

The Effect of Family Ownership on Cash Holdings of the Firm (Karachi Stock Exchange)

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Abstract

The study was conducted to find out the family control on firm cash holding. The study was conducted in the non financial sector of Pakistan. 100 non financial firms were selected for the data collection. The data was collected from the annual reports of the list firms from 2008 to 2013. Family ownership, board size, net working capital and firm size are the independent and cash holding as dependent variable of the study. Panel data regression was used in the current study for the data analysis. As per the results of fixed effect model as recommended by the hausman test; 1) Family ownership has positive and significant effects on firm cash holdings; 2) Board size has positive and insignificant effects on firm cash holdings; 3) Net working capital has negative and insignificant effects on firm cash holdings and 4) Firm size has negative and significant effects on firm cash holdings.

Keywords: Family ownership, cash holdings, non financial, KSE, fixed effect model etc.

Introduction

One of the most common and significant pattern of ownership structure is establishing family organizations that have attracted researchers` consideration. Current literature has commonly concluded that family firms, majorly in corporate decisions react different from non-family organizations. Although research on the family-controlled firms is in bulk plus advancing, the research gap is related to the family ownership and its effects on cash holdings. In case, as previous research has explored, other firm policies are being impacted by family control, (Hu et al., 2007), for example decisions about disbursing. So it is naturally expected same effect to deploy cash on firm`s decision in family ownership. In fact US firms carry progressively more current assets; particularly makes current research question interesting (Bates, Kahle, and Stulz, 2009).

An important role is being played by corporate cash holding policies in financial policy of a firm. Empirical research targets an ample concentration over few factors of cash holdings, and

the presence of outstanding line of corporate cash holdings (Kim et al., 1998; Opler et al., 1999). From the view point of transaction and precaution, in case the figure of some other financing resource is strong, firms gather cash to fulfill their unforeseen contingencies (Opler et al., 1999; Han and Qiu, 2007). On the other hand, according to agency theory, largest shareholder powers lead to lessen cash holdings. It illustrates that shareowners demand for bounding funds upon decision of managerial staff of corporate cash holdings (Jensen and Meckling, 1976; Jensen, 1986; Dittmar et al., 2003). Mostly research with regard to corporate control concentrates over the concern of businesses for corporate cash holdings; although very limited literature is available about the alliance between corporate control and cash holdings at those firms, governed by family.

Central issue is family control in solving rivalry amongst shareholders and managers, by the virtue of dissolution of governance and ownership (La Porta et al., 1999; Anderson et al., 2003). Businesses with a family-ruled usually involve themselves with family interest, or try to pass the business to the coming children. Even though, Yeh et al. (2001) discusses about the firm might be forced by family-controlled shareholders to approve those practices that suit their personal concerns, as compare to minor shareowners. Therefore, those firms, works under the families would be complicated, because, additional deal to simple firm essentials along with scopes, they must (Ward, 1987) acknowledge necessities as well as eagerness of the family shareowners.

There is single research that concludes about the family oriented business organizations the only custodians to own plenty of cash as compare to non family ruled businesses (Ozkan , 2004).

Problem Statement

Whenever an organization owns cash in excess of some expenses it could be for many motives for example, for further transactions, safety or critical times, it can be opportunity expenditures. The main conflict between managers and shareholders is the decision of how to position internal fund (Jensen, 1986). This issue may direct to agency conflict. It is well known truth that, to maximize shareholders assets and perform in the best interest of the each and every stakeholder is the incomparable destination of a business. Ownership of family governance effects (Hu et al., 2007), other policies of the firm, like decisions about payout it is naturally expected by someone same impact of ownership of family on the decision of firm to circulate funds. In current study, following three questions are being examined. How does cash holdings are being influenced by family oriented firms? What accelerates connection among family governance and cash holdings? How does perceived value of cash is affected by founding family firms?

Objectives of the study

- To find out the effects of family ownership on cash holdings.

Literature review

Previous theory investigates firms' financing options in informational context asymmetry, agency costs of debt, and the efficient renegotiation of debt claims. Current approach is not differentiating non-family from family oriented businesses. However, (Klasa, 2007; Bauguess and Stegemoller, 2008) a proof exists about the family businesses follow a lot of guarded policies regarding corporate decisions like acquisitions; many thing is unknown about decisions of financing nature and, exclusively, either their behavior of financing contradict from non family ruled businesses.

Demsetz and Lehn, and Holdemess, (1985) along with Sheehan (1988) primarily concluded that controlling every single shareowner so by extension the family ownership have control on the firm, they are giving value to the opportunities to use perquisites more than firm stock holders, due to non-pecuniary and non-transferable benefits. In family businesses ownership mostly inclined towards the benefits of family shareowners as compare to non family shareowners. Thus, risky decision regarding financing is not appreciated in family-oriented firms (i.e. capital) which may weaken power of them and some time that governance might be in danger. As a result firms that are ruled by families rely on debt rather than equity financing; because raise in assets may decline their capital share as well as regulating ground will be less secured.

It has been described in capital structure theories about creditors plus shareholders being not desirous to provide cash on the time owner and manager possess more knowledge about the organization than outsider investors (Myers, 1984). In family firms, mostly family member and the largest shareholders are appointed as executives or directors, who definitely know better about investment opportunities and prospective cash flows as compare to other investors. Tunneling (Shleifer and Vishny, 1997) is also one of the possible issues in firms

controlled by families. As a result, the family firms are cloudy to investors from outside and junior most security is equity in structure of capital and trickier to facts and figure irregularity as compare to credit, for family firms, equity amount with respect to credit going to be very bigger in contrast to non-family organizations. Thus, less attraction will be in equity financing to family based businesses. The higher cost of equity arising from information asymmetries, considerations of the value of control, and wealth expropriation suggest that family firms are less likely to issue equity than non family firms. Preferring debt financing (Anderson et al., 2003) is another reason that family-oriented firms relates to portfolio diversification. Indeed, huge amount of investment is being done in the personal businesses by most of the families that why they get interested to survive for long-term and with good reputation, it's the only concern the creditors know about. Family firms are more appealed by debt financing, because of low cost incurring from low agency costs of debt with respect to firms with non-family ownerships. Consistently it has been found by Anderson et al. (2003) and Ellul (2009) this view that in USA that higher debt has been taken by family firms as compare to non-family.

In China, board structure of companies examined by Chen, Fan, and Wong 2002 that became public. He also investigated documents in which he found that directors' ratio was one-third that they have some sort of affiliations with the government bodies. The bureaucratic network indicates few number of directors authentically have the professional academic background that is required. In China boards are appointed mostly males, with low level qualified senior directors. It proves the agency view of decentralization of government. Also in Malaysia and Indonesia political connections have high values as examined by Johnson (2003).

Family owned firms in Taiwan appoint most of the family members to boards, Yeh (2002) rights differentiation of cash flow and governance get more noticeable. Apart from this, when families controlled firms boost their rights of cash-flow, they will likely appoint fewer family members as directors. Also it has been documented by him, that there is also a powerful inverse correlation between involvement of family in firm value and board. Conclusions by him are same to Claessens et al. (2002) about the negative entrenchment and positive incentive effects.

Methodology

The study was conducted in the non financial sector of Pakistan. Randomly 100 non financial firms were selected for the data collection. The data was collected from the annual reports of the sampled firms from their official websites. The data were collected from 2008 to 2013.

Variables

Independent:

Family ownership: It was measured by the number of shares holds by the family of directors especially by their spouses and children.

Board size: The board size was measured by the number of director in a firm in a particular year.

Net working capital: current assets divided by current liabilities

Firm size: it was measured by taking log of the total assets.

Dependent

Cash holdings:It was measured by the cash and cash equivalent posses by the firm in a particular year.

Hypothesis

- H₁: Family ownership has significant effect on cash holdings.
- H₂: Board size has significant effect on cash holdings.
- H₃: NWC has significant effect on cash holdings.
- H₄: Firm size has significant effect on cash holdings.

Analysis and interpretations

**Model 2: Fixed-effects,
Dependent variable: Cash holding**

	Coefficient	Std. Error	t-ratio	p-value	
const	0.843401	0.206567	4.0829	0.00005	***
FML	-0.303781	0.0863403	-3.5184	0.00048	***
BSZ	0.00378124	0.00576921	0.6554	0.51253	
NWC	-3.24387e-05	0.00220112	-0.0147	0.98825	
Size	-0.07409	0.0201767	-3.6721	0.00027	***

R-squared	0.679642	Adjusted R-squared	0.621244
F(70, 384)	11.63801	P-value(F)	7.09e-61

The above table shows the results of fixed effect model from panel data regression used in the current research study. As the nature of the data is panel (both cross sectional and time series) that is the reason of selecting panel data regression. The fixed effect model shows the results of variance explained by the family ownership, board size, net working capital and firm size on the cash holdings. The R² (Coefficient of determination) of the model is 0.67, which means that the independent variables explained 67 percent variance in the dependent variable (Cash holdings). The f-value of the model is 11.63, which is more than 4. It means that the model is statistically significant. The p-value of the model is less than 0.05 i.e. 0.000, which shows the overall significance. The coefficient of family ownership shows per unit change in the cash holding due to family ownership. The value is 0.843401 means that 1 unit change in the family ownership will lead to change 0.843401 unit in the cash holdings and in positive direction. The t-value of the family ownership is 4.0829 which is more than 2, so family ownership has positive and significant effects on cash holdings. The coefficient of board size

shows per unit change in the cash holding due to board size. The value is 0.00378124 means that 1 unit change in the board size will lead to change 0.00378124 unit in the cash holdings and in positive direction. The t-value of the board size is 0.6554 which is less than 2, so board size has positive and insignificant effects on cash holdings. The coefficient of net working capital shows per unit change in the cash holding due to NWC. The value is -3.24387e-05 means that 1 unit change in the NWC will lead to change -3.24387e-05 unit in the cash holdings and in opposite direction. The t-value of the NWC is -0.0147 which is less than 2, so NWC has negative and insignificant effects on cash holdings. The coefficient of firm size shows per unit change in the cash holding due to firm size. The value is -0.07409 means that 1 unit change in the firm size will lead to change -0.07409 unit in the cash holdings and in opposite direction. The t-value of the firm size is -3.6721 which is more than the absolute 2, so firm size has negative and significant effects on cash holdings.

Hausman test statistic

$H = 13.1228$ with $p\text{-value} = \text{prob}(\text{chi-square}(3) > 13.1228) = 0.00437841$

(A low p-value counts against the null hypothesis that the random effects model is consistent, in favor of the fixed effects model.)

The above results are of the hausman specification test used to select between fixed and random effect model. The hausman specification test has a standard value, if the p-value is less than 0.05 then alternate hypothesis will be accepted and fixed effect will be appropriate for the study OR if the p-value is more than 0.05 then null will be supported and in favor of random effect model.

Multicollinearity

Variable	Value
Family ownership	1.423
Board size	1.118
Net working capital	1.024
Firm size	1.422

The above table shows the result of multicollinearity test (Variance Inflation Factor test). The standard of this test is that the value of the variable should be less than 10. If it is less than 10 it has no problem of multicollinearity and they will have the problem if the value is higher than 10. The above result shows that there is no problem of multicollinearity in the current study.

Conclusion

The study was conducted to find out the effect of family ownership on firm cash holdings. The data was conducting in the non financial sector of Pakistan. The result indicates that if the firm is controlled by family then they will maintain higher cash holdings. The intentions might be to invest more in the market and get opportunities and more profit. It can be further hypothesized that this supports the idea that if family firms employ outside managers, they should be required to hold equity in the firm. We also find that when ownership and control fully coincide, these firms hold less cash.

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