myopic to define a family firm as one in which a family member owns majority of the shares of a business, or one in which a family member owns a controlling interest in a business. In any case, there is a consensus that a business does not have to be wholly owned and controlled in order to qualify as a Family Controlled Business (FCB). FCB's tend to contract with other businesses on a more personal level and for longer periods of time, thereby fostering long-term business relationships.

There are some particularities attributed to family firms, mainly due to facts like long CEO tenures (typically more than 15 years) and concern for subsequent family generations. Thus:

- i) family firms are more likely to take a long-term orientation in making strategic investments (Le, 2006);
- ii) family firms have to deal with additional issues – namely family ones (Schulze et al., 2001) which might be resource-consuming;
- iii) family firms are more hesitant to invest in risky projects (Barth et al., 2005), and thus, could miss investment opportunities; and

iv) non-family firms are often regarded as being more innovative than family firms (Gomez-Mejia et al., 2001).

Usually in the FCBs, family members not only invest in business but also possesses a personal interest in that FCB, hoping that their business grow and evolve much as their children matures and develops over time (Klein, Shapiro, & Young, 2005).

2.2 How family ownership affects firm performance and value?

Following the leads of Jensen and Meckling (1976) through separation of ownership and control, research has long focused on the impact of ownership on corporate value. But the agency theory approach oversimplifies the complexity of the agency relationship. So traditional finance literature has little to say about how family ownership affects the way a firm is operated, and, consequently, its performance and value. For example, family members have advantages in monitoring and disciplining related decision agents (Fama and Jensen, 1983a and 1983b) but no separation between ownership and management can offset the positive long-term orientation of the business. In addition, role conflict and family differences can lead to behavior that does not support the best interests of the firm. In this context, the effect of family ownership on corporate performance and value remains an open issue.

Berle and Means (1932) are among the first to consider the relations between a firm's ownership structure and its performance where their argument was that, since interests of management and shareholders are not generally aligned, corporate resources are not used efficiently for maximizing corporate profit, and consequently suggested a negative relationship between control and performance. In fact, Holderness and Sheehan (1999) find that firms under family ownership create less economic value than non-family ones.

On the other hand, research by Demsetz and Lehn (1985) and Demsetz and Villalonga (2001) has sought to explain how ownership and other governance variables endogenously respond to firm and industry characteristics, without necessarily inducing a causal effect of ownership on performance. However, recent studies by McConaughy et al. (1998), Anderson and Reeb (2003a), Adams et al. (2005) and Fahlenbrach (2006) provide empirical evidence that the relation between family ownership and firm performance is associated with higher ratios when compared to widely-held companies, both in terms of accounting performance and market valuation.

In East Asian economies Claessens et al. (2000) show that, the excess of large shareholders' voting rights over cash flow rights reduces the overall value of the firm, though not enough to offset the benefits of ownership concentration. No direct effect of large shareholders on firm value in Japan (McConnell and Servaes 1990); although their results suggest the existence of a certain joint influence of concentration and inside ownership. Thomsen and Pederson (2000) find mixed evidence about the relation between the nature of the dominant shareholder, the share of concentration and performance in a sample of large companies from 12 European nations. In other economies, the evidence is scarce but also mixed (e.g. Miller et al., 2008).

2.3 Family control, firms' performance and the institutional environment

Following La Porta et al., (1999), De Miguel et al. (2003) established a comparison between the main corporate governance systems, and the way they affect the relationship between ownership concentration, performance and valuation of family firms. They find that there is a link between the presence of controlling shareholders and the strength of the legal rules protecting creditors and shareholders (especially minority shareholders). The empirical results are not consensual.

Barontini and Caprio (2006) show that, after considering that families tend to use more control enhancing mechanisms, valuation is positively related to family control. Nevertheless, Fahlenbrach (2009), and Villalonga and Amit (2006) show that control enhancing mechanisms have a negative effect on firm value, even though US law protects minority shareholders better than most other countries' legislation and makes expropriation less likely to occur. In fact, in East Asia, where transparency is lower, Faccio et al., (2002) claim that politically powerful families in control of public firms have been able to expropriate minority shareholders. Consequently, major-shareholders are more usual when investor protection is weak, whereas more dispersed shareholdings are typical wherever the law strongly protects shareholders' and creditors' rights.

2.4 Family management and firm performance

A common characteristic of family firms is that family members occupy the top management positions, often being the CEO of the company. In this context, it is obvious that owner-management assures the interests of owners and managers, thus reducing the level of agency costs and mitigating managerial expropriation.

Nevertheless, the owner-management combination also has some negative effects; especially when protection of minority shareholders is weak and agency problems are too severe to allow separation of ownership and management (e.g. the family has enough ownership for unchallenged control). For instance, family owners' major stake reduces the probability of bidding by other agents, therefore reducing the value of the firm. Gomez-Mejia et al., (2003) show that third parties experience difficulties in capturing control of the firm when families influence selection of managers.

Many papers highlight that founder-CEOs' control has a positive effect on corporate performance and valuation (McConaughy et al., 1998; Smith and Amoako-Adu, 1999; Anderson and Reeb, 2003a; Fahlenbrach, 2009; Adams et al., 2005). Recent research overall suggests there seems to be a positive effect on performance by founder and professional management but a negative effect from descendant management. For example, Villalonga and Amit (2009) find that founder management is positive for valuation and that descendant management decreases valuation. This evidence is explained by the fact that the founder adds special competence to the firm, which is not expected to be transferred to the next generation. In addition, Barontini and Caprio (2006) show that founder management is strongly positive for valuation in family firms. Furthermore, the family's sustained presence in the firm also creates powerful reputation effects and provides incentives to improve the firm's performance. Similar evidence is provided by Andersen and Reeb (2003a). Based on accounting performance measures, Anderson and Reeb's (2003a) results indicate that family firms only perform better when a founder family member is a CEO.

3.0 Bangladesh Institutional Setting: Corporate Governance Setup in Financial Sector

Bangladesh is an emerging economy. Corporate governance systems here are arguably less evolved than those in developed countries such as the Anglo-American countries, Germany, or Japan. Emerging markets as a whole differ substantially from developed countries in their institutional, regulatory and legal environments (Prowse, 1999) and thus Bangladesh comfortably fits the emerging market model.

Bangladesh has weak, relatively unsophisticated, legal and regulatory frameworks and enforcement mechanisms to protect investor rights; although it inherited “English common-law”. Problems related to delays and inefficient, distorted, or differential treatment in enforcing existing laws and securing outcomes, lack of transparency and accountability are not uncommon in the corporate sector of Bangladesh, and are similar to those in other emerging East and South East Asian countries (Prowse, 1999). Furthermore, Bangladesh lacks an active market for corporate control, strong incentive contracts for management, and outside directors, etc despite having a market-based system similar to Anglo-American firms. Furthermore it is widely recognized the presence of market anomalies and malpractices (e.g. unavailability of information to investors, insider control and collusion to manipulate stock prices in the market).

As a natural outcome of the above conditions prevailing in the corporate sector, the Bangladesh market comprises of mainly small and medium-sized firms with highly concentrated ownership. Ownership has become the predominant corporate governance mechanism, similar to the control model found in Germany and Japan though it differs in institutional majority owners of Japanese and German firms concentrated individual or founder-family owners dominate private listed firms in Bangladesh. Therefore, institutional activism occurs less in Bangladesh than in the Japanese-German systems (Farooque et. al., 2007). Therefore, the institutional setting for ownership structure in Bangladesh has unique features, an appreciation of which is important to understanding the governance mechanisms and processes that have evolved in Bangladesh. Corporate governance systems in Bangladesh are firmly based on family ownership and insider-domination. Controlling families dominate the boards in most companies, filling positions of executive directors, and CEOs/Chairpersons. Thus, family-based board ownership has its costs in the form of potential expropriation of small shareholders’ wealth in the firm by owners/board members representing founding families. However, some other ownership types, in particular, institutional shareholders, are capable of offsetting such costs of board ownership through their large shareholdings and ability to monitor managerial behavior.

This study seeks to evaluate whether a significant number of Bangladeshi banks, NBFIs and insurance firms are family owned and, if so, the extent to which these firms are governed as a FCB. In doing so this study develops the null hypothesis that firm performance in Bangladeshi financial sector is not affected by FFC as well as industry differences. Accordingly, this study examines the financial performance of this sector; as represented by 30 Banks, 21 NBFIs and 34 Insurance companies and seeks to account for answers that explain such financial performance. It is expected that regulation exerts a heavy influence on financial performance, and accordingly, these firms are expected to be influenced not similarly by other industry in other country.

3.1 Banking Industry of Bangladesh

In Bangladesh, practices of corporate governance in banking companies are governed by Company Act 1994, Bank Company Act 1991 and Code of Corporate Governance 2006 of Bangladesh Securities and Exchange Commission (BSEC). Besides, The International Finance Corporation (IFC) and Bangladesh Enterprise Institute (BEI) work a lot to provide guideline, training, recommendation and advices to improve better corporate governance.

After the recent amendment of the law, it is not necessary for the bank to keep any depositor director. So bank can have only three type of directors now – regular director, alternate director and independent director. Maximum 20 members including independent directors are allowed in the board of directors of a bank. Number of independent director should be 3 if there are to be 20 members in total. But if the board has less than 20 members it must have at least 2 independent directors. The maximum term of a director is 3 years and can be reelected for 2 terms consecutively. After that he or she cannot be a director for next 3 years but after the end of this 3 years period he or she can again be a director. In every Annual General Meeting (AGM) of the bank, one-tenth of board should be replaced with new directors. In the law, maximum 2 members from the same family are allowed to be the directors and a family can own maximum 10% of the total share of the bank. As the definition of the family it includes father, mother, son and daughter, brother, sister and other dependent on them. Directorship cannot be assigned to someone else but alternate director can be appointed in certain circumstances like if the original director needs to go outside the country for a period of 3 months or more. This alternate director will work for the original director but as he is in the position on a temporary basis, alternate director cannot be the member of any committee of the bank. Any director cannot hold any position in the bank of which he or she is a director that fetch income or salary to him or her. Banks cannot appoint any managing agent and so banks require CEO or Managing Directors. Chairman of the Board is not allowed to be the CEO of the bank in Bangladesh. Besides, CEO of any bank cannot be the CEO of any other bank or financial institutions. CEO can hold his or her position for maximum 5 years in each term but can be reappointed multiple times consecutively.

Bangladesh Bank (BB) and BSEC monitor the corporate governance practices by the Banks. Each bank has to take approval before appointing or removing directors. In appointing alternate director banks also need to take approval. In case of appointing independent directors, banks need the approval of BSEC. Information about the directors should be reported to the BB on a regular basis. Banks also need to take approval before appointing CEO. BB holds the power to remove any of the director, chairman or CEO if thinks necessary for the welfare of the depositors. If anyone wants to hold more than 5% of total share, he or she has to have the approval from the BB.

Among the 30 listed banks average board size is 13 and there are 2 independent directors on an average in every bank (on a percentage basis which is 15% of the board). This is an exact compliance with the existing law and guidelines. Board owns on an average around 27% of the total shares of the bank. Around 15% of the board is from the founding family within the firms those have directors from founding family (in number which is around 2 directors on an average). These founding families hold around 3% of the total shares on an average. Finally there is no CEO from the founding family and average tenure of the current CEO is around 3 years.

3.2 NBFIs of Bangladesh

A few research papers have considered the effect of founding family influence on firm value and corporate governance in NBFIs in context of Bangladesh and still now there have been very few formal and recognized studies on the concerned issue. So, it is a burning issue today to work on the topic. For this reason, there is much rationale to find out the existing scenario of corporate governance in Bangladesh and at the same time to find out how much founding family ownership and directorship can improve corporate governance and firm value. Non-bank financial institutions (NBFIs) represent one of the most important parts of a financial system. In compared to banking sector, NBFIs are quite new in Bangladesh.

NBFIs are contributing much in order to meet the credit gap and to guarantee flow of long term loans. Additionally, NBFIs are very important in extending the mobilization of term savings and providing support services to the capital market. So, an attempt has been taken to identify corporate governance condition in nonbank financial institutions and founding family influence on its governance and firm value.

In Bangladesh, NBFIs are licensed and controlled by the Financial Institutions Act of 1993 (FIA '93). NBFIs provide loans and advances for commerce, industry, housing and real estate, agriculture, carry on the business of hire purchase transactions including leasing of machinery or equipment carry on underwriting or acquisition business or the investment and re-investment in stocks, shares, bonds, debentures issued by the government or any local authority.

In case of leading non-banking listed companies in our country, the board is heavily dominated by sponsor shareholders who generally belong to a single family. The boards are actively involved in management. The Chairman and the CEO should be separate and the responsibility should be clearly identified. But most often the same person holds the same post. Normally the most senior member of the family holds the two posts according to seniority in the family relationship and juniors are director. Most independent directors represent current or former, government officials or bureaucrats or sometimes university teachers who are skilled in the field of accounts and finance. They are appointed directors to assist company in getting licenses or as payback for previous favors when he was govt. officer. Very often they do not act as an advocate for minority shareholders.

Among the 21 listed NBFIs in our study average board size is 11 and there are 2 independent directors on an average in every non-bank FIs (on a percentage basis which is 19.80% of the board). This is a moderate compliance with the existing law and guidelines. Board owns on an average around 29.32% of the total shares of the non-bank FIs. Around 6.65% of the board is from the founding family within the firms those have directors from founding family (in number which is around 1 director on an average). These founding families hold around 1.68% of the total shares on an average. Finally there is no CEO from the founding family and average tenure of the current CEO is around 4 years.

3.3 Insurance of Bangladesh

The insurance industry of Bangladesh is going through a reform. As a first step towards achieving the objective, the Insurance Act, 2010 in replacement of the Insurance Act, 1938, and the Insurance Development and Regulatory Authority Act, 2010 for establishing the Insurance Development and Regulatory Authority (IDRA), were passed by the Jatiya Sangshad in March, 2010. However, insurance companies in Bangladesh are still at lowest disclosure level.

Among the 34 listed Insurance Companies in our study average board size is 15 and there are 2 independent directors on an average in almost every insurance company (on a percentage basis which is 11.48% of the board). This is a moderate compliance with the existing law and guidelines. Board owns on an average around 33.12% of the total shares of the insurance company. Around 4.5% of the board is from the founding family within the firms those have directors from founding family (in number which is around 1 director on an average). These founding families hold around 2.42% of the total shares on an average. Finally there is no CEO from the founding family and average tenure of the current CEO is around 5.52 years.

4.0 Literature Review and Hypothesis Development

It is importantly notable that external conditions have significant impact on family firm performance. Evidence indicates that in the United States, FCB's exhibit notable performance advantages over non-family firms. However, in Canada, ownership type (even family ownership) does not appear to significantly affect performance (Klein, Shapiro, & Young, 2005). From this, one can infer that governmental regulations exert a heavier influence on corporate governance in Canada—thereby diluting the impact that than they do in the United States, a country more known for its *laissez-faire* approach to businesses. Studies examining family firm performance have drawn widely different conclusions recently when compared with those drawn in previous years. Formerly, family firms are looked at as miniscule, inefficient businesses rife with internal struggles due to intra-family conflicts governing business decisions.

While these are the flaws that continue to characterize FCB's, there is new evidence that amplifies the advantages that FCB's possess. FCB's tend to operate very efficiently during periods when resources in an environment are scarce – it can raise capital and sell assets quickly during tight economic periods.

Given that ownership and control are largely unified in a FCB, owner-managers are less subject to external scrutiny with reference to disclosure and transparency of financial statements. This unification all but eliminates the agency problem that may serve as a detriment to firms that engage in managerial and alliance governance. Furthermore, that the owner-manager is likely to exercise authority for a prolonged period of time and have lengthy job tenure circumvents the need to maximize short-term profits at the risk of marring long-run gains, a problem pointed out by agency theorists. FCB's subscribe to investment strategies that differ from those of other types of businesses. FCB's are more inclined to possess a long-run financial outlook and consequently are much less concerned with short-run gains. All things being equal, these businesses might sacrifice significant short-run gains in the name of prudence.

Evidence shows that given this inherent outlook and given that agency costs are negligible, on an average FCB's will tend to outperform other types of businesses in financial returns. However, there is also evidence to indicate that an independent board of directors might temper poor financial returns found in family firms where too many family members possess diametrically opposed financial and business objectives. These diverging objectives particularly arise due to the inclusion of multiple family generations, each of which possesses its own individual objective. (Mishra & McConaughy, 1999) reported that founding family controlled firms are run differently than those firms with concentrated management ownership.

McConaughy, Walker, Henderson, & Mishra, (1998) find that founding family controlled firms in the US are more valuable than similar firms without founding family control. They study the operating efficiency and relative value of a sample of US founding family controlled firms whose CEOs are either founders themselves or are related to the founders. They find that both founders and their descendants run their firms more efficiently than CEOs without founding family ties.

The few empirical studies conducted so far on the relation between firm value and founding family control, have produced mostly inconsistent results. For example, McConaughy et al. (1998) find a positive effect of founding family control in the US, whereas Lauterbach and Vaninsky (1999) find that family firms in Israel under-perform other firms. Mishra (1999) indicate that founding family control is positively related to firm value and that founding family firms are governed differently than firms without family control. This finding is consistent with Fama and Jensen (1983), as well as De Angelo and De Angelo (1985), who suggest that founding family involvement reduces agency costs and allows improved monitoring of the firm's managers. Mishra's analysis also suggest that founding family CEOs can enhance firm performance when family influence does not create shareholder entrenchment or when their cash flow rights are more aligned with their control rights.

Some of these studies attribute the economic crisis to bad corporate governance practices, especially among the family controlled firms. For example, in a World Bank study, Claessens et al. (2000) find that East Asian firms that use dual-class shares, stock pyramiding, and cross-holdings, have lower market values, especially in those firms under family control. It may be noted that Norwegian law does not allow a single person to serve both as the CEO and the chairman of the board simultaneously, whereas this combined leadership structure is frequently observed among US firms. The market for corporate control is less developed in Norway than in the US or UK, and compared to countries such as Canada.

Jensen and Meckling (1976) argue that firm value is positively correlated with the level of managerial ownership because of reduced agency costs and increased alignment of interests between managers and shareholders. Stulz (1988), however, argues that managerial ownership in excess of 50 per cent insulates managers from the market for corporate control.

Morck et al., (1988) find a significant but non-linear relationship between managerial ownership and firm value, suggesting that some levels of managerial ownership are advantages.

Mishra and McConaughy (1999) report that founding family controlled firms are run differently than those firms with concentrated *management* ownership. McConaughy et al., (1998) find that

founding family controlled firms in the US are more valuable than similar firms without founding family control. They study the operating efficiency and relative value of a sample of US founding family controlled firms whose CEOs are either founders themselves or are related to the founders. They find that both founders and their descendants run their firms more efficiently than CEOs without founding family ties. Kang (1998) also finds that founding family owners enjoy an increased firm performance.

Chami (1997) develops a theory of family business that explains then dynamics of market forces and the family. He shows that family businesses are fundamentally different from other businesses. Family traits can encourage an atmosphere of love for the business and a sense of commitment. Nepotism and favoritism are held in check by the need for the family business to compete and succeed in the product and capital market.

Claessens et al. (1999), in surveying nine East Asian countries, find that many family controlled firms are older and smaller. They find a negative correlation between founding family firms and firm performance. Morck et al. (1988) also find that the presence of a founding family member among the top two executives increases firm value for younger firms and reduces it for older firms. Kang (1998) documents that early generation family owners are associated with higher performance than their descendants. Overall, the evidence is that older family firms perform more poorly than younger ones.

In examining the relation between board size and firm value, Yermack(1996) finds that firms with small board sizes have higher stock market value. Using a sample of large US corporations, he finds an inverse relationship between firm value and board size. Yermack reports a negative 26 per cent correlation between board size and founding family control.

However, Booth and Deli (1996) find a negative relationship between the number of outside directors and the firm's growth prospects. Similarly, Agrawal and Knoeber (1996) and Subrahmanyam et al., (1997) find that firm performance is actually reduced when additional outsiders serve on the board.

Moreover, Hermalin and Weisbach (1991) do not find any relation between firm performance and the fraction of outside directors. These contradictory findings suggest that more research is needed on the issue of board independence.

Fama and Jensen (1983) suggest that family relationships between managers and owners should reduce agency costs. Kang's (1998) field research suggests that founding family members are active monitors of their managers. He suggests that the information flow between managers and family members acts as a control mechanism, where managers make decisions with the understanding that they have to eventually justify them to family owners in face-to-face conversations. Because founding family control is unique, as suggested by the above authors, the level of outside representation on the board might not affect the relation between founding family control and firm value.

Economic Cooperation and Development (OECD), Nikomborirak and Tangkitvanich (1999) argue that the East Asian crisis can be partly attributed to bad corporate governance practices which

include risky investment by managers, expropriation of company's funds by directors, managers and large shareholders, shady business deals, and poor audits.

In Mishra's analysis, it is found that firm value, as measured by the December 31, 1996, log q-value, is significantly higher for founding family controlled firms. All of the corporate governance variables, reveal significant differences between founding family controlled firms and non-founding family controlled firms. Board size is smaller in founding family controlled firms, and the board has fewer outside representatives. Board stock ownership is higher and the CEO tenure is longer in founding family controlled firms. In examining the correlation matrix of Mishra's analysis, it is found that firm value has an 18 percent positive correlation with the founding family control composite variable. It is also found that firm value has significant positive correlation to interest income growth, and significant negative correlation to the following variables: firm size, financial leverage, firm age, asset tangibility, board size, board stockownership.

Family control is also significantly negatively correlated with board size, financial leverage, firm age, and the percentage of outside directors. Yermack (1996) finds a negative 26 per cent correlation between board size and founding family control in his US sample of firms, which is similar to a negative 24 per cent correlation in Mishra's sample. Board size is, however, highly positively correlated with firm size (45 per cent) and firm age (38 per cent), and negatively correlated with the percentage of family directors on the board (-43 per cent).

To further test the relation between firm value and founding family control, Mishra has also used regression analysis. In this regression analysis, the following variables i.e. six firm characteristics: firm size, sales growth, financial leverage, return on assets, asset tangibility, and firm age; four corporate governance characteristics: size, board independence, board stock ownership, and CEO tenure have been used. The regression analysis of Mishra's results indicate that the valuation impact of founding family control is fairly significant. In all of the regression models of Mishra indicates that firm size has a significantly negative impact on firm value, consistent with the argument that smaller firms have higher q-values. The effect of asset tangibility on firm value is significantly negative, implying that firms with a substantial proportion of their assets in property, plant and equipment display lower q-values.

In addition, the board independence variable is significantly negative in most regressions, suggesting that firms with higher board independence have lower q-values, as previously reported by Agrawal and Knoeber (1996) and Subrahmanyam et al., (1997). The board size variable is also significantly negative in regressions, suggesting that firms with smaller boards, higher q-values, which is consistent with Yermack (1996). A firm's age has apparently little impact on the effect of founding family control. Not all aspects of founding family control are significant, suggesting that there is a moderating corporate governance effect. Consistent with Mishra's findings, it can be said that founding family control through directorship has little impact on firm value.

Chen (2001 1993) has found that firm age has positive impact on firm value. That means older firms are considered to be more efficient than younger ones. Chen (2001), Mohanty (2002), Weir et al. (2003), Mollah and Talukdar (2007) find out significant negative relationship between size and firm performance. On the other hand, Jog and Dutta (2004) and Kim (2005) found significant

positive relationship between firm size and performance. There are mixed evidences available in the literature on the relationship between leverage and profitability. Chen (2001) found out the insignificant negative relationship between leverage and profitability.

On the other hand, Kim (2005), Khiari et al., (2005) examined the positive association between leverage and profitability. There are various measures of financial leverage employed by the researchers. But in line with Chen (2001), Khiari et al., (2005) and Kim (2005), equity ratio has been employed as a measure of financial leverage. In regression analysis by Chen and Kim, it is found that there is positive relationship between firm age and corporate governance and firm performance yet the relationship is insignificant one.

5.0 Models and Data

In their article Mishra et al., (2001), the authors have taken shipping, manufacturing, information technology and other industry except financial industry as family control is not allowed in Norway for financial industry. However, the primary model used by the authors has been replicated for the financial sector in Bangladesh as family control is allowed here. As Bangladesh financial sector is mainly combined of banks, non-bank financial institutions (NBFIs), and insurance companies, we took a total sample of 85 companies: 30 banks, 21 NBFIs, and 34 insurance companies, on the basis of data availability. The corporate governance information as well as other variables are mainly collected from the respective firm's websites, annual financial statements. Of the 85 companies, based on the definition mentioned below, 29 (13 banks, 10 NBFIs, and 6 insurance companies) are family controlled firms and 54 non-family controlled firms. All of the measures of this study, except for the 2010 to 2012 interest/premium growth rates, are measured as of December 31, 2012. Multiple indicators to capture the phenomena of family control have been used. Family control is measured by: (1) the percentage of ownership by the family, and (2) the percentage of directors that are members of the family. Finally, (3) a composite variable that equals 1 if the firm satisfies at least one of the two indicators above. The three criteria, mentioned above, are new measures used in the study of Mishra et al., (2001). Firm value is measured by q-value, which is defined as the ratio of market value of the firm to the book value of total assets, where the market value of the firm is measured by the sum of the market value of equity and the book value of total liabilities. Natural log of the q-value has been applied as the dependent variable.

The q-value measure is an approximation of Tobin's Q Chung and Pruitt (1994); Perfect and Wiles (1994). This measure has been used extensively in similar studies by, for example, Morck et al., (1988), McConnell and Servaes, (1990), Yermack (1996), McConaughy et al., (1998), and others. To estimate Tobin's Q, the replacement cost of total assets and the market value of total debt are approximated by their book values Mishra et al., (2001). According to Perfect and Wiles, (1994) measure of Tobin's Q has a 93 per cent correlation with the estimate using the Lindenberg and Ross, (1981) algorithm. Cronqvist and Nilsson, (1999) also used this approximation of q-value to examine the structure of corporate ownership in US. Following multiple regression model has been used in the study:

$$Q\text{-VALUE} = a + (\beta_1 \text{FAMILYCONTROL}) + (\beta_2 \text{INCOMEGR}) + (\beta_3 \text{FIRMSIZE}) + (\beta_4 \text{FINLEV}) + (\beta_5 \text{FIRMAGE}) + (\beta_6 \text{ROA}) + (\beta_7 \text{ASSETTANG}) + (\beta_8 \text{BRDSIZE}) + (\beta_9 \text{BRDIND}) + (\beta_{10} \text{BRDOWNSP}) + (\beta_{11} \text{CEOTEN}) + \varepsilon_i \quad (1)$$

In each regression, three sets of variables: (1) six firm characteristics: firm size, interest/premium growth, financial leverage, return on assets, asset tangibility, and firm age; (2) four corporate governance characteristics: board size, board independence, board stock ownership, and CEO tenure have been controlled for. The relation between firm value and family control under three corporate governance conditions has been tested.

6.0 Empirical Analysis

Table 1 reports the descriptive statistics of variables used in the study and the t-statistics (two-tailed) that test the mean differences of these variables between family controlled firms and non-family controlled firms. The firm value is found, as measured by the December 31, 2012 log q-value, slightly higher for non family controlled firms. This output is completely opposite to the statistics Mishra et al. (2001) found in their research for Norwegian financial market. All variables are significantly different between FC and NFC firms in case of Bangladesh financial industry. Non-family controlled firms use lower debt level, which is not consistent with the findings of Mishra and McConaughy, (1999). Assets tangibility was significantly different for founding family controlled firms versus non-family controlled firms. All corporate governance variables reveal significant differences between FC and NFC firms. Board size is smaller in the case of FC firms. Board stock ownership is higher but the CEO tenure is shorter in FC firms.

In examining the correlation matrix in Table 2, firm value has 2.6 per cent negative correlation with the family control composite variable which is inconsistent with the findings of Mishra et al. (2001). Firm value is significantly positively correlated to asset tangibility.

Table1. Descriptive Statistics of Bangladesh Financial Sector's Family Controlled Firms (FCFs) and Non-Family Controlled Firms (Non-FCFs)¹

Variable	Operating Definition	N	Mean	Std Dev	FFCs (N=30) Mean	NFFCs (N=55) Mean	t-Statistics	Mean Differences
Qvalue	Firm Value: Log of Q-Value	85	1.525	1.416	1.474	1.551	9.928***	1.525
Familyownership	Family Ownership	85	0.024	0.057	0.069	0.000	3.981***	0.024
Incomegr	Interest Income Growth: Last 3 years sales growth	85	0.249	0.271	0.344	0.197	8.477***	0.249
Firmsize	Firm Size: Log of Interest Income	85	9.196	0.767	9.354	9.109	110.570***	9.196
Finlev	Financial Leverage: Total Liability/Total Asset	85	0.624	0.324	0.694	0.586	17.768***	0.624
Firmage	Years of founding	85	18.588	7.155	16.6	19.67	23.951***	18.588
Roa	Return on Asset: Net Income/Total Asset	85	0.050	0.062	0.043	0.052	7.420***	0.050
Assttang	Asset Tangibility : Net PPE/Total Asset	85	0.073	0.098	0.056	0.082	6.875***	0.073
Brdsize	Board Size: # of Directors	85	13.271	3.630	13	14	33.706***	13.271
Brdind	Board Independence: % of Independent Directors	85	0.144	0.088	0.143	0.143	15.014***	0.144
Brdownsp	Board Stock Ownership	85	0.298	0.162	0.313	0.290	17.013***	0.298
Ceoten	CEO Tenure	85	4.279	4.377	3.876	4.498	9.012***	4.279
Ffc	Founding Family Composite	85	0.353	0.481	n/a	n/a	6.768***	0.353
Familydirector	Founding Family Director	85	0.055	0.103	0.156	0.00	4.937***	0.055

¹***Significant at 1% level (two-tailed). **Significant at 5% level (two-tailed). *Significant at 10% level (two-tailed). The full sample is divided into FFCs and non-FFCs using the variable, founding family composite (FFC). Numbers are presented up to two decimal points.

The FC variables are highly correlated with each other. Family control is also negatively correlated with board size and board independence. Yermack, (1996) mentioned about a negative 26 per cent correlation between board size and founding family control in his US sample of firms, which is closer to a negative 14.4 per cent correlation in the case of Bangladesh financial sector. Board size is, however, highly, significantly and negatively correlated with financial leverage, and board independence (34 and 38.5 per cent), and significantly positively correlated with the asset tangibility, and board stock ownership (30.2 and 39.7 per cent).

To further test financial industry performance, the regression equation 1 has been used. Three alternative measures of family control have been used, as defined earlier. In each regression, two sets of variables were controlled: (1) six firm characteristics: interest/premium income growth, firm size, financial leverage, firm age, return on assets, and asset tangibility; and (2) four corporate governance characteristics: board size, board independence, board stock ownership, and CEO tenure. Three models for each measure of founding family control have been reported in table 3.

Table 2: Correlation Matrix

Pearson Correlation Coefficient, N = 85 ²														
Prob > r under H ₀ : ρ= 0														
	Qvalue	Incomegr	Firm size	Finlev	Firmage	Roa	Assttang	Brdsize	Brdind	Brdownsp	Ceoten	Ffc	Family director	Family ownership
Qvalue	1													
Incomegr	0.03	1												
Firm size	-0.17	0.05	1											
Finlev	-0.14	0.18*	0.74***	1										
Firmage	-0.03	-0.09	0.23**	0.05	1									
Roa	0.05	-0.21**	-0.51***	-0.77***	-0.04	1								
Assttang	0.22**	-0.23**	-0.38***	-0.54***	0.17	0.28***	1							
Brdsize	0.02	-0.07	-0.04	-0.34***	0.05	0.20*	0.30***	1						
Brdind	-0.06	-0.04	-0.02	0.13	-0.09	-0.11	-0.18*	-0.38***	1					
Brdownsp	0.15	-0.15	-0.07	-0.09	-0.19*	0.04	0.18*	0.40***	-0.28***	1				
Ceoten	0.04	-0.07	-0.06	-0.26**	0.13	0.20*	0.22**	0.10	-0.04	0.14	1			
Ffc	-0.03	0.26**	0.15	0.16	-0.21**	-0.07	-0.13	-0.14	0.00	0.07	-0.07	1		
Family director	-0.07	0.06	0.12	0.03	-0.03	-0.02	0.02	-0.11	0.00	0.08	0.21**	0.73***	1	
Family ownership	-0.11	0.00	0.15	-0.02	0.03	0.00	0.06	-0.04	-0.04	0.10	0.24**	0.59***	0.84***	1

² ***Significant at 1% level (two-tailed). **Significant at 5% level (two-tailed). *Significant at 10% level (two-tailed).

In model 1, the six firm financial variables are included. In model 2, all ten control variables were included. Finally, in model 3, the financial leverage and asset tangibility variables were excluded, due to high correlation with board size. The regression coefficients were reported in Table 3. To detect heteroskedasticity with unknown form, White test without cross term has been applied to each model. However, it is found that the squared residuals are unrelated to the regressors and their quadratic and cross terms. As a result there is no heteroskedasticity. Each measure of family control (using model 1, 2 and 3), except model 1 using FC as family control variable, is negative but not significant, suggesting a negative as well as weak association between family control and firm value. Results indicate an insignificant valuation impact of family control. The family control

coefficients shown in Table 3 suggest that FC firms were valued slightly lower than NFC firms. For example, the regression coefficient of -0.068 from the family composite variable in model 2 implies that one standard deviation change in the family composite variable is associated with a -0.068 standard deviation change in the q-value. As one standard deviation of the log q-value is 1.416 and the standard deviation of the family composite variable is 0.481 (Table 1), the log q-value for the family controlled firms is lower by -0.20018 (1.416*-0.068/0.481). In Table 1, it can be observed that the q-value difference between FC and NFC firms is -0.077 (1.474 – 1.551) which can be considered as very low premium to NFCs. Financial Leverage is showing positive influence on firm value when corporate governance variables are not involved. This indicates that inefficiency in managing external funds with the presence of family control. On the other hand, firm age is negative both with the presence of corporate governance variables and not. This suggests that family control is effective at no stage of in the case of our financial sector.

Table 3: The Effect of Family Control on Firm Value

$Q\text{-VALUE} = a + (\beta_1 \text{ FAMILYCONTROL}) + (\beta_2 \text{ INCOMEGR}) + (\beta_3 \text{ FIRMSIZE}) + (\beta_4 \text{ FINLEV}) + (\beta_5 \text{ FIRMAGE}) + (\beta_6 \text{ ROA}) + (\beta_7 \text{ ASSETTANG}) + (\beta_8 \text{ BRDSIZE}) + (\beta_9 \text{ BRDIND}) + (\beta_{10} \text{ BRDOWNSP}) + (\beta_{11} \text{ CEOTEN}) + \varepsilon_i^3$										
	Expected Sign	Family Composite			Family Ownership			Family Directors		
Independent Variables		Model 1	Model 2	Model 3	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3
Family control	+	0.013 (0.353)	-0.068 (0.368)	-0.021 (0.366)	-2.696 (2.841)	-3.592 (3.004)	-2.890 (2.947)	-0.838 (1.540)	-1.285 (1.639)	-0.993 (1.622)
Incomegr	+	0.038 (0.627)	0.180 (0.658)	-0.026 (0.642)	0.066 (0.603)	0.190 (0.626)	-0.018 (0.614)	0.072 (0.607)	0.199 (0.632)	-0.004 (0.618)
Firmsize	-	-0.264 (0.323)	-0.175 (0.366)	-0.375 (0.257)	-0.184 (0.329)	-0.068 (0.369)	-0.334 (0.252)	-0.231 (0.325)	-0.127 (0.365)	-0.354 (0.252)
Finlev	-	0.015 (1.084)	-0.187 (1.224)		0.004 (1.086)	-0.442 (1.231)		0.115 (1.081)	-0.292 (1.227)	
Firmage	-	-0.006 (0.024)	-0.001 (0.025)	0.009 (0.025)	-0.007 (0.023)	-0.001 (0.025)	0.008 (0.024)	-0.007 (0.024)	-0.002 (0.025)	0.008 (0.024)
Roa	+	-1.296 (4.171)	-1.465 (4.274)	-1.298 (3.266)	-1.419 (4.120)	-1.838 (4.218)	-1.104 (3.220)	-1.274 (4.133)	-1.617 (4.235)	-1.197 (3.232)
Assettang	-	2.966 (2.032)	2.728 (2.118)		3.092 (2.018)	2.825 (2.094)		3.046 (2.027)	2.798 (2.106)	
Brdsiz	-		-0.044 (0.058)	-0.024 (0.052)		-0.055 (0.058)	-0.029 (0.051)		-0.052 (0.058)	-0.028 (0.052)
Brdind	-		-0.500 (2.018)	-0.744 (2.010)		-0.542 (1.999)	-0.799 (1.998)		-0.509 (2.009)	-0.763 (2.005)
Brdownsp	-		1.305 (1.188)	1.334 (1.169)		1.455 (1.173)	1.444 (1.154)		1.394 (1.179)	1.408 (1.160)
Ceoten	-		-0.006 (0.040)	0.004 (0.038)		0.003 (0.040)	0.013 (0.039)		0.000 (0.040)	0.009 (0.039)
BPG Test ⁴ = N*R ²		13.128	24.565	15.81	17.000	27.795	18.36	17.255	24.990	15.895
Sample Size		85	85	85	85	85	85	85	85	85
F Value		0.743	0.592	0.499	0.880	0.730	0.612	0.788	0.649	0.543
R-Square		0.063	0.082	0.057	0.074	0.099	0.068	0.067	0.089	0.061
Adjusted R-Square		-0.022	-0.056	-0.057	-0.010	-0.037	-0.043	-0.018	-0.048	-0.051

³ ***Significant at 1% level (two-tailed). **Significant at 5% level (two-tailed). *Significant at 10% level (two-tailed). The dependent variable is log q-value measured Dec. 31, 2011. Standardized regression coefficients are reported. The coefficients for the intercept are not reported. In parentheses t-statistics probability of the parameters are reported.

⁴ For BPG test at 95% confidence level and df= 14, 18 and 22 Chi Square values are 23.69, 28.87 and 33.92 respectively.

In all three regression models, firm size has a negative impact on firm value, consistent but not significant with the argument that smaller firms have higher q-values. The effect of asset tangibility on firm value is positive for all models, implying that firms with a substantial proportion of their assets in property, plant and equipment have higher q-values.

In addition, the board independence variable is negative, suggesting that firms with higher board independence have lower q-values, consistent as previously reported by Mishra et al., (2001), Agarwal and Knoeber, (1996) and Subrahmanyam et al., (1997). The board size variable is negative in all regression models, suggesting that firms with larger boards have lower q-values, which is also consistent with Mishra et al., (2001) and Yermack, (1996). In the case of Bangladesh financial industry family influence is offset by healthy corporate governance mechanisms. CEO tenure is found to be positive in most of the cases implies that increase in CEO tenure is associated with good firm performance. It is expected that more direct CEO influence should alleviate the need for outside corporate governance monitoring in FC. The explanatory powers of the variables are found very weak as well as not significant to validate model indicated by the F-statistics. Accordingly, this finding indicates the limitation of data as well as requirement for other influential factor that exclusively influence the Bangladesh financial industry in compare to Norwegian non-financial industry.

7.0 Summary and Conclusion

This paper evaluates 85 financial companies in Bangladesh financial industry among which 30 are FCs and 55 are NFCs. An attempt has been made to compare the output with empirical findings especially with non-financial Norwegian industry. The objective of the study was to find out (1) does family control of a public company make financial sense for different industry, and (2) do family businesses have a governance advantage over those that are not? Firstly, a negative relationship was found between family control and firm value for Bangladesh financial industry, not similar with Mishra et al., (2001), and McConaughy, et al., (1998). This implies that FCs have no advantage to improve the firm's performance in compare to NFC firms in Bangladesh financial industry. Secondly, family control is found to be valuable for the newly established companies as the decrease in firms age increases the firm value which is consistent with McConaughy, et al., (1998) and Mishra et al., (2001). This indicates a better and efficient management and corporate governance practice by the younger owners. Thirdly, the study reveals a weak firm performance with larger boards. This finding is consistent with Mishra et al., (2001) and Yermack, (1996). However, even though larger boards offer more efficiency as these ensure distributed control and more accountability, but in case of financial companies in Bangladesh smaller boards can help the CEO to take quick decision and offer more flexibility. Fourthly, the study explores that the outside or independent directors representation do not improve corporate governance in family controlled firms in Bangladesh financial industry also consistent with Mishra et al., (2001). However, this result also indicates the lack of family values, commitment and possibility for wealth

expropriation and nepotism which may not be controlled by independent and fair board monitoring. Accordingly, higher board independence not necessarily ensures efficient corporate governance practice in Bangladesh Financial Industry. Finally, this study finds positive but weaker relation between firm value and board stock ownership in Bangladesh Financial industry. This indicates that when controls are concentrated with few peoples in board, then management can act on behalf of the shareholders. This practice influences them not to act only for own interest which thereby increases the firm performance. The results found in this study are different in some context from the non-financial Norwegian firms. This is acceptable as the corporate governance regulation and practices are different from country to country. Even they can be different for different industry.

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