Investigation of the Agency Costs in Family and Non-Family Firms Listed in Tehran Stock Exchange

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Abstract

The main purpose of this study is to assess and compare agency costs in family and non-family firms based on 4 different criteria of the ratio of operating expenses to sales; asset-turnover ratio, Tobin's Q ratio and the interaction between growth opportunities and free cash flow. Sample of the study consists of 31 family and 97 non-family firms during 10-year time period of 2004-2013. Using Test to compare two independent groups, family and non-family firms have been compared to each other and using linear regression model and panel data, the relationship of family ownership and agency cost of family firms has been evaluated. Obtained results from analysis of research hypotheses indicate that generally, there is significant difference only between family and non-family firms in terms of Tobin's Q ratio.

Keywords: family firms, agency costs, family ownership

Introduction

One of the most common problems with agency is encouraging agents to make decisions to maximize wealth of owners (stockholders). With the formation of agency relationship as a result of conflict of interests between parties, agency costs would be created (Norvash et al, 2009). According to theoretical literature of agency, adequate controlling methods should be considered to decrease conflicts of agency and to reduce its costs. Governance structure of organization is one of the basic factors of these controlling methods. One of the most important elements of governance structure is ownership structure of firm and its controlling group.

On the other hand, existential philosophy of theory of agency is that as number of stockholders (firm owners) is large and all of them can't participate in controlling and managing the firm, they select some individuals as manager and allocate authority to them. This can result in creation of agency. If some stockholders can buy major part of stock, they can have control on decisions. In this case, these individuals as owners of stock can select managers easily that are known to them and the managers would take step in way of their goals. Moreover, a mode can be imagined that several relatives purchase stock of a firm listed in Stock Exchange with the cooperation of each other and achieve considerable influence and control on firm through this.

Family firms have been defined as companies, at which family founders are members of board of directors and have preserved important ranks of senior management or are main stockholders of firm

(Chen et al, 2008). Generally, scholars have accepted interference of family in firm as a factor that results in difference among these firms (Miller and Rice, 1967). Majority of them interpret interference of family as ownership and management (Handler, 1989). Churchill and Hatten (1987) have added family succession to this interpretation. Hence, comprehensively, family firm is a firm, at which family member of founder maintain their position in senior management and have function in board of directors or are holders of large contribution of firm.

Family firms play key role in modern economy, similar to other firms, and they can be found in any level of advancement of technology and organizational structure. Family ownership is common for small and medium firms; although it can be existed in large firms too. Many firms across the world are being managed by family owners. Moreover, family firms form considerable percent of listed firms in Tehran Stock Exchange. For instance, more than 80% of firms of North America and 35% of Fortune 500 firms are under family management (Wang, 2006).

Existence of conflict of advantages can result in concern of owners (stockholders) to an extent that they take action to have supervision on activities of managers to ensure of optimal resource allocation by managers. Over the time, it has been cleared that some decisions of managers may cause waste of resources of firm and destruction of wealth of owners. On the other hand, managers have sought to maximize their interests and ensure owners that the decisions made by them are in benefit of owners (Namazi, 2005). Same issues can result in costs called as agency costs. Sometimes, it is claimed that family firms are the only attractive field in economy, since the conflict between owners and managers and agency costs resulted from it can be maximized because of participation of family in both management and ownership of firm (Chrisman et al, 2007). According to Chrisman et al (2004), family firms have the potential to improve financial performance of company or decline it through the agency costs.

Compared to other stockholders, family owners are usually more active in management of firm than others through maintenance of some managerial positions for themselves. Hence, they have more access to information of firm and can have better supervision and control on it compared to others. As a result, agency problems between management and stockholders (Chen et al, 2008). Moreover, family members may be responsible for management of firm absolutely as owner of a part or whole stock of firm. Therefore, these individuals are both owner and agent. Till the time that firm is considered from this perspective, no problem would be emerged in owner-agent relationships; although it should be noted that in addition to family members, other people are also stockholders of firm who have no position in managerial positions (Namazi and Mohammadi, 2010). Therefore, it is possible for family members of board of directors to act against other stockholders and enhance their wealth through this (Jensen, 1983).

The issue of agency and some problems with it in family firms is different from other firms to some extent. In family firms, due to ownership of large contribution of stock and presence of family members in board of directors and other managerial ranks and presence of other stockholders in firm with lower contribution, the question should be presented that are relevant features of family firms different from non-family firms? According to the mentioned issues and potential differences of family firm with other firms in terms of agency theory, it seems that evaluation and recognition of different dimensions of family firms in Iran can be helpful for stockholders, investors, creditors and others in process of decision making. Hence, the present study is aimed in evaluating and comparing agency costs in family and non-family firms to test available hypotheses in this field empirically.

Literature Review

Family firms have been defined as companies, at which family founders are members of board of directors and have preserved important ranks of senior management or are main stockholders of firm (Chen et al, 2008). Compared to other stockholders, family owners are usually more active in management of firm than others through maintenance of some managerial positions for themselves.

Hence, they have more access to information of firm and can have better supervision and control on it compared to others. As a result, agency problems between management and stockholders (Chen et al, 2008). Moreover, family members may be responsible for management of firm absolutely as owner of a part or whole stock of firm. Therefore, these individuals are both owner and agent. Hence, family members can act against benefit of other stockholders and enhance their wealth through this (Fama and Jensen, 1983).

Anderson et al (2003) have studied effect of family ownership structure on debt's agency cost. In this study, it has been cleared that family firms tolerate lower financing costs than others. The result is in consistence with the idea that family firms have motivation to decrease agency problems between owners and creditors of firm. Wu et al (2007) have adopted a study to investigate relationship between agency theory in family firms and finance of these firms. Obtained results from the study indicated that participation of family in management of company can have significant effect on finance of small size firms. However, the impact is reverse. It means that participation of family in controlling management and ownership can result in reduction of financing through increase in investment and finance through liabilities. Chrisman et al (2004) have compared agency costs in family and non-family firms. Family firms have the potential to improve financial performance or decline it through agency costs. In this study, they have discussed on nature of agency costs in family firms and have also determined required conditions to determine relevant levels of agency costs in family firms through effect of controlling mechanisms of agency costs on performance. Moreover, according to obtained results from study of 1141 family and non-family firms in the U.S, it seems that issue of agency in family firms is generally problematic less than non-family firms. Chrisman et al (2007) have adopted a study to specify that family managers in family firms are agent or steward. In view of scholars who are active in field of family firms, family managers in family firms can be divided to two groups of agent or supervisor. If family managers act as an agent, it is expected that family firm impose agency cost on them and this can result in improvement of performance of firm. Obtained results from studying a sample of small family firms indicated that family managers are under support of family owners through incentives of rewarding. Because of gaining higher performance by family managers, one can guess existence of agency behavior among them and theory of improvement of firm performance can confirm agency costs through providing controlling mechanisms. Ampenberger et al (2012) have studied decisions of capital structure in family firms. They have found that presence of family members in managerial positions of firm has reverse effect on financial leverage. On the contrary, effect of ownership and membership in board of directors has not been too significant in applied models. Moreover, according to theory of agency, they found that if family founders who are owners of main part of stocks are motivated to control managerial positions, liability ratio reaches the lowest level. Abdolhamid et al (2015) have evaluated capital structure and profitability in family firms. Sample of this study consisted of 276 Malaysian firms during 2009-2011. Obtained results from their study indicated that liability ratio has reverse impact on profitability of family firms.

In Iran, Moghimi and Sayed Amiri (2010) have studied factors affecting development of family firms in Tehran in two textile and oil industries. Obtained results from this study showed that growth and development of family firms is balanced and in average level of society and such development is in positive and significant correlation with variables including owner's risk-taking, , willingness to innovate, management skills, the willingness of family members to join the business, the prospect of working in the family, political and legal environment, cultural environment and social and economic and technical environment. However, there is no significant correlation between family governance and control and development of family businesses in these two industries. Namazi and Mohammadi (2010) have adopted a study to compare quality of profits and stock returns of family and non-family firms listed in Tehran Stock Exchange. Obtained results from the study indicated that there is no significant correlation between earning quality in family and non-family firms. Moreover, through investigation of earning quality in family firms and study of its relationship with family ownership percent, it was found that there is positive and significant correlation between family ownership percent and earning quality. Moreover, family and non-family firms have been evaluated in terms of

stock return and obtained results indicated that their stock returns are not significantly different from each other.

Methodology

The present study is in kind of quasi-empirical and post-event studies and in terms of purpose; the study is an applied research. Relevant information of theoretical literature is based on information of reliable specialized English and Persian journals and books. Quantitative data of the study are also collected through referring to financial statements of Tehran Stock Exchange firms, management processor software and other databanks of Tehran Stock Exchange. For purpose of data analysis in hypothesis 1, test to compare two independent groups is applied and to evaluate the relationship between family ownership and capital structure, regression mode and panel data methods are applied.

Research Hypotheses

According to literature and due to purpose of this study, main hypotheses of the study are present3ed as follows:
- Hypothesis 1: there is significant difference between agency costs of family and non-family firms listed in Tehran Stock Exchange.
- Hypothesis 2: there is significant correlation between family ownership and agency costs of family firms listed in Tehran Stock Exchange.

Statistical Population and Sample

Statistical population of the study consists of all listed firms in Tehran Stock Exchange. In order to enhance validity of the study and increase number of studied firms, the study has not used statistical sampling. Existing firms in statistical population have been studied that have following conditions:
1. In terms of increase in comparability, their fiscal period should be ended in March
2. They should have no change in fiscal year and pause of operations during 2004-2013
3. Selected firm should not be among financial and investment firms and banks
4. Their status in terms of family or non-family nature should be specified
5. All required information should be available.

Accordingly, 31 family firms and 97 non-family firms have been selected for purpose of statistical analysis. Time period of the study is 2004-2013.

Definition of Research Variables

Measurement Criterion of Family Firms

Family firms can be defined from different dimensions: 1) membership of family members in board of directors (or important managerial positions) 2) stock ownership percent by family members and 3) considerable control or influence of family in firm (Namazi and Mohammadi, 2010). Membership in board of directors and ownership percent of stock has been expressed in most of the definitions of family firm. There are different theories about stock ownership percent and ownership of minimum 5% and maximum more than 50% of stock by family members is mentioned as a condition. For example, Mishra et al (2001) have considered 3 criteria for family firms as follows: 1) CEO should be same founder of firm or dependent people to founder 2) at least 10% of ownership percent of stock should be in limit of authority of family members of founder and 3) at least, one family member should attend board of directors. Anderson and Reeb (2003) and Chen et al (2008) have considered definition of family firms on basis of ownership of a contribution of stock by family member or presence of family members in board of directors. Wang (2006) has defined family firms as firms that have at least one of the criteria of presence of family members in board of directors and senior management of firm or

ownership of firm stock by family members. In Iran, Namazi and Mohammadi (2010) have defined family firm as a firm that at least 20% of stock is in ownership of family members individually or in group or at least, one of the original or by marriage members of family is member of board of directors or executive manager with active presence in board of directors and at least, two generations of family should attend management of firm. In this study, definition of Namazi and Mohammadi (2010) is applied.

Criteria of Agency Cost

Dependent variable in this study is agency cost, selected according to criteria of Henry (2010), Norvash et al (2009) and Mahdavi and Monfared Maharlooyi (2010) as follows: efficiency ratios: including operation costs to sales ratio that is a criterion of extremism of management to take optional costs and the more it is, the more agency costs would be; and asset turnover ratio that is productivity by managers and a reverse criterion for agency costs. It means that the higher the ratio is the lower agency costs would be.

Growth opportunities: in this study, the index would be measured using Tobin's Q ratio. The higher the ratio is the lower agency costs would be. In this study, Tobin's Q is calculated through subtraction of total market value of stockholder equity in addition to total liabilities, dividing by total book value of assets. Hence, the equation would be as follows (Randoy and Goel, 2003):

$$Tobin's\ Q = \frac{MVE + TL}{TA}$$

Where;
Tobin's Q: Tobin's Q ratio
MVE: the market value of equity
TL: total liabilities
TA: total assets of firm.

The interaction between growth opportunities and free cash flow: the criterion is measured as follows: first, sample firms use median of Tobin's Q to be divided to two groups with high and low growth. Firms with high growth are scored by 0 and firms with low growth are scored by 1. Then, free cash flow is calculated for firms. Finally, through multiplying two mentioned factors, agency costs could be obtained. In this study, Lehn-Poulsen Model (1989) is applied to determine free cash flows of the business unit. According to the mentioned model, free cash flows can be estimated as follows (Lehn and Poulsen, 1989):

$$FCF_{i,t} = INC_{i,t} - TAX_{i,t} - INTEXP_{i,t} - CSDIV_{i,t}$$

Where;
FCF$_{i,t}$: free cash flows of firm i in year t
INC$_{i,t}$: Operating profit before depreciation of firm i in year t
TAX$_{,t}$: total tax paid by firm i in year t
INTEXP$_{,t}$: interest expense payable by firm i in year t
CSDIV$_{i,t}$: common stockholder dividend of firm i in year t
Control variables

In order to control other probable factors affecting agency costs firm size and financial leverage are controlled according to previous studies (Ang et al, 2000; Jarkous et al, 2010 and Norvash et al, 2009).

Results
Comparison of Family and Non-Family Firms

Hypothesis 1 of this study has compared agency costs of family and non-family firms. Table 1 has presented descriptive statistics of agency cost and control variables in family and non-family firms.

Table 1: descriptive statistics of research variables

variables		number of firms	mean	SD	min	max
The ratio of operating costs to sales	family firms	31	0.0917	0.04947	0.01	0.28
	non-family firms	97	0.851	0.09425	0.01	1.37
asset turnover ratio	family firms	31	0.92.82	0.3935	0.19	2.32
	non-family firms	97	0.8642	0.5207	0.03	4.35
Tobin's Q ratio	family firms	31	1.2785	0.4501	0.71	3.79
		97	1.3773	0.6746	0.23	7.74
growth opportunities-free cash flow interaction	family firms	31	5115.5	20379.01	-135793	99073
	non-family firms	97	51482.1	385158.4	-1880169	4764929
firm size	family firms	31	11.519	1.201	9.06	14.34
	non-family firms	97	12.801	1.473	9.31	17.21
financial leverage	family firms	31	0.6336	0.2363	0.19	1.72
	non-family firms	97	0.6629	0.1768	0.15	1.31

According to table 1, mean values for variables of ratio of operating costs to sales and asset turnover ratio are high for family firms and mean values of Tobin's Q ratio, growth opportunities-free cash flow interaction, firm size and financial leverage are in high level for non-family firms. In order to find out that is the difference significant statistically or not, test to compare two independent groups is applied. Firstly, to determine normality of data distribution, Kolmogorov-Smirnov test is applied and results are presented in table 2. According to abnormality of data distribution, in order to compare mean value of variables in two populations, nonparametric test of U Mann Whitney is applied and results are presented in table 3.

Table 2: normality test of variables

agency cost criterion		test statistics	sig	result
operating cost to sales ratio	family firms	3.73	0.000	not normal
	non-family firms	9.91	0.000	
asset turnover ratio	family firms	6.43	0.000	not normal
	non-family firms	13.1	0.000	
Tobin's Q ratio	family firms	1.40	0.039	not normal
	non-family firms	3.1	0.000	
growth opportunities-free cash flow interaction	family firms	4.53	0.000	non normal
	non-family firms	5.13	0.000	

Table 3: results of U Mann Whitney test

		family firms	non-family firms	Z	sig
agency cost criteria	operating cost to sales ratio	0.0917	0.0851	0.229	0.229
	asset turnover ratio	0.928	0.864	0.381	0.218
	Tobin's Q ratio	1.27	1.37	-3.01	0.002
	growth opportunities-free cash flow interaction	5115.5	51482.1	0.751	0.142

As it is clear, significance level is obtained to 0.05 for 3 criteria of agency cost including operating cost to sales ration, asset turnover ratio and growth opportunities-free cash flow interaction and this indicates that there is no significant difference between agency costs based on these 3 criteria in family and non-family firms. However, Tobin's Q ratio is significantly different between family and non-family firms. The ratio in family firms is less than non-family firms and indicates more agency costs of family costs in Tehran Stock Exchange.

Regression Model to Assess Relationship between Family Ownership and Agency Cost

For purpose of careful assessment of the relationship between family ownership and agency costs, multivariate regression has been applied as follows:

$$AC = \alpha + \beta_1(\text{Family Ownership}) + \beta_2(\text{Size}) + \beta_3(\text{LEV}) + \varepsilon$$

Where; AC: agency costs; Family Ownership: family ownership is equal to 1 and non-family ownership is equal to 0; Size: firm size and LEV: financial leverage

Linearity of variables: before estimating regression model, linearity test of explanatory variables is performed and the results are presented in table 4. If linearity is high in a regression model, it means that there is high correlation between independent variables and the model may not be reliable even with high level of determinant coefficient of the model. In table 4, relevant values of variance inflation factor (VIF) of existence of linearity are evaluated. The more the factor is close to 1; it refers to lack of linearity problem in the model. If the factor is higher than 5, it means that the linearity problem is existed in the model and should be solved. Clearly, linearity indices of variables are below 5 and as a result, it could be mentioned that there is no linearity problem in this model.

Table 4:   linearity test

variable	tolerance factor	VIF
family and non-family firms	0.966	1.004
size	0.598	1.674
financial leverage	0.931	1.074

Test of Homogeneity of Variances: according to assumptions of regression model, variance of error sentences should not be homogenous. In order to evaluate homogeneity of variances, White test is applied and the results are presented in table 5. According to obtained results from White test, there is no homogeneity among variances of errors in 4 estimated regression models.

Table 5:   results of testing homogeneity of variances

row	regression model of correlation of family ownership and different criteria of capital structure	test value	sig	result
first model	correlation between family ownership and operating costs to sales ratio	0.79	0.62	no homogeneity
second model	correlation between family ownership and asset turnover ratio	1.24	0.26	no homogeneity
third model	correlation between family ownership and Tobin's Q ratio	0.81	0.54	no homogeneity
fourth model	correlation between family ownership and growth opportunity-free cash flow interaction	1.19	0.24	no homogeneity

As the method is using panel data, firstly reliability of data during time period of the research is tested using Levene test of Lin and Chu (2002) and obtained results have shown reliability of variables. Moreover, before estimation of main regression models, using Chaw and Housman Test, one of the models of random, fixed and common effects is selected and final regression model is estimated on this basis (table 4). As in the 3 models, Chaw test indicates priority of common effects method, there is no need to perform Housman test and the common effect method was selected fot 3 dependent variables.

Table 4:   results of tests to select regression model

dependent variable in regression model	test	test value	sig	model
operating costs to sales ratio		1.01	0.47	common effects method for 4 models
	Housman test	-	-	
asset turnover ratio	Chaw Test	.720	0.69	
	Housman Test	-	-	
Tobin's Q ratio	Chaw Test	0.54	0.84	
	Housman Test	-	-	
growth opportunities-free cash flow interaction	Chaw Test	0.59	0.82	
	Housman Test	-	-	

Table 5: obtained results from multivariate regression

row	regression model of relationship of family ownership and different criteria of capital structure	family ownership coefficient	type of relationship	sig	F-value significance of regression model	model determinant coefficient	Durbin-Watson value
first	relationship between family ownership and operating cost to sales ratio	-0.013	negative	0.73	0.000	0.54	2.4
second	relationship between family ownership and asset turnover ratio	0.08	positive	0.75	0.000	0.75	1.85
third	relationship between family ownership and Tobin's Q ratio	0.102	positive	0.04	0.000	0.19	1.70
fourth	relationship between family ownership and growth opportunities-free cash flow interaction	13580	positive	0.81	0.000	0.25	1.94

Table 5 has presented obtained results from estimation of regression models to evaluate relationship between family ownership and different criteria of agency cost through controlling variables of firm size and financial leverage. In table 5, coefficient of independent variable; family ownership (equal to 1) and non-family ownership (to 0) and type of relationship, along with significance level and obtained result are presented.

In first model, the relationship between family and non-family ownership with operation cost to sales ratio is tested. Coefficient of independent variable of family ownership is equal to -0.013 and is negative and it is insignificant according to significance level of 0.73. Hence, it could be mentioned that there is no significant correlation between family ownership and operating cost to sales ratio.

In second model, the relationship between family and non-family ownership with asset turnover ratio is tested. Coefficient of independent variable of family ownership is equal to 0.08 and is positive and it is insignificant due to significance level of 0.75. Hence, it could be mentioned that there is no significant correlation between family ownership and asset turnover ratio.

In third model, the relationship between family and non-family ownership with Tobin's Q ratio is tested. Coefficient of independent variable of family ownership is equal to 0.102 and positive and according to significance level of 0.04, it is significant. Hence, it could be mentioned that there is significant correlation between family ownership and Tobin's Q ratio. Positive coefficient of family ownership indicates that increase in family ownership can result in increase in Tobin's Q ratio and there is direct relationship between them.

Finally, in fourth model, the relationship between family and non-family ownership with the interaction between growth opportunities and free cash flow is tested. Coefficient of independent variable of family ownership to 1580 is positive and due to significance level to 0.81, it is insignificant. Hence, it could be mentioned that there is no significant correlation between family ownership and interaction between growth opportunities and free cash flow.

Discussion and Conclusion

The main purpose of this study is to assess and compare agency costs in family and non-family firms based on 4 different criteria including operating costs to sales ratio, asset turnover ratio, Tobin's Q ratio and interaction between growth opportunities and free cash flow. Obtained results from the study indicate that there is significant difference between family and non-family firms only in terms of Tobin's Q ratio. In general, obtained results from the study (in terms of agency and its costs) are inconsistent with study of Anderson et al (2003) and are in consistence with study of Chrisman et al (2004) to high extent. In terms of Tobin's Q ratio (growth opportunities), the results of this study is in consistence with study of Anderson (2008) and in contrary to Anderson and Reeb (2003), Maori (2006) and Martins et al (2007). However, in terms of ratio of operating costs to sales, the interaction between growth opportunities and free cash flow and asset turnover ratio, no similar study is in hand. It is

believed that weak performance of management can probably result in making decisions that enhance agency costs. Hence, low Tobin's Q ratio in family firms indicates problems with agency and high costs resulted from it (Henry, 2010). As a result, it could be mentioned that family firms have lower agency costs than non-family firms based on this criterion. Although some scholars like Demstes and Len (1985), McConagy et al (2001), Chrisman et al (2007) and Chen et al (2008) claim that problems of agency in family firms are in low level and this can result in improvement of performance and firm value and family can provide competitive advantages for firm and board of directors formed of family members thinks mostly about maximization of firm value instead of taking motivational projects because of gaining less rewards and bonuses than board of directors of other firms; some others (Fama and Jensen, 1983; Shleifer and Somers (1988); Shleifer and Vishny (1997); Burkhart (1997); di Angelo and di Angelo 2000) claim that family owners sought gaining personal interest from the firm and this can usually be taken through additional rewards, dealing with dependent individuals and specific types of dividend distribution and this can finally lead to decrease in growth opportunities and firm value. Moreover, actions of families in way of their benefit can have negative impacts on efforts of firm staffs and productivity. As families may take some actions to maximize their personal benefit, major art of these actions can potentially result in weak performance of firm compared to non-family firms (Anderson and Reeb, 2003; 1305). Shleifer and Vishny (1997) guess that one of the biggest agency costs imposed by main stockholders is remaining actively in managerial position; especially if the manager is not competent for such position and especially presence of amateur managers gained these positions through family relations. Moreover, tendency of families to own managerial positions by family members can result in reduction of competitive advantages compared to non-family firms.

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