

University of Nebraska - Lincoln

DigitalCommons@University of Nebraska - Lincoln

Cornhusker Economics

Agricultural Economics Department

April 2005

The Comparative Advantages of Family-Owned Businesses

Jeffrey S. Royer

University of Nebraska-Lincoln

Follow this and additional works at: https://digitalcommons.unl.edu/agecon_cornhusker



Part of the [Agricultural and Resource Economics Commons](#)

Royer, Jeffrey S., "The Comparative Advantages of Family-Owned Businesses" (2005). *Cornhusker Economics*. 211.

https://digitalcommons.unl.edu/agecon_cornhusker/211

This Article is brought to you for free and open access by the Agricultural Economics Department at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in Cornhusker Economics by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.

Cornhusker Economics

Cooperative Extension

Institute of Agriculture & Natural Resources
Department of Agricultural Economics
University of Nebraska – Lincoln
<http://agecon.unl.edu/pub/cornhusker.htm>

The Comparative Advantages of Family-Owned Businesses

Market Report	Yr Ago	4 Wks Ago	4/15/05
<u>Livestock and Products,</u>			
<u>Weekly Average</u>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight	\$87.66	\$91.34	\$91.83
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb	119.09	136.24	136.80
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb	100.16	114.78	114.41
Choice Boxed Beef, 600-750 lb. Carcass	161.77	156.72	155.03
Western Corn Belt Base Hog Price Carcass, Negotiated	64.76	67.17	70.30
Feeder Pigs, National Direct 45 lbs, FOB	47.76	69.10	69.82
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean	69.65	70.30	68.26
Slaughter Lambs, Ch. & Pr., 90-160 lbs., Shorn, Midwest	94.00	110.00	105.00
National Carcass Lamb Cutout, FOB	228.60	273.44	260.60
<u>Crops,</u>			
<u>Daily Spot Prices</u>			
Wheat, No. 1, H.W. Omaha, bu	3.85	3.48	2.75
Corn, No. 2, Yellow Omaha, bu	2.96	1.85	1.83
Soybeans, No. 1, Yellow Omaha, bu	9.61	5.90	6.08
Grain Sorghum, No. 2, Yellow Columbus, cwt	4.91	2.77	2.60
Oats, No. 2, Heavy Minneapolis, MN, bu	1.79	1.82	1.82
<u>Hay</u>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton	115.00	115.00	115.00
Alfalfa, Large Rounds, Good Platte Valley, ton	62.50	62.50	62.50
Grass Hay, Large Rounds, Good Northeast Nebraska, ton	57.50	57.50	57.50
* No market.			

According to the U.S. Department of Agriculture, approximately 97 percent of the farms in the United States are family farms (Banker and MacDonald). In addition, many agricultural input suppliers, marketing and processing firms, and other agricultural businesses are family-owned or controlled. Among the food processing and wholesaling companies that are family-owned or controlled are Archer Daniels Midland, Campbell Soup, Pilgrim's Pride, Smithfield Foods, J. M. Smucker, and Tyson Foods (Boland). More generally, over 35 percent of the firms included in the Standard and Poor's 500 Index are family-held firms (Anderson and Reeb).

In the past, businesses that are owned and controlled by families have been commonly perceived as less efficient and profitable than firms with more dispersed ownership structures. Financial economists have offered numerous explanations for why family ownership might result in poorer firm performance. More recently, however, economists have begun to provide reasons for why family ownership may be associated with superior performance.

In family firms, executive management positions are frequently restricted to family members, thereby significantly limiting the labor pool from which qualified candidates can be drawn. The decision to hire only family members to such positions can preclude hiring more capable and talented professional managers from outside, thus placing family firms at a competitive disadvantage relative to other firms. Research on small private firms has suggested that the bias of family firms toward hiring family members for management positions results in poorer investment decisions and lower profitability. Appointing family members to senior management positions also can create resentment on the part of other employees because skills, merit, and tenure with the organization are overlooked.

The tendency of family firms to appoint family members to executive management positions also can create

problems when executives remain active after they are no longer qualified or competent to lead the firm. Research shows that the founders of family firms are often associated with strong performance early in their careers, but that they are often more entrenched in their positions and likely to be characterized by poorer performance in later years.

When ownership and control are held by a concentrated group of shareholders, as is often the case in family firms, the firm may not be able to benefit from several important efficiencies associated with the separation of ownership and control. These include efficiencies stemming from the specialization of the risk-bearing and managerial functions and from the access to additional capital sources.

In addition, when ownership and control are combined, the owners can sometimes act to benefit themselves at the expense of the firm. They may divert resources from investments that would increase future cash flows in order to enjoy greater current profits or nonpecuniary perquisites. They also may be willing to sacrifice some of the firm's market value to pursue other objectives such as the maximization of personal utility. In particular, the owners of family firms can be expected to have their own interests and concerns, such as firm survival and capital preservation, that may not be consistent with the interests of the firm or other investors. They also may expropriate wealth from the firm through excessive compensation or special dividends, and they may seek to extract rents from employees, adversely affecting employee effort and productivity in the process.

On the other hand, the combined ownership and control in family firms can be advantageous. The owners of family firms may identify strongly with the firms and consider their performance as very important. These owners are apt to act as stewards of the firms, especially if they have family members to whom they want to pass their businesses when they retire or die. Because the owners of family firms may view the firms as assets for passing onto descendants, they may be more likely than hired managers to make efficient investments that will strengthen the long-term viability of the firms.

Because of the family's concentrated equity position in the firm, it has strong economic incentives to monitor the firm's performance, and its sustained presence in the firm and its control of management and director positions provide it a unique capacity for monitoring the firm and minimizing agency conflicts between ownership and management. When the technology of the firm is important, family members may do a better job of monitoring the firm because they are more knowledgeable due to the longstanding relationship they have with it. Thus, although the restricted labor pool for hiring firm executives may in general create problems, family members may possess special skills that outsiders do not.

Due to the family's long-term involvement in the firm, third parties, such as input suppliers and capital providers, may deal with the same managers, directors, and policies for longer periods of time. Thus the family's reputation can play an important role. Economists have suggested that reputational effects provide family managers strong incentives to improve the performance of the firm and that extended relationships with financial institutions can result in lower costs of debt financing.

Ultimately, the question of whether family-held firms are more or less efficient than other firms is an empirical one. A recent study of industrial firms (Anderson and Reeb) concluded that family firms are associated with significantly better accounting and market performance than nonfamily firms. A recent Kansas State University analysis of food companies (Boland) found that family-owned companies were able to sustain greater rates of profitability during the 1980–2003 period and suggested that this result could stem from the ability of family firms to focus on long-term strategies without frequent turnovers in leadership.

Jeffrey S. Royer, (402) 472-3108
Professor of Agricultural Economics

References:

- Anderson, Ronald C. and David M. Reeb. 2003. "Founding-Family Ownership and Firm Performance: Evidence from the S&P 500." *Journal of Finance* 58, 3 (June): 1301–28.
- Banker, David E. and James M. MacDonald, eds. 2005. *Structural and Financial Characteristics of U.S. Farms: 2004 Family Farm Report*. Agriculture Information Bulletin 797, Economic Research Service, U.S. Department of Agriculture, Mar.
- Boland, Michael A. 2004. "Governance of Family-Owned Food Business and Agribusiness Investor-Oriented Firms: Lessons for Producer-Owned Businesses." Paper presented at the European Research Conference, "Vertical Markets and Cooperative Hierarchies: The Role of Cooperatives in the International Agri-Food Industry," Mediterranean Agronomic Institute of Chania, Chania, Greece, Sept. 3–7.