CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF FAMILY BUSINESSES LISTED IN THE SECURITY EXCHANGE OF THAILAND

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Abstract

The objective of this research is to examine the corporate governance and its relationship to the financial performance of family businesses listed in the Security Exchange of Thailand (SET) during 2008-2015 by contrasting between the family business (FB) group with the non-family business (NFB) group. The corporate governance of the FB group is found to be not different from the NFB group at statistically significant level of .05 and for the FB group, the score for corporate governance is correlated with the market capitalization, the net profit margin, the gross profit margin, the return on asset and the return on equity of the group at statistically significant level of .05,; while it is not correlated with the earning per share at the same statistically significant level.

Keywords: Family Business, Corporate Governance, Financial Performance

1. Introduction

Family business is one of the oldest forms of business organization, and still could be found widely today, contributing to the world economy significantly. Currently, family business enterprises account for two thirds of the enterprises worldwide, generating revenue of over 70% of annual world GDP (KPMG Enterprise, 2015). They could be considered the backbone of the world economy because they are evidently influential both in the developed and the developing countries. However, family business enterprises are facing many challenges not only the decision making on business operation and investment, but also on ownership and family relations as well. Most of them would not survive for more than one generation, only one third have been successful in the succession of business from one generation to the next (Deloitte, 2016). They are most vulnerable during the succession process because of the potential conflicts such as the intention to maintain and honor the traditional practices being contradictory to the effort to adapt and make progress in response to the changing business environment. Thus they are in need of an appropriate management system one of the approaches would be good corporate governance. Several studies have pointed out that good corporate governance is essential for long-term survival of family business enterprises through the safeguarding of the interest of shareholders and stakeholders. The implementation of good corporate governance is another challenge for family business enterprises. It could enhance operational efficiency and safeguarding the long-term interest of shareholders, and improve the well-being and welfare of family members consequently maintaining family unity as well. It can be concluded that good corporate governance is basically essential for successful family business enterprises wanting to protect their assets and transfer to their heirs in the future, because good corporate governance is the formulated internal working framework covering the roles, policy, process, and control guidelines for decision making to be implemented.

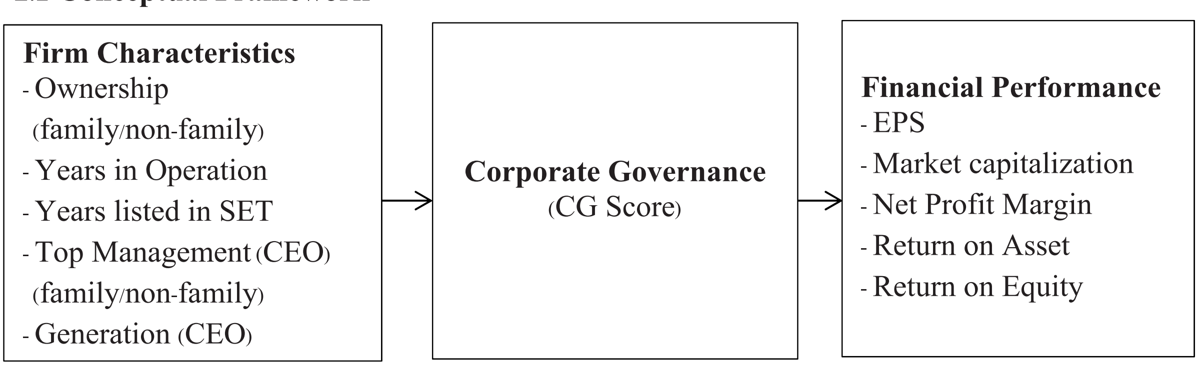
Family business enterprises pay greater attention to corporate governance currently than during the past 10 years (PwC, 2015). Although, the family business enterprises may have good framework for corporate governance but the new generation heirs might see the need for more organized procedures of corporate governance (Deloitte, 2016). Therefore, those enterprises aiming for improved performance and survival in the global market with increased competitiveness, profitability, being attractive to investors, and reaching more customers, would have to apply the principles and standards of good corporate governance to their strategy and decision making process (Todorovic̆, 2013). Consequently, family business enterprises should study and understand good corporate governance practices to enable them to make decision on what are best for their operation in facing the existing challenges of the organizations efficiently.

The author is thus interested in examining the corporate governance practices and their relationship to the financial performance of business firms listed in the Security Exchange of Thailand (SET). Listed companies are in the position to recognize the importance of good corporate governance because they are owned by many shareholders who could not all participate in the management. They have to vote for trusted persons as directors to supervise the management. To foster the trust and confidence in the successive empowering of authority, there is a need for good corporate governance procedures. This study would examine the family business firms in comparison with non-family business firms. The criteria for being a family business firm would be those used by the Family Business Study Center, University of the Thai Chamber of Commerce. The parameters representing financial performance to be investigated include Market Capitalization, EPS, Gross Profit Margin, Net Profit Margin, Return on Asset and Return on Equity. These are tested for relationship with the level of corporate governance of listed companies.

2. Conceptual Framework and Research Hypotheses

With the objective of investigating the level of corporate governance of listed companies in the SET and its relationship with their financial performance, the relevant conceptual framework and research hypotheses are shown below:

2.1 Conceptual Framework



2.2 Research Hypotheses: (FB/NFB comparison)

H1: Years in operation is correlated with CG Score

H2: Years listed in the SET is correlated with CG Score

H3: Listed firms with family-member CEO exhibit different CG Score than those with non-family-member CEO.

H4: Generation of family-member CEO of listed firms is correlated with CG Score.

H5: Firms in different industrial sectors exhibit different CG Scores.

H6: CG Score of listed family firms is different from that of non-family listed firms.

H7: CG Score of listed firms is correlated with their financial performance.

H7.1: CG Score of listed firms is correlated with EPS.

H7.2: CG Score of listed firms is correlated with Gross Profit Margin.

H7.3: CG Score of listed firms is correlated with Net Profit Margin.

H7.4: CG Score of listed firms is correlated with Return on Asset (ROA).

H7.5: CG Score of listed firms is correlated with Return on Equity (ROE).

H7.6: CG Score of listed firms is correlated with Market Capitalization.

3. Research Method

3.1 Research Sample

The sample set used for this study is the set of 413 firms listed in the SET for 5 or more years (back to the year 2008) satisfying the given criteria fully and with complete data, breaking down to 202 family firms and 211 non-family firms. One of the criteria for selecting the securities is the exclusion of Mutual Funds, rehabilitating firms, potentially delisted firms, and firms under suspension (SP). The criterion for being family firms is being controlled by one family in accordance with the definition given by Family Business Study Center, the University of the Thai Chamber of Commerce as: "Family business must:

3.1.1 be owned by the founding family,

3.1.2 have at least one family member being one of the top 5 directors, and

3.1.3 have strategic shareholders or major shareholders being members of the family (all combined).

Note: Strategic shareholder according to the Security Exchange Commission (SEC) refers to shareholder having "management control" defined as (1) Holding more than 50 percent of shares with voting rights in the legal entity, (2) Having control of the majority of votes at the General Meeting of shareholders directly or indirectly for whatever reasons, (3) Having authority to appoint of remove half or more of the directors directly or indirectly.

3.2 Research Instruments

The instruments for this study are 1) corporate governance (CG) scores of listed firms as reported in the corporate Governance Report of Thai Listed Companies (CGR) published by the Thai Institute of Directors Association: IOD) compiled with the support of the Security Exchange of Thailand and the Office of the Security Exchange Commission from data surveyed during 2008-2015 (IOD, 2016), 2) financial performance measures being relevant financial ratios to represent the operational efficiency of the management from SETSMART database of SET (as of 30 May 2016) consisting of parameters being: Market Capitalization, Net Profit Margin, Gross Profit Margin, Return on Asset, Return on Equity, and Earning per Share (EPS).

4. Summary of Results and Discussion

4.1 Summary of Results

Part 1: General Information

Of the sample set of 413 firms, there are 211 firms being non-family firms (NFB) accounting for 51.10 percent, and 202 family firms (FB) accounting for 48.90 percent. For the FB the minimum years in operation is 7 with the maximum of 83 and the mean of 35.08; for the NFB the minimum years in operation is 11 with the maximum of 140 and the mean of 38.26. With respect to the years listed in the SET, the minimum, maximum and mean of the FB are 5, 41, and 20.73 respectively; and those of NFB are 6, 41, and 21.51 respectively.

Part 2: Corporate Governance of Firms Listed in the SET

1) Corporate Governance of Family Business Firms Listed in the SET

Calculating the Pearson product moment correlation coefficients to test the correlation of the CG Score and Years in Operation for the FB group the results (Table 1) found no correlation at statistically significant level of 0.5.

Table 1: Correlation of CG Scores and Years in Operation for the FB group listed in the SET

Variables	**n**	**r**	**p**
CG Score – Years in Operation	202	0.124	0.08

Note: statistically significant level of .05

Calculating the Pearson product moment correlation coefficients to test the correlation of the CG Score and Years Listed in SET for the FB group the results (Table 2) found positive correlation at statistically significant level of 0.5

Table 2: Correlation of CG Scores and Years Listed in SET for the FB group listed in the SET

Variables	**n**	**r**	**p**
CG Score – Years Listed in SET	202	0.181	.010*

Note: * = statistically significant level of .05

To test whether listed firms with Family-Member CEO exhibit different CG Score than those with Non-Family Member CEO, independent sample t-test was performed for the data and the results (Table 3) show that the difference in CG Score is confirmed at statistically significant level of .05.

Table 3: Comparison of CG Scores between the Family Member CEO firms and Non-Family Member CEO firms

Variable	$\bar{x}$	SD	df	t	p
Family Member CEO -	19.78	10.931	200	-1.79	0.075
Non-Family Member CEO	22.72	11.733			

Note: statistically significant level of .05

To test the correlation between the CG Score with the Generation of CEO, the Spearman rank correlation coefficient calculated from the data (Table 4) confirms positive correlation at statistically significant level of 0.5 indicating further generation CEO firm to get higher CG Score.

Table 4: Correlation of CG Scores and Generation of CEO for the FB group listed in the SET

Variables	n	r	p
CG Score – Generation of CEO	202	0.294	.001*

Note: * = statistically significant level of .05

To test whether FB firms in different industrial sectors exhibit different CG Scores, the data were analysed by One-Way ANOVA (Table 5) showing no significant differences at statistically significant level of .05.

Table 5: Differences in CG Scores of FB Firms in Different Industrial Sectors.

Variables	n	df	F	p
CG Score – Industrial Sector	202	7	1.838	0.082

Note: statistically significant level of .05

2) Corporate Governance of Non-Family Business Firms Listed in the SET

Calculating the Pearson product moment correlation coefficients to test the correlation of the CG Score and Years in Operation for the NFB group the results (Table 6) found no correlation at statistically significant level of 0.5.

Table 6: Correlation of CG Scores and Years in Operation for the NFB group listed in the SET

Variables	n	r	p
CG Score – Years in Operation	211	-0.001	0.99

Note: statistically significant level of .05

Employing the Pearson product moment correlation coefficients to test the correlation of the CG Score and Years Listed in SET for the NFB group the results (Table 7) found no correlation at statistically significant level of 0.5.

Table 7: Correlation of CG Scores and Years Listed in SET for the NFB group listed in the SET

Variables	n	r	p
CG Score – Years Listed in SET	211	-0.005	0.944

Note: statistically significant level of .05

To test whether NFB firms in different industrial sectors exhibit different CG Scores, the data were analyzed by One-Way ANOVA (Table 8) showing differences at statistically significant level of .05. indicating at least one pair of difference in the CG Score.

Table 8: Differences in CG Scores of NFB Firms in Different Industrial Sectors.

Variables	n	df	F	p
CG Score – Industrial Sector	211	7	6.382	0

Note: * = statistically significant level of .05

3) CG Scores of Listed Firms in the SET: Comparing FB Firms with NFB Firms

Independent sample t-test was performed on the data (Table 9) to test the differences in CG Scores of the FB firms compared to those of NFB firms, the results point to no difference at statistically significant level of .05

Table 9: Differences in CG Scores of FB Firms compared to NFB Firms

Comparison	n	$\bar{x}$	SD	df	t	p
FB Firms -	202	20.86	11.291	411	0.325	0.745
NFB Firms	211	20.48	12.269			

Note: * = statistically significant level of .05

Part 3: Correlations between CG Scores and Financial Performance of Firms Listed in the SET

Examining the correlation between CG Scores and the financial performance of FB firms listed in the SET, the Pearson product moment correlation coefficients (Table 10) calculated indicate positive correlation for Market Capitalization, EPS, Gross Profit Margin, Return on Asset, and Return on Equity at statistically significant level of .05 but no significant correlation for Net Profit Margin at the same statistically significant level of .05.

Table 10: Correlation between CG Scores and the Financial Performance of FB Firms Listed in the SET

Variables	n	r	p
CG Score			
Market Capitalization	202	0.28	.000*
Earning per Share (EPS)	202	0.193	.006*
Gross Profit Margin	186	0.171	.020*
Net Profit Margin	202	0.061	0.387
Return on Asset	202	0.194	.006*
Return on Equity	202	0.166	.018*

Note: * = statistically significant level of .05

As to the correlation between CG Scores and the financial performance of NFB firms listed in the SET, the Pearson product moment correlation coefficients (Table 11) calculated indicate positive correlation for Market Capitalization, Gross Profit Margin, Net Profit Margin, Return on Asset, and Return on Equity at statistically significant level of .05 but no significant correlation for Earning per Share (EPS) at the same statistically significant level of .05.

Table 11: Correlation between CG Scores and the Financial Performance of NFB Firms Listed in the SET

Variables	n	r	p
CG Score			
Market Capitalization	211	0.353	.000*
Earning per Share (EPS)	211	0.019	0.784
Gross Profit Margin	180	0.265	.000*
Net Profit Margin	211	0.277	.000*
Return on Asset	211	0.409	.000*
Return on Equity	211	0.289	.000*

Note: * = statistically significant level of .05

4.2 Discussion

Section 1: Corporate Governance of Firms Listed in the SET

1. For the correlation of corporate governance and years in operation, the CG Score is not significantly correlated with the Years of Operation for both the FB group and the NFB group. This could be that upon being listed in the SET both groups have to observe the corporate governance guidelines of the SET regardless of the number of years they have been in operation. In the case of FB firms in ASEAN, it is found that the cultures of the family and the business could not be separated, they are likely to be shared back and forth. The family culture and values are often relies upon in the implementation of good corporate governance or taken as strong point in corporate governance. For Asian families, family business has been a source of pride for the family and good corporate governance would promote the dedication of the family business to operate consistently and sustainably. Corporate governance is achieved through the dedicated actions of the family members, the executive committee, shareholders and executives of the family firms. The owning families in ASEAN mostly express their strong desire to have formal mechanism for corporate governance of the business and the family (BFI@SMU and Deloitte Southeast Asia, 2015). Currently, family business firms pay greater interest in corporate governance during the past 10 years according to the survey of PwC conducted in 2013 pointing out that most business firms have executive committees representing the owners in overseeing and running of the business (PwC, 2015). It is found that 88% of the family business firms confirmed that they have certain corporate governance mechanism in their organizations (European Family Businesses (EFB) and KPMG. 2015). However, due to the specific circumstances of each family firm, the firm thus

has to undertake a comprehensive examination of the corporate governance practices in order to select the appropriate practices to be adopted to meet the facing challenges efficiently (PwC, 2015). This could be extended to those non-family firms as well.

2. With reference to the positive correlation between the CG Score and the Years listed in SET for the FB group while no significant correlation for the NFB group, a possible explanation is that most of the FB firms were originally not run professionally in their corporate governance and become gradually more experience in this regard upon being listed. They also aimed at business growth through being more professional in their internal organization management. The business firms especially those still in the 1st or 2nd generation during which the founders are still active, would take up logical business procedures and processes, focusing more on human resource management and less on strategy and business planning. They have the attitude of doing things on their own, but with the expansion of the business the transformation to professional management was inevitable when growth was the very top priorities of the firms. Therefore, family firms would be readily improving their corporate governance mechanism by providing education to family members and hiring professionals from outside. It is reported that 85% of family business firms confirmed that the existence of corporate governance mechanism and process would be related to the important factors driving the success of family business; they also recognized the importance of corporate governance (European Family Businesses (EFB) and KPMG, 2015).

For family firms, the existence of corporate governance committee and Family Council would foster the balance when the business expands (Moore and Juenemann, 2008). In addition the consultant of the family firm could assist in the decision making on the form of corporate governance appropriate to the current situation and the future requirements of the firm. The consultant could also advise on the appropriate composition of the board of directors and the approaches for making the board meeting highly valuable (KPMG Enterprise, 2015) in order to attain higher CG Score in successive years.

3. Although the finding indicates no statistically significant difference between the CG Score of FB firms with family member CEO and that with non-family member CEO, the actual CG Score of the former tends to be higher than that of the latter. A global study found that the non-family executives could make the business grow faster, foster innovation, expand internationally, and diversify the business more readily. Doing business professionally was also considered of top priority more often than family executive who would focus more on the family, the community and give priority to the establishment of legend in the world. Family firms might achieve low financial performance or lack the ambition to expand if they were run by family members (PwC, 2014) Recently, a study in Germany (PwC Deutschland, 2014) found that firms hiring non-family members in top executive positions would drive the business growth more rapidly. The professional business management is not sufficient for the long-term survival of the business, the important thing to realize is that professional management needs to be in both the business and the family.

However, the improper transfer of business for one generation to the next which is the most important stage of the life cycle of family business could impact negatively on the business. In addition, it could be the cause of family conflicts arising from the complexity of the succession process and various factors such as relying too much on the owner and the owner-executive not willing to relinquish control, etc., even with some study pointing out that family succession could have negative impact on the business if the successor is not a family member (Credit Suisse, 2012) Because the founder/CEO and company board are aware of the strengths, weaknesses, and success of the appointed family executives, and these executives know the firm, the industry sector and the company culture very well with well known information of the customers and the employees as well as being well associated and trusted by the family, they are more valuable and preferable. However, if the firm could not find competent family members or they are not ready to take the CEO position, the alternative is to select non-family member from outside (PwC, 2015) For certain family firms, the use of non-family member CEO is considered normal practice. The succession plan or the CEO recruitment is the same process for business firms of non-family type. The family may need periodical challenge in deciding whether to hire non-family member CEO, especially when there are family members who are capable of taking the job (PwC, 2015). However, several firms express the opinion that it would be more equitable if the successor is not related to the business (Bennedson, M. et al., 2014; Wang, Y. et al., 2004). This is consistent with the study on the importance of hiring executive and/or consultants of non-family members undertaken by Deloitte Southeast Asia (2013) pointing out that non-family member consultants are valuable to the development and coaching of the new generation of successor in assuming important position in the firm. This is indicative that the family recognizes the benefit of having non-family member executive in leveraging the needs of the business and those of the family and in making necessary changes for the growth of the family business. In addition the study also confirms the linkage between the hiring of non-family member executives with the competitiveness of firms because of the introduction of new dynamic and skills necessary for the success of firms into the organization enable the firms to be managed professionally (European Family Businesses (EFB) and KMPG, 2015).

4. On the positive correlation (statistically significant level of .05) between the CG Score of FB firms and the generation of CEO, indicating that higher generation CEO firms would have higher CG Scores, the finding could be the consequence of careful selection of successors being critical to the survival and sustainability of the firms. Especially for ASEAN family firms at the point of succession of CEO, the training and development of the new generation heir would be very important (Deloitte Southeast Asia, 2013). Regarding succession, family business represents the values of the family as formulated by the founder and would be passed on to the successive generations. These values would become of greater importance over time when the family grows larger and the business expands. The common values of the family would be essential in binding the members of the family. It may be concluded that the maintenance of ownership and control of family business within the family could be the goals of the owners (Deloitte, 2016).

5. Regarding finding of no significant difference of CG Score among the different industrial sectors for the FB group but significance (at statistically significant level of .05) for the NFB group, it could be from the fact that the FB firms are highly aware of the importance of corporate governance in the long-run survival of the business and the safeguard of shareholders' interests as well as those of stakeholders. Thus corporate governance is another major challenge facing family business firms. Good corporate governance would enhance the

operational efficiency and safeguarding the long-term interest of shareholders, and improve the well-being and welfare of family members consequently maintaining family unity as well. It could foster confidence of the investors, trade partners, and customers. It would also lead to the acceptance of employees making them feel committed to the organization in the long-run. The preparation of succession plan and security handling plan clearly, transparently, with open access to information for all parties would build up trust upon the successor to take over the business. The stakeholders would be confident and keep on supporting the business. The family business firms are advantageous with respect to: 1) They have financial liquidity, are efficient in asset management and debt servicing, and are capable of earning profit and growing; 2) They maintain unity within the family, are satisfied and committed to the business, have little conflicts or workplace disputes; and are satisfied with the performance of the business (Issaranukuldej and Suttarat, 2010). Therefore, FB firms with similar backgrounds even in different industries would not have taken much different corporate governance approaches. While the NFB firms run by professional in different industries could be effected by other factors for them to have different levels of corporate governance reflecting in the differences of their CG Scores.

6. On the difference of CG Scores between those of FB group and NFB group with no statistically significance at the level of .05, the likely cause might be that upon both groups being listed in the SET they would have to follow the same rules and regulations regarding corporate governance as they are under strict auditing of the SET. The adherence to the regulations is particularly true for the FB firms whose owners recognize very well that the success of their business is crucial for the security of themselves and the future of their next generation heirs. The non-family executives would also realize that the ability to earn profit and the flexibility of the firms would be essential for the survival of the operation and financial performance (PwC, 2016). The important point is that the family recognizes that the succession within the family would affect the security of the family, the firm and the employees and thus could motivate other family members to follow the steps in working for the firm. It is therefore necessary to lay good foundations and guidelines for the firm to be ready for the succession. The needs of the new generation to take over the business may be affected by several external factors such as the size of the firm and the success of the business, affecting the intention of succession for most of the new generation heirs. The proportion of the family heirs willing to take over the business is highest for the group with high financial performance and the proportion increases with the size of firm (Zellweger, Siege and Englisch, 2015). Therefore, the listed FB firms would attempt to be professional within the framework of good corporate governance no less than the NFB firms in order to maintain their competitiveness in the fiercely competitive market at present. This could be the reason for the finding of no significant difference between the two groups.

Section 2: Correlation between CG Scores and Financial Performance of Listed Firms

The findings of positive correlations between CG Scores and almost all six financial performance ratios except Net Profit Margin for the FB group and also positive correlations between the CG Score and almost all six financial performance ratios except Earning per Share (EPS) for the NFB group could be explained as follows:

Good corporate governance would foster confidence among investors making it more efficient in raising capital, more easy in forming business alliances; and with sufficient capital and business alliances, the competitiveness of the firm would improve nationally and globally. In particular, for the FB firms the formation of an executive committee formally in the family firms would significantly improve the performance of the business; and the efficient assessment of the practices of the executive committee would lead to better performance of the family firms compared to their competitors in general. According to the study by Brenes, Madrigal and Requena (2011), the executive directors of both family members and non-family members are valuable to the firms. The family members could contribute with knowledge, experience, family values and cultures, while the non-family members would contribute in terms of fairness and professional approach to business. In addition, the non-family members also facilitate the transparency and confidence in the operation of the firms especially among the non-family stakeholders.The study also concludes that the establishment of formal governance unit such as a professional executive committee or business council would improve the business performance of family firms and most importantly in many family firms the non-family directors have taken the conciliatory role in resolving conflict between business and family. This is supported by Wali-ul-Maroof Matin (2006) study of corporate governance of FB firms listed in the MAI of the SET finding positive correlation between corporate governance and business performance. Another study by Ibrahim, H. and Samad, F.A. (2011) on the relationship between corporate governance arrangement and business performance of firms listed in the Malaysian Security Exchange found that the ROE of FB firms are higher than those of NFB firms while the Tobin's Q and ROA of NFB firms are higher. In addition, the corporate governance arrangements such as the size of the board, independent directors, of both FB and NFB firms are found to influence significantly on the performance of firms.

This finding is also consistent with the study on the impact of corporate governance on business performance conducted by Todorović (2013), on a sample of firms listed in the Banja Luka Stock Exchange of the Republic of Srpska, examining the financial ratios of Net Profit Margin, Earning per Share, pointing out that corporate governance principles are correlated with the business performance. The firms with higher levels of corporate governance and following good corporate governance principles would have higher profitability and business performance. It is supported by the study of Ahmad, N. et al. (2014) on the impact of family business ownership on financial performance of 4 firms listed in the Karachi Stock Exchange of Pakistan. Two of the firms are in the manufacturing sector while the other two are in the financial sector. The financial performance is measured by ROA and ROE. The ownership of firms by families is positively correlated to good corporate governance by not only improving profit by also operational performance of the firms. In the same direction, the study of Phan, Butler and Lee (2005) on corporate governance and succession planning of family firms efficiently and effectively points out that good corporate governance correlated with operational effectiveness and efficiency of succession plan of family firms as evidenced by the fact that in the succession plan there would be the arrangement of properties or inherited assets and the agreement of shareholders of the family firms clearly. The forms of the corporate governance arrangement would depend on the size and sophistication of the business.

Although the correlations between CG Scores and the financial performance are not significant with respect to Net Profit Margin for the NFB group and Earning per Share (EPS) for the FB group, the general trends are found to be positively related. The finding may be affected by other variables. Corporate governance may not always be associated with good performance because the performance depends more on the management and other financial variables (Wali-ul-maroof Matin, 2006).

5. Recommendations for Further Research

The measurement of corporate governance practices of firms listed in the SET could be undertaken by several methods. The use of CG Score of the SET is just one, several other interesting and important variables include the various aspects of corporate governance, non-financial performance. Qualitative research could be employed in parallel to ensure greater validity and reliability.

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