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OWNERSHIP STRUCTURE AND BUSINESS EVALUATION PRACTICES IN FAMILY SMEs: EVIDENCE FROM EMPIRICAL RESEARCH IN ITALY.

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Abstract

This paper presents early results from a pilot project which aims to investigate the relationship between proprietary structure of small and medium- sized Italian family firms and their owners' orientation towards a "business evaluation process".

Evidence from many studies point out the importance of family business in a worldwide economic environment: in Italy 93% of the businesses are represented by family firms; 98% of them have less than 50 employees (Italian Association of Family Firms, 2004) so we judged family SMEs as a relevant field of investigation.

In this study we assume a broad definition of family business as "a firm whose control (50% of shares or voting rights) is closely held by the members of the same family" (Corbetta, 1995).

"Business evaluation process" is intended here both as "continuous evaluation process" (which is the expression of a well developed managerial attitude) or as an "immediate

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valuation” (i.e. in the case of new shareholder’s entrance, share exchange among siblings, etc).

We set two hypotheses to be tested in this paper: the first is “quantitative” and aims to verify whether the number of owners (independent variable) in a family firm is positively correlated to the business evaluation process.

If a family firm is led by only one subject, it is more likely that personal values, culture and feelings may affect his choices more than “purely economic opportunities”; so there is less concern about monitoring economic performance or about the economic value of the firm. As the shareholders’ number increases, economic aspects in managing the firm grow in importance over the personal values and "value orientation" acquires a central role.

The second hypothesis investigates if and to what extent the presence of “non- family members” among the owners affects their orientation to the business evaluation process.

The “Cramer’s V” test has been used to test the hypotheses; both were not confirmed from these early results; next steps will lead to make an inferential analysis on a representative sample of the population.

Introduction and theoretical assumptions.

This research investigates the relationship between ownership structure of family small and medium enterprises (SMEs) and their owners’ attitude towards the firm’s evaluation process. Below we present some results from a pilot project of an ongoing empirical analysis in the Italian context.

Evidence from many studies point out the importance of family business in a worldwide economic environment: according to a joint survey led by the Bank of Italy and the Italian Association of Family Firms (AIdAF), family firms represent the 93% of total firms and 98%

of the workforce in manufacturing companies fewer than 50 employees in Italy (Bank of Italy, 2004). Relevance of family firms is combined with importance of small and medium-size firms. Most small and medium firms are family owned and account for a significant portion of the Italian economy: small and medium- size firms employ 93% of the wotkforce and represent over 99% of total companies, according to the national Institute of Statistics (ISTAT, 1991).

The ownership structure of family firms has been widely investigated in two different fields: *Corporate Governance* and *Family Business*. Distinctions between alternative forms of ownership (family business versus non family business) have been a viable assumption for many researchers; they consider it a "discrete determination" (Astrachan, Klein & Smyrnios, 2001) since their interest has been to define a "continuum spectrum" which goes from the "entrepreneurial business" to "professionalized firms" in order to exploit the differences between family and non family firms (Daily & Thompson, 1994).

Since the leading idea is that ownership typology conditions firm processes, outcomes and value, many researchers disagreed as to whether, and to what extent, there are differences between family and non family firms. On this point academic literature is not unanimous. While Gudmundson, Hartman & Tower (1999) found no difference in strategic orientation and behaviour between family and non family firms (Daily & Thompson, 1994), Ward (1988) states that strategic planning processes in family business significantly differ from non family business, also assuming it remains necessary to manage the firm.

Ownership structure has also been tested to assess whether family firms perform better or not than non family firms (Gallo, Tapies & Cappuyns, 2000); accordingly, a few studies suggest that family ownership per se does not create or destroy value (Villalonga & Amit, 2004), alleviating simply the conflict of interests between owners and management (Berle & Means, 1932).

When the focus switches to family firms alone, researchers define the ownership configuration according to the different phases they (FB) pass through, each with challenges and characteristics (Ward, 2001). As the interaction of business and family life- cycle with owners' decisions changes, it determines the shareholders' composition. It varies through six different phases from entrepreneurial to collaboration and family syndacate.

We found little evidence as regards the relationship between ownership configuration and the "business evaluation process".

The F- Pec scale (Astrachan, Klein & Smyrnios, 2001) defines the "ownership configuration" as one of the most influencing determinants for the "power level" of the family over the firm; it increasingly affects family involvement (Astrachan & Shanker, 1996) as the overlap of family, ownership and management groups grows within the firm (Davis & Tagiuri, 1999).

If on the one hand the level of family involvement is determined by the ownership configuration, on the other it strongly influences the system of values (or the values themselves), aims and objectives of the firm itself; since the firm is seen as an instrument to reach owners' objectives (Ferrero, 1987) these may vary across people and time, taking shape diversely from firm to firm. Emotional attachment to family firm ownership may detract from the firm's focus on economic goals; thus a typical family firm violates almost all the underlying assumptions of traditional governance theories (Mustakallio, Autio & Zhara, 2002).

At the same time the "shareholder value approach" (Fernandez, 2001) and "shareholder value maximization" (Copeland, Koller & Murrin, 1996) cannot be fully applied to the family business model; owners' expectations and objectives rely upon a personal system of values which could overwhelm the economic and financial perspective. Existing duality between economic and non- economic goals help us to define "value assessment" within the family firm: private benefits and “amenity (potentials)” are a relevant part of the whole value configuration (Demsetz & Lehn, 1983).

Hence interest towards economic value assessment varies through the different scales of family involvement over the firm: the “family effect” seems to be inversely correlated to the “purely economic goals”; as a consequence, owners are less concerned with monitoring economic aspects while running the firm.

Literature about firm value and evaluation process focuses mostly on the several objectives of firm value assessment and its evaluation techniques; a common concern is that business evaluation is essential for the decision making process and management of all firms.

There are two main approaches when considering the firm’s value assessment: the first one is immediate, evaluation occurs either with an extraordinary transaction (such as merger, share exchange, acquisition, shareholder’s exit and entrance, split, etc..) or during a succession phase; the second approach is systematic and it emerges as a recurrent performance evaluation, intentional strategy and investment project (Viganò R., 2001).

Hypotheses formulation

We set two hypotheses to be tested in this paper as regards the influence of the ownership structure of family firms over the family- owners’ attitude towards economic appraisal. Shareholders’ composition may modify the extent of the “family effect” over the firm; as family involvement grows, the more likely it is that private benefits and non- economic goals will gain importance over the pure economic goals: family- owners have little (or no) interest in monitoring the value of the firm when approaching strategic decisions.

If a family firm is led by only one subject (ownership configuration), it is more likely that personal values, culture and feelings may affect (family involvement) his choices more than “purely economic opportunities” (value assessment); thus there is less concern about monitoring economic performance or the total value of the firm. As the number of subjects increases, even if they are still family members, social interaction decreases (Mustakallio, Autio & Zhara; 2002) and economic aspects in managing the firm gain more importance than personal values: monitoring the "value creation" gains a central role.

Insert figure 1 about here

Hp 1: in family firms there is a positive correlation between the number of shareholders and their attitude towards a firm evaluation process.

The second hypothesis investigates a more “qualitative” aspect about the structure of the family firm; it examines whether the presence of “non- family members” among the owners may affect their leaning towards the business evaluation process.

Insert figure 2 about here

Hp 2: in family firms, the presence of non- family members among the shareholders increases the owners' attitude towards a firm evaluation process.

We expected both hypotheses to be confirmed; hypothesis 1will be verified if “Cramer’s V” test is significantly far from zero (approximately around 0.6), while hypothesis 2 will be confirmed in case the test- value is higher than the other.

Methods

Below we present results from a pilot project carried out between July and December 2004 on a group of Small and Medium Family Businesses.

As no official database exists for Family Enterprises in Italy, we lack information on the real size and the main features of such a group of firms. The survey has been led through a web-questionnaire, emailed to 1.105 companies chosen from the databases of the "Entrepreneurial Association" of Naples and Milan; a cover letter from the Association they belong to was gone ahead the questionnaires.

A total of 120 completed questionnaires were returned, with a response rate of 10,9 %.

The final sample is of 88 firms as we erased non- family firms, large corporations and incomplete or incorrect answers.

Definition of family firm.

In this study we assume a broad definition of family business as "a firm whose control (50%+1 of shares or voting rights) is closely held by the members of the same family". Whenever a firm is owned by only one subject, we considered it as a family firm only when at least another family member is involved in the enterprise activities. In our final sample, we identified family firms crossing the questions about the percentage of capital (rights to vote) owned by one family, with the presence of family members among the employees -managers.

Definition of SMEs.

We consider as "small or medium firm" an enterprise whose turnover is less than 50 million of euros per year, and if it employs less than 100 people in one year. Two questions are set up to meet those parameters: turnover ranges across nine different levels, from less than 2,7 million up to more than 1.000 million of euros per year; employees' average number per year varies across six different levels, from "less than 20" to "more than 1.000".

Questionnaire overview.

The questionnaire is structured and semi- closed; it was addressed to owners, managers or members of the board. They were asked to fill in all the three parts according to the instructions.

• Section A (5 items) is addressed to the person him/herself: it defines the respondent's profile in terms of position, tenure, ownership, relation to founder (if existing), sex and age.

• Section B (12 items) deals with the firm's profile in terms of age, generation, (involvement) in a succession process, geographical location, core business, legal organization, sales performance, number of employees, industry and business growth rate, ownership structure in terms of shareholders' concentration and number of non family members among the owners.

• Section C (8 items) focuses on the business evaluation process: first they were asked whether the firm has ever been evaluated. Should the answer be positive, they also specify 1) on which occasions they took this step (multiple choices depict all the different objectives in a firm evaluation process: selling off the activity, shares exchange among siblings, mergers & acquisition, financing, succession or performance assessment); 2) frequency of the evaluation process (if it is a one- off or recurrent); 3) who leads the value assessment (consultants, managers, owners); 4) the evaluation techniques and if "family discount rates" were applied. Should the answer be negative, respondents are asked if they have any interest in knowing the firm value, and if they perceive any advantages or disadvantages in ignoring it. The last question concerns the presence of a "Family Pact" or if, in some ways, a succession process has been planned.

Measuring the two investigated variables.

"Ownership structure" is intended here simply as the shareholders' composition; in order to define this variable through all firms, we set up three specific items about the following issues: i) how many owners the firm has; ii) the percentage of shares owned by a single family; iii) the presence of non family members among the owners.

When assessing the variable "firm evaluation process", we investigated three specific items:

1. the first uses a "binary variable" on responses to the question concerning whether the firm has ever been evaluated or not;
2. the second item investigates the objectives of the firm appraisal: it might occur "external and occasional circumstances" (selling off entirely or partially the firm, share exchange, etc.), or during a "firm's performance measurement";
3. the third aspect raises the question about the frequency of the evaluation process, if it is an "immediate evaluation" or a continuous (periodic) one.

The two variables have been crossed in a double entry matrix according to a "bivariate analysis model"; hence we obtained the total frequencies for the investigated relationship and the "Cramer's V test" was performed.

Results.

To test the effects of ownership structure on the firm evaluation process, we analysed a final sample of 88 firms.

Table 1 represents the ownership structure of all the firms in the sample; it summarizes their frequency distribution into the different classes according to their shareholders' number. Since we did not find any firm with more than 9 owners, we identified only five classes. In the column "conditioned frequencies" we classify only the firms with at least one non family member among the owners.

Insert table 1 about here

Table 2 shows the frequency distribution of the evaluation process. In the third column (evaluation process) we sub- divide the firms according to their answers about the frequency of the evaluation process whether it is a continuous approach or an immediate one. Events are dichotomous.

Insert table 2 about here

The table above, shows that 48.8% of the firms in the sample have been involved in a "business evaluation process"; 31% of them do it recurrently, while the remaining 69% took into step only occasionally.

We did not analyse specifically the reasons which led to the evaluation process, but it seemed quite interesting to cross them with their frequency (matr. 1).

Insert matrix 1 about here

As we chose a "pilot project", we had support only from the descriptive statistics methods and no inference was attempted. Our sample is not representative of the whole population, consequently we can describe our results through a bi- variate analysis and a double- entry contingency matrix.

The “χ square test” in a preliminary stage and the “Cramer’s V” were used to test both the hypotheses (table 3).

Insert table 3 about here.

Cramer's V index is used to measure the strength association for the contingency table. Since its value ranges between 0 (no connexion) and 1 (maximum connexion), our result (Cramer’s V = 0,08) suggests that the two variables are totally unrelated.

The third column shows how the percentage of frequencies for each class does not change significantly as the shareholders’ number increases, leaving frequencies around the general average of 48,8%.

Hypothesis 1 is not verified.

Such counter- intuitive results led us to go ahead with an in- depth analysis between the two variables.

Since there are relevant differences among a continuous evaluation practice of the firm and an immediate one, we tried to split them up to check whether or not ownership structure may have an impact on an on- going value orientation (table 4).

Insert table 4 about here

Neither does table above support our initial hypothesis. The possibility that firms are oriented towards a “continuous evaluation approach” does not depend on the shareholders’ number.

“Cramer’s V test” presents a result of 0.125, which is slightly larger than the overall value (0,08) but is not enough to suggest any connexion. The same results occur in case we analyse the occasional evaluation process since it is complementary to the other event.

Insert table 5 about here

To test hypothesis n° 2 we used the “χ square test” in a preliminary stage and the “Cramer’s V”; we aimed to verify if the firm’s evaluation process would be affected by the presence of non- family members among the shareholders. Results fail to adequately confirm our hypothesis since the “Cramer’s V” test scores 0.38, which is larger than the overall value (0.08) but it is still too close to zero. Moreover the percentage of firms involved in a business evaluation process does not vary with the presence of non- family members among the owners.

Hypothesis 2 is not (entirely) verified.

Conclusion and research implications.

These results indicate there is no relationship between the ownership structure and the evaluation practices of small and medium family firms. Hypotheses have been tested through statistical descriptive procedures (Cramer’s V), and we found no connexion between the two variables: neither the number of owners nor the presence of non- family members among the shareholders seems to be affecting economic value orientation in a family business.

When approaching a plausible explanation for unexpected results, we identified two possible reasons. Since we investigated the ownership structure of firms whose control is closely held by one family, we can assume that increasing the number of owners or the presence of non-family members does not reduce the "family effect", which still strongly influences both the business strategic orientation and value assessment.

The second reason is linked to the legal organization of Italian firms. Choices about the legal organization mainly depend on the tax benefits and the limited liabilities provided to the firms organized under the "corporation- type". "Limited liability companies" necessarily comply with more than one shareholder, but many of them might be fictitious only to reap in those benefits: in this sense ownership structure does not truly reflect the real "proprietary configuration" and the decision- making process is held in the "real owner's hands". As the managerial attitude is not affected by ownership structure, firm value orientation does not substantially change as the shareholders' composition modifies.

Implications for Theory

Growing evidence highlights the importance of studying ownership structure of family firms; nevertheless, existing literature is not exhaustive in explaining how the shareholders' composition can affect managerial attitude and economic value orientation in family firms. This study has sought to go some way to filling this gap and the pilot project represents the first step to be taken before an inferential analysis. Early results suggest that a deeper analysis about the relationship between firms' features (legal organization, turnover, number of employees, etc) and their "economic value orientation" is required. A model based on a multivariate analysis will be used to measure the extent of their reciprocal influences. As we cannot extend those early results to the whole population, forthcoming steps will aim to find a representative sample of the population to allow inferential procedures.

Implications for practice

When approaching to family- owners' attitude towards "economic value orientation" we moved from the acknowledged idea that value orientation and performance measurement are necessary for the managers to better run the firm. Few studies attempted to explore the "value assessment" for family firms and how it differs from the non family business; strong agreement among researchers emerges when recognising that non- economic goals are as important as economic ones. Hence, both need to be monitored in order to reach an economic value driven approach either in strategic choices or to managing some crucial events in the family firm's life, such as the succession process.

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APPENDIX – TABLES AND FIGURES.

FIGURE 1: Hypothesis n° 1

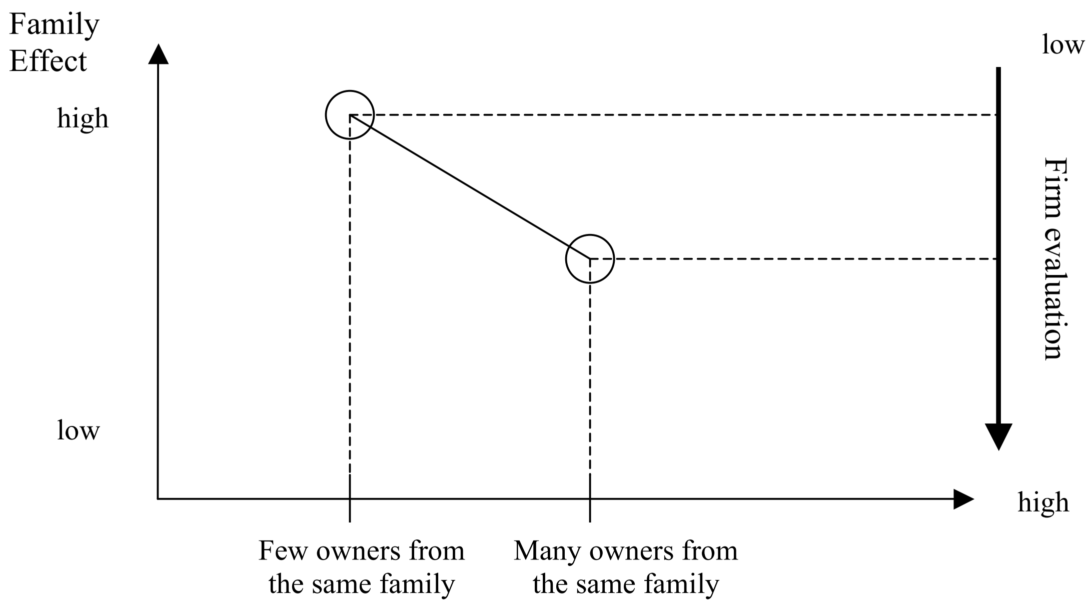

FIGURE 2: Hypothesis n°2.

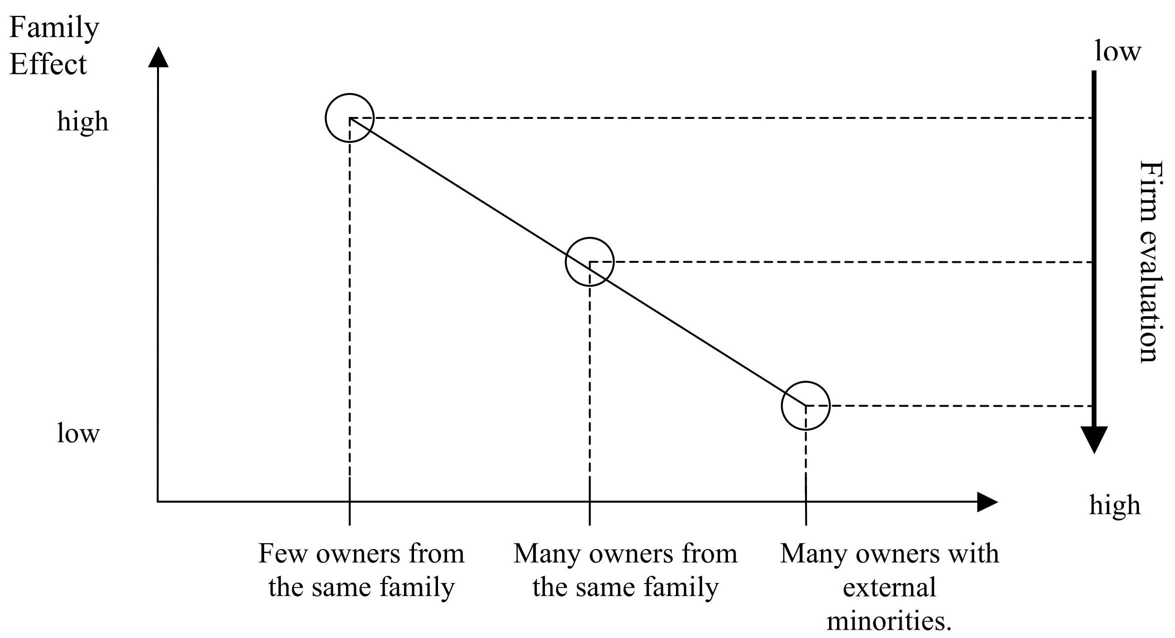

TABLE n° 1: Frequencies of the ownership structure

Number of owners	**Frequencies**	**% freq.**	**Conditioned frequencies**
1	9	*10.2*	/
2	24	*27.3*	3
3	29	*33*	6
4	18	*20.4*	4
5 – 9	8	*9.1*	3
Total	88	*100*	16

TABLE n° 2: Frequencies in case of an evaluation process

Have you ever carried out a "business evaluation process"	**Frequencies**	**Evaluation process**	
		Continuous	*Immediate*
Positive answer	43	13	30
Negative answer	45		
Total	*88*		

MATRIX n°1: crossed matrix of objectives and frequency of evaluation

Objectives

Frequency	Performance	Other objectives	
Continuous	10	3	*13*
Occasional	11	19	*30*
	21	*22*	***43***

TABLE n°3: Cross sectional analysis of the two variables.

Shareholders' numbers	**Business evaluation process**			**Total**
	Positive		**Negative**	
	Total frequencies	*(%)*	*Total frequencies*	
1	4	*44,4*	5	*9*
2	12	*50*	12	*24*
3	13	*44,8*	16	*29*
4	10	*55,5*	8	*18*
5-9	4	*50*	4	*8*
Total	*43*	***48,8***	*45*	**88**

Cramer's V = 0,08

TABLE n° 4: Frequency distribution in the case of business evaluation process.

Shareholders' number	**Continuous evaluation**		**Immediate evaluation**		**Total**
	Tot freq.	%	Tot freq.	%	
1	1	**25**	3	**75**	*4*
2	3	**25**	9	**75**	*12*
3	5	**38,4**	8	**61,6**	*13*
4	3	**30**	7	**70**	*10*
5-9	1	**25**	3	**75**	*4*
Total	*13*	***30,2***	*30*	***69,8***	**43**

Cramer's V = 0,125

TABLE n° 5: Total distribution in case of non family members among the owners

Shareholders' numbers	Business evaluation process			Total
	Positive		Negative	
	Total frequencies	*(%)*	*Total frequencies*	
1				
2	2	66.6	1	*3*
3	4	66.6	2	*6*
4	1	25	3	*4*
5-9	1	33.3	2	*3*
Total	*8*	*50*	*8*	**16**

Cramer's V = 0.38