Are External Directors Contributing to Mexican Family Firms’ Diversification?

Abstract

This study examines the role that external directors play on implementing diversification strategies in public family businesses. We try to define first whether the presence of external directors in the family business board of directors becomes a crucial element on diversification strategies undertaken by the firms. Second, we assess the contribution of these diversification strategies on value creation by using Tobin’s Q. The theory of agency, RBV, and the concept of social capital provide a sound theoretical basis for building our research hypotheses. Based on these, on the one hand, there are some grounds to expect that the role played by external directors will mitigate financial risks created by family property concentration and their willingness to retain control. For the empirical part of research we use data of 75 Mexican listed companies during the period 2005–2011, and apply Fixed-effect regression analysis.

Keywords: Family business, external directors, diversification strategies, Mexico.

Introduction

This work seeks to analyze how the role of external director in family business boards influence on selecting diversification strategies. Diversification as a strategy can favor companies to improve debt capacity, reduce bankruptcy risk by entering to other markets (Higgins & Schall, 1975) and extend companies lifetime (Pandya and Rao, 1998). To carry on diversification strategies requires creating new processes, operations and entering new areas where external non-family talent can contribute to reach these changes in companies’ operations (Ramanujam and Varadarajan, 1989). However, according to Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, and Moyano-Fuentes (2007), family business desire to preserve socioemotional wealth can lead families to assume a greater financial risk by excluding external actors from their boards in trying to protect family control. Thus, Gómez-Mejía, Makri, and Larraza-Kintana (2007) suggest that family businesses could opt to have low levels of diversification as a way to protect that wealth.

A study undertaken by Jones, Makri, and Gómez-Mejía (2008) on diversification strategies shows that the role of affiliate directors on the boards of directors may serve well to mitigate family owners’ perception of risk. Their ability to create strong ties with family managers based on the social capital generated in their interaction with family members motivates family firms to take on diversification initiatives. In addition, affiliate directors provide specialist knowledge that fills those gaps in the family talent stock and may act as conduits for getting access to more financial resources.

This study by Jones et al. (2008) takes us to review agency theory and the resource based viewpoint (RBV) in order to better explain how governance structure contributes to improve decision-making in family businesses. In doing so, we find that for reasons of avoiding owner
entrenchment and promoting firm’s wealth creation, the role of independent directors on the boards may serve to support diversification strategies (Anderson and Reeb, 2004; Miller and Le Breton Miller, 2006). By representing minority shareholders, these independent directors are interested to look for benefits for the firm as a whole.

Family members acting as stewardships may also modify the contributions of external directors (affiliate or independent), particularly for supporting diversification strategies (Gómez-Mejía and Wiseman, 1997; Westphal, 1999; García-Ramos and García-Olalla, 2011; Pieper, Klein, and Jaskiewicz, 2008). Therefore, we analyze those variables that contribute to families making these decisions, including the level of concentration of family ownership, the time the company has been in operation, family membership of the CEO, and the size of the firm.

Also, we consider an observation made Combs (2008) about the results achieved by the study of Jones et al. (2008) that argues over the opportunistic behavior that affiliates may take when acting on the board of directors. According to Combs (2008), the behavior of affiliate directors may respond to their employers’ interests, affecting negatively their host firms. Finally, we explore further the contribution of these diversification strategies for improving performance by measuring wealth creation. This was a topic that was left out of the analysis made by Jones et al. (2008)’s study.

In summary, we aim at defining the influence of external directors on the Mexican public family firms’ boards of directors on undertaking diversifications strategies. Then, we examine the contribution of these strategies to firms’ performance. In this way, this study contributes to broaden knowledge about the role of board of directors in family businesses by examining their participation on decision-making in an emergent country such as Mexico.

After describing in this section the purpose of this study, in the following section we review the pertaining literature connected to a better understanding of the role of the boards in supporting decision-making and wealth creation in family firms. From this review we formulate a set of hypotheses related to the business diversification and to the family firms’ level of performance. Then we describe the methodology, indicating our sample composition, and the measures and analysis we develop for this study. Next, we present our results in relation to each one of the hypotheses. These results are explained and discussed in the context if the Mexican public family firms. Finally, we arrive to our conclusions and provide some ideas for further research.

2. Literature review

2.1 Agency theory and performance

The costs of the divergence of interests between managers and owners, in combination with the costs of monitoring and bonding the manager to limit this divergence, are termed agency costs (Berle and Means, 1932). For the family firms, Jensen and Meckling (1976) explain...
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that these are likely to incur fewer agency costs because the goals of a firm’s principals (owners) are aligned with its agents (managers) since they are typically one and the same. As the well-being of the family is tied directly to the welfare of the company, families have further incentives to reduce agency costs that might impede performance. To the extent that a family brings to the firm common goals, high trust, and shared values in addition to unified governance, cumbersome and costly monitoring mechanisms can be avoided. Thus, studies indicate that having family involvement in firm ownership and management may significantly reduce certain costs, potentially enhancing firm performance (McConaughy, Walker, Henderson, and Mishra, 1998; McConaughy 2000).

Family members, because of their undiversified shareholding, long-term interest, and concern for reputation have a fundamentally different risk profile to typical equity holders (Bartholemeusz and Tanewski, 2006). As a consequence, they are more likely to maximize the overall value of the company (as opposed to the value of equity) reducing the agency cost of debt (Anderson, Mansi, and Reeb, 2003). Altruism in turn develops loyalty, facilitates communication, and increases time horizons for decision-making, ultimately reducing agency costs (Eschel, Samuelson, and Shaked, 1998; Simon, 1993). This fact reflects the tendency for privately held family businesses to be used as vehicles for sustaining a family’s transgenerational economic and socioemotional needs. In contrast, in publicly traded family businesses, the distance between the family and the business can grow and the family incentive to exploit rather than nurture the business can become quite real (Miller, Le Breton-Miller and Scholnick, 2008; Morck and Yeung, 2003). One stream of extant literature suggests that family control is, potentially, an agency cost reducing mechanism in itself (Anderson and Reeb, 2003; Tufano, 1998). Furthermore, as the wealth of the family is directly tied to the future of the company—and decision-making in family firms is predicated on much longer time horizons than in nonfamily firms—family firms more strictly adhere to wealth maximization (Chami, 1999; James, 1999).

In contrast, it has also been posited that family ownership leads to an increase in agency costs (for example, Anderson and Reeb 2003; Perez-Gonzalez, 2002). The family firm may, in fact, incur significant agency costs due to the conflicts that accompany family involvement (Schulze, Lubatkin, and Dino, 2003). Morck, Stangeland, and Yeung (2000) identify the possibility that family firms might use their concentrated blockholding to expropriate wealth from other shareholders through excessive compensation, related party transactions, and special dividends. Moreover, in this context, altruism has the potential to create agency costs if family members pursue the interest of other members at the expense of outsiders (Schulze, Lubatkin, Dino, and Buchholtz, 2001; Gómez-Mejía, Núñez-Nickel, and Gutiérrez, 2001). Also, Perrow (1972) believes that nepotism makes it difficult, if not impossible, for family members to monitor each other effectively.

Therefore, the question of whether family ownership provides incentives to reduce agency costs (through a better alignment of shareholder and managerial interests) or create it (by providing opportunities for family members to expropriate the wealth of outside shareholders) remains an open empirical issue (Bartholomeusz ans Tanewski, 2006). The
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The strongest evidence in the emerging literature tends to corroborate the former, monitoring hypothesis (Anderson and Reeb 2003; Anderson, Mansi, and Reeb 2003), whereas research by Schulze et al. (2001), conducted in the context of proprietary companies, supports the alternative, expropriation hypothesis.

In an attempt to clarify the relationship between ownership and management, in a study of non-listed of Spanish family firms, Arosa, Iturralde, and Maseda (2009) find that in first generation family firms there is a positive relationship between ownership concentration and corporate performance at low level of control rights as a result of the monitoring hypothesis. However, when ownership concentration is high this relationship becomes negative as shareholders try to expropriate wealth from minority shareholders because of the great influence that a controlling family can exercise. Therefore, the expropriation hypothesis prevails. Furthermore, Block, Jaskiewicz, and Miller (2012) assess the distinctive performance effects of family and founder presence in both ownership and management by using Bayesian regression analyses in order to avoid incurring into problems of multicollinearity. Their results show that the probability of ownership by family having a positive influence on performance is much higher than that of family management. In both cases the ownership and management by founder exert a larger positive influence than for later generations. These arguments connect to another theoretical stream that deals with the way that family firms are managed to which we turn now.

2.2 Resource-Based Viewpoint and Performance

This perspective suggests that firms with assets that are valuable, rare, inimitable, and no substitutable may be able to create a sustainable competitive advantage (Barney, 1991; Penrose, 1959; Habbershon and Williams, 1999; Sirmon and Hitt, 2003; Miller and Le Breton Miller, 2006). It is argued that certain unique governance conditions make some family-controlled business especially apt to invest in the long term, thereby helping to create inimitable or “asymmetric” capabilities that sustain competitive advantage (Miller, LeBreton-Miller, and Cannella, 2007). These investments can be in infrastructure and R&D, knowledge creation and preservation, and broad-based and long-term relationships with external stakeholders. Thus, three types of capital (or assets) have been associated to the performance of family firms: (1) human capital, (2) social capital, and (3) physical/financial capital (Dyer, 2006).

Human capital. One resource that can give a firm a competitive advantage is human capital. The family business’s unique features (commitment, shared values, culture, trust, reputation, and so on) give it certain strategic resources and capabilities that could account for its long-term success (Cabrera-Suárez and De Saá Pérez, 1996; Habbershon and Williams, 1999). However, to perform well, a firm needs more than its bundle of resources and capabilities. It also requires the tacit collective knowledge embedded in the firm’s routines to integrate, coordinate, and mobilize those resources and capabilities successfully (Grant, 1996). Following Chandler (1962) and Rumelt (1974), there must be an alignment between the firm’s strategy and structures for a positive performance. Considering this fit premise, Lindow, Stubner, and Wulf (2010) find that the family power leads to lower delegation on
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decision-making power in a family firm organizational structure. This is in line with prior studies (e.g. Bartholomeusz & Tanewski, 2006; Gómez-Mejía et al., 2007) that show that when family influence is highest family firms are least willing to give up control. As a result of their findings, Lindow et al. (2010) show that family firms are better aligned to pursue a defender rather than a analyzer or prospector strategy (Miles and Snow, 1978), given the centralization degree in family business. Moreover family firms potentially retain their centralized structures as they grow and therefore, encounter strategic misfit. Additionally, family firms have a limited pool of potential recruits, thus the family may not be able to supply the firm with enough talented people to manage the key operations (Dyer, 2006).

Social capital. This is a complex phenomenon, but simply stated, it is “the goodwill that is engendered by the fabric of social relations and that can be mobilized to facilitate action” (Adler and Kwon, 2002, p.75). Therefore, the enduring nature of family connections and commitments may give families certain advantages in developing and maintaining social capital (Sirmon and Hitt, 2003; Steier, 2001). A study by Athanassiou, Crittenden, Kelly, and Márquez (2002) reveals the role of the founder in Mexican family business using social networks to understand the founder’s influence on key strategic behaviors. Their results indicate that family-goal performance (providing family members with employment opportunities, funding family members’ education expenses or providing other short-and long-term family welfare goals) is not merely an extension of the wish or will of the founder, but requires top management group (TMG) cohesiveness for this achievement. Thus, personal networks and relationships would be expected to play a much bigger role in business success in Mexico than they do in the developed countries, like the U.S. (Kras, 1989; Stephens and Greer, 1995). In summary, to the extent that familial social capital provides access to resources, generate “goodwill on the part of customers and other stakeholders, and forces strong ties between the family and its work force, family firms may have some unique resources to create a competitive advantage (Dyer, 2006)

Physical and financial capital. In the case of this type of capital, Sirmon and Hitt (2003) believe that family firms with “survivability capital, which represents the pooled of financial resources of the family, can provide the firm with a competitive advantage compared to those firms without access to such resources. However, Haynes, Walker, Rowe, and Hong (1999) argue that families are much more likely to draw on firm resource to meet family needs that they are to use family resources for the benefit of the firm. This may cause that in the search for self-disciplining their finances, family firm may decide to become public family firms, while having a larger access to resources, too. However, according to O’Boyle Jr. Pollack, Jeffrey, and Rutherford (2012), we should not overstate the benefits of being public for their access to capital; the propensity for members of smaller firms to display stewardship behaviors explains this finding.

Within this context described by the agency theory and the RBV in the family firm, Gómez-Mejía, et al. (2007) argue that family firms are likely to place high priority on preserving socioemotional wealth by maintaining family control even if this means accepting an increased risk of poor firm performance. Yet, because they must also keep the firm from
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failing, they may also act more conservatively by avoiding business decision that may increase performance variability. Socioemotional wealth is referred to non-financial aspects of the firm that meets the family’s affective needs, such as identity, the ability to exercise family influence, and the perpetuation of the family dynasty. The stronger the role of the family, the more likely the firm is to strive to protect its socioemotional wealth, such that willingness to give up family control is lowest at the founding-family-controlled and managed stage, moderate at the non-founding extended-family-owned and managed stage, and highest at the extended-family-owned and professionally managed stage. In summary, by trying to keep socioeconomic wealth family firms may avoid undertaking diversification strategies. The process of diversification is complex and usually requires outsiders’ talent or external funding that can be perceived as a loss of control, and posed a hazard to the family’s socioemotional wealth. Therefore, we suggest the following hypothesis:

H1: The higher the concentration of family ownership the lower the degree of diversification.

In order to get the benefits of agency costs and the RBV and overcome their negative effects, firms may create governance structures. When ownership or control is too concentrated or dispersed, when control is exercised without much ownership, and when too many family members clash or drain resources, financial performance suffers (Miller and Le-Breton Miller, 2006).

2.3. Role of Board of Directors

As García-Ramos and García-Olalla (2011) argue, from an agency theory standpoint, a primary task that the board of directors should perform as an internal administrative body is the monitoring of management on behalf of shareholders, since effective monitoring can improve firm performance by reducing agency costs (Eisenhardt, 1989; Fama & Jensen, 1983; Jensen, 1993; Jensen and Meckling, 1976). Agency problems emerge not only from shareholder–manager conflict but also from the owner–owner conflict stemming from the divergent interests of majority and minority shareholders (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 1999; Shleifer and Vishny, 1997). With respect to the latter, two sources of agency problems can be identified: the owning family’s pursuit of its own economic interests and the owning family’s pursuit of its own noneconomic interests (Bammnes, Voordecker, and Van Gils, 2010). When examining the board’s possible role in mitigating conflicts between opposing shareholder groups, Anderson and Reeb (2004) argue that founding families are in exceptional control positions to pursue their interests, indicating the potential for conflicts over the distribution of wealth between opposing shareholder groups.

Although firms with concentrated ownership, i.e. family controlled firms, tend to prefer lower levels of diversification as a means of protecting their socioemotional wealth (Gómez-Mejía et al., 2007). Jones, et al. (2008) posit the role of affiliate directors in mitigating fears family firms top management of losing control and reduce the threats to their socioemotional wealth. Affiliates, accordingly, are those directors linked to the focal firms through a business relationship forged between their employer and the focal firm. Affiliates are able to create
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strong ties with family managers based on the social capital generated in their interaction with family members. In this way they motivate the family firms to take on diversification initiative. On the one hand, affiliates provide specialist knowledge that fills those gaps in the family talent stock. On the other hand, they may serve as the conducts for getting access to more financial resources.

At this point, we have to consider some particular aspects related to corporate governance in Mexican listed firms. According to the Mexican Stock Exchange Law, the figure of affiliates is not accepted as they can be a source of conflict of interests between the focal firm and the other firms with whom it maintains business relationships. Besides the participation of shareholders in the board of directors, according to this law, there are two other type of directors: related and independent. The former are those directors who, not being a member of the controlling or founder family, participate in the top management group of the company. The latter, the independent directors, are those who neither maintain a family tie with the founding or controlling family, nor hold any position in the company’s staff, nor maintain directly or indirectly any kind of trade relationship with the company.

Concerning the related directors, we can expect them to play an important role within the boards as potential promoters of diversification strategies. They have created strong ties with family managers based on the social capital generated in their interaction with family members, and they are evidently a valuable source of talent and knowledge that complements those of the family members (Athanassiou, et al., 2002).

Independent director may certainly play a positive role in firms by creating greater value as some authors have found (Miller and Le Breton Miller, 2006; Anderson and Reeb, 2004). Because of the relative lack of some governance mechanisms in family firms, outside shareholders potentially rely on boards of directors to monitor and control families’ opportunism. Independent directors contribute expertise and objectivity that ostensibly minimize managerial entrenchment and expropriation (Dalton, Daily, Ellstrand, and Johnson, 1988). Independent directors can also impose structural constraints on the family by limiting their participation in important board subcommittee, nominating committee, and compensation committee (Anderson and Reeb, 2004).

This contribution is more important when there is a strong family CEO without complete voting control and accountable to independent directors, when multiple family members serve as managers, and when the family intends to keep the business for generations. (Miller and Le Breton Miller, 2006). Often, these conditions are found in an established family business still being run by its founder.

However, according to Anderson and Reeb (2004), families themselves do not necessarily seek to place independent director on the firm’s board. Instead, it implies that outside shareholders call for independent directors on the board to minimize founding-family opportunism. These results highlight the importance of appropriate governance mechanisms in the presence of large shareholders, even in countries with relatively strong legal
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safeguards. According to Villalonga and Amit (2006) that have examined extensively the role of external directors in the U.S., a disproportionate board representation by family members comes at the cost of reduced firm value. However, using voting agreements tends to increase family firm value.

Thus, we find sufficient grounds to expect that both, independent and related, or external directors’ presence on boards may be linked to promoting diversification strategies. In this way, their role focuses family firm’s attention to new options for increasing financial wealth and reducing entrenchment and expropriation of the main shareholders. Therefore, we advance the following hypothesis:

H2. The higher the percentage of external directors on the board the higher the degree of diversification.

The notion of stewardship in family businesses may provide a different explanation on the role of boards. Families, acting as stewards, may constitute boards to assist in decision-making processes, collaborate in defining corporate strategy, offer improved access to information and capital, and generally to promote corporate welfare (Gómez-Mejía and Wiseman, 1997; Westphal, 1999). Thus, stewardship and agency theories provide a complementary perspective on the role that external directors play on the board and in the firm. Following this line of thought we can advance the following hypothesis:

H3. The higher the percentage of external directors on the board combined with larger family ownership the higher the degree of diversification.

As García-Ramos and García-Olalla (2011) argue, founder lead family business (FLFB) may choose independent directors people who are not truly independent, but have a friendly or contractual relationship with the company or its founder. On the other hand, in non-founder lead family businesses (NFLFB) participation in board of directors of firm executives with specific knowledge becomes more relevant for firm performance. Lambrecht and Lievens (2008) have also explained that in the course of setting boards in FLFBs, directors often comprise family or non-family members who share the same interests, values and perspectives with the founder. Dyer (1988) finds that 80% of FLFBs have a paternalistic management culture and style characterized by hierarchical relationships, top management control of power and authority, and close supervision. These results indicate that families may place external directors on the board to facilitate the family’s expropriation of the firm’s resources. (Anderson and Reeb, 2004). These findings suggest the following hypothesis:

H4. The role of external directors on the board in promoting diversification is higher in NFLFB than in FLFB.

In connection to the hypothesis mentioned above, we can also deduce that when the position of the CEO is occupied by a member of the family, firms will be less inclined to pursue diversification strategies. In support of this, Amihud and Lev (1981) find that manager-controlled firms engage in conglomerate acquisition to a greater extent than ownership-controlled firms. Thus, we propose the following hypothesis:
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H5. The family membership of the CEO is linked to lower degree of diversification.

Also, size becomes relevant in this context. According to Tsai, Kuo, and Hung (2009), large family firms are more likely to engage in corporate diversification than small firms given the larger reserve of resources and capacities at their disposal. Therefore, we propose the next hypothesis:

H6. Large firms exhibit significantly higher degree of diversification than small firms.

Combs (2008) questions Jones et al. (2008)’s findings because they tried to generalize these to family firms when the governance structure, strategic focus and performance goals of public family firms may be different to private family firms. Following this line of thought he argues that affiliates on public family firms’ boards can be finally trying to get advantages for their employers. And, as they maintain a close relationship with family managers, they are able to be listened and trusted by family managers. If that is so, Combs (2008) expects that affiliates will be able to motivate family firms to diversify into other businesses even though these are not very promising in terms of contributing to the level of performance. Attending to this possible opportunistic behavior of affiliate directors, external in our case, we would expect that their presence will most likely lead to deteriorate firm’s performance. These arguments conduce us to suggest the following hypothesis:

H7. The higher the degree of diversification the lower the level of performance in family firms.

3. Method

3.1. The sample

To test our hypotheses we use data of public businesses in Mexico for the period 2005-2011. The selected companies should have sales in at least two different business segments, and the available data should cover the whole period under analysis, 2005-2011. There were 75 companies that fulfill these conditions. We obtained financial indicators from Economatica\(^1\) and Isi Emerging markets. Information about industrial sector and board composition was obtained from the company annual reports published by the Mexican Stock Exchange on its website. Thus, we were able to count with 525 observations. To differentiate between family and non-family companies we use the cutoff point of 40 percent of family ownership concentration (San Martín and Duran, 2012).

3.2 Measures

The extent of degree of diversification (DD) is measured using the entropy measure (Hitt, Hoskisson and Kim, 1997). Following Hitt et al., that measure is estimated as follows:

\(^1\) This is an important data base that contains financial and economic data of Mexican firms.
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Entropy = \sum_i [P_i \times \ln(1/P_i)]

Where \(P_i\) represents the proportion of sales attributed to business segment “\(i\)”.

To measure performance we use one market and one financial measure, “Tobin’s Q”\(^2\) or the asset market-to-book ratio, and the return on equity (ROE). The percentage of external directors in the board composition was represented by the variable “\%External”. “FAMOWN” measures the ownership concentration of the founder or family business, “CFAM” is a binary variable that takes the value of 1 when the position CEO is occupied by a member of the dominant family, and “0” otherwise. The joint effect of external directors in the board and the concentration of family ownership was calculated by multiplying \%External by FAMOWN. “Assets” indicates the assets amount in millions of Mexican pesos of total as measured by the natural logarithm of assets, and finally, and “Age” is used to represent the number of years a company has been in operation as a proxy for the family generation in control of the firm.

3.3. Regression analysis

To test our hypothesis we applied the Fixed-effect regression analysis. Given the aim of the study, the panel data methodology seems to be the most accurate (Arellano and Bover, 1990; Arellano, 1993). The fixed-effects term is unobservable, and hence becomes part of the random component in the estimated model. It is quite convincing that each one of the firms in the sample has its own specificity (e.g., the way it is run by the managers, the impression it makes to the market, the way it generates growth opportunities, etc). This specificity is different from a company to company and it is almost certain to be kept throughout the study period. A pooling analysis of all the companies without noticing these peculiar characteristics could cause an omission bias and distort the results. On the other hand, the dynamic dimension of a panel data enhances testing long time adjusting processes and determining the degree of diversification or the market performance when the explanatory variables change (De Andres, López, and Rodríguez, A 2005). The random error term \(\varepsilon_{it}\) controls both, the error in the measurement of the variables and the omission of some relevant explanatory variables. With regard to the basic model to be estimated, a multivariate regression model has been built including most of the previously cited variables. This model can be expressed with the following equation, where \(i\) refers to the firms and \(t\) to the year (\(i = 1,...,75; t = 1,...,7\))

\[
DD = \beta + \beta_1 \text{Age}_{it} + \beta_2 \text{CFAM}_{it} + \beta_3 \text{Assets}_{it} + \beta_4 \text{FAMOWN}_{it} + \beta_5 \text{FamExternal}_{it} + \beta_6 \%\text{External}_{it} + \varepsilon_{it}
\]

4. Results

In table 1 we present the main descriptive statistics of the sample.

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\(^2\) It is common in the literature on corporate governance to use this measure as the dependent variable (De Andres et al., 2005; Fernández, Gómez-Ansón, and Fernández, 1998)
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Table 1
Descriptive statistics of the sample

<table>
<thead>
<tr>
<th>Parameter</th>
<th>FAMOWN</th>
<th>CFAM Directors</th>
<th>No. Owners</th>
<th>No. Independents</th>
<th>No. Related</th>
<th>No. Externals</th>
<th>% Related</th>
<th>% Independents</th>
<th>% External</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td>0.54</td>
<td>56.7%</td>
<td>11.9</td>
<td>4.3</td>
<td>5.4</td>
<td>2.1</td>
<td>7.6</td>
<td>16.5%</td>
<td>45.6%</td>
</tr>
<tr>
<td>StDev.</td>
<td>0.21</td>
<td>0.50</td>
<td>3.63</td>
<td>2.31</td>
<td>2.42</td>
<td>2.45</td>
<td>3.68</td>
<td>0.17</td>
<td>0.14</td>
</tr>
<tr>
<td>Minimum</td>
<td>0.02</td>
<td>0.0%</td>
<td>5.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Maximum</td>
<td>0.98</td>
<td>100.0%</td>
<td>20.0</td>
<td>11.0</td>
<td>14.0</td>
<td>11.0</td>
<td>19.0</td>
<td>72.7%</td>
<td>81.8%</td>
</tr>
</tbody>
</table>

We can observe that the concentration of family ownership in public companies in Mexico is very high, an average of 54%, and that in most companies (56.7%) the position of CEO is occupied by a member of the dominant family. In terms of the board composition we observe that external directors tend to dominate, as an average of 62% is covered by this type of director, mainly the independent type, with an average of 45.6%. The average age of these companies is 41 years, ranging from a minimum of 7 to a maximum of 164 years.

We show the results of the first model that regresses degree of diversification (DD) on the other variables in table 2.

Table 2
Regression analysis of degree of diversification on percentage of external directors and other relevant variables
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<table>
<thead>
<tr>
<th>DD</th>
<th>Coefficient</th>
<th>t-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>0.0066135</td>
<td>1.20</td>
<td>0.230</td>
</tr>
<tr>
<td>CFAM</td>
<td>0.0073221</td>
<td>0.10</td>
<td>0.919</td>
</tr>
<tr>
<td>Assets</td>
<td>0.0053114</td>
<td>0.16</td>
<td>0.873</td>
</tr>
<tr>
<td>FAMOWN</td>
<td>-0.1318237</td>
<td>-1.95</td>
<td>0.050</td>
</tr>
<tr>
<td>FamExternal</td>
<td>0.2992133</td>
<td>2.15</td>
<td>0.032</td>
</tr>
<tr>
<td>% External</td>
<td>-0.1007243</td>
<td>-0.86</td>
<td>0.390</td>
</tr>
<tr>
<td>_cons</td>
<td>0.5598684</td>
<td>-0.86</td>
<td>0.390</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hausman Test</td>
<td>46.21</td>
<td></td>
<td>0.000</td>
</tr>
</tbody>
</table>

According to the results hypothesis 1 is accepted as there is a negative and significant relationship between the level of family ownership concentration and the degree of diversification. However, there does not seem to be an association between the percentage of external directors in the boards and the degree of diversification.

The hypothesis 3 that combines the effect of percentage of external in the board and family ownership is supported, as there is a high significant positive association of this variable with the degree of diversification.

The hypothesis 4 that associates the generation in charge (FLFB or NFLFB) to the degree of diversification using the age as a proxy is rejected. Neither the hypothesis 5 that links the membership to a lower degree of diversification, nor hypothesis 6 that associates this latter to size of the firm show a significant relationship.

In order to test hypothesis 7 we divided the sample into two subsamples, considering on the one hand, family firms as those whose family ownership concentration is equal or greater than 40%, and non-family firms with an ownership concentration of less than 40%. The results of the regression of Tobin’s Q on the degree of diversification and other variables are shown in table 3.

**Table 3**

Regression analysis of Tobin’s Q on degree of diversification in family and non-family firms
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Hypothesis 7 is supported as the higher the degree of diversification the lower the level of performance in family firms as measured by Tobin’s Q. On the other hand, for non-family business the opposite is true, there is a positive association between Tobin’s Q and the degree of diversification.

5. Discussion

From the results obtained we are able to corroborate that effectively family firms tend to keep a more conservative view about expanding the company into other related or unrelated businesses. The pursuance of socioemotional wealth, moreover in the context of developing countries, seems to influence owners’ attitude against taking risks in new business areas. The reliance on outsiders to conduct this diversification and probably the need to incur into debt for carrying on this type of strategies create real limits in family firms’ initiatives.

The participation of external directors in the boards by itself does not seem to be enough to surmount those fears held by family business shareholders. As we see, a large proportion of these externals are represented by independent directors whose lack of interaction with family members makes them unable to mitigate family owners’ perception of risk, role that apparently affiliates do well in the study of Jones et al. (2008). Moreover, in the case of related directors, we may think that their interest to maintain managerial positions and remunerations within the family firms leads them to assume a conservative attitude that reduces venturing into new businesses.

Nevertheless, when the high level of family ownership concentration is complemented by a significant participation of external directors, firms are more prone to undertake diversification strategies. We can think that the shareholders in this case, given their high participation in the firm’s equity, are more inclined to take into account the views of independent and related directors, as they may understand these options as a way to preserve
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and grow their wealth. The large level of resources they control within the family firm may serve as an incentive to look for new ventures where these can be invested. Another possible explanation may come from the need to enter new businesses as a way to open opportunities to other members of the dominant family.

However, the high level of property concentration does not necessarily mean that owners are willing to assume the CEO position, as there is not a significant association of this with diversification strategies. In this case, it seems important to mention the findings of Block et al. (2008) that owners try to influence more in firms’ performance by participating in the ownership rather than in management, independently of the level of performance.

The larger size and the number of years in operations do not show any influence in the degree of diversification. Probably, an important proportion of these firms have a monopolistic position in the market that makes it unnecessary, by the time being, to enter into new product-markets. This situation may compensate the cases where older and large companies may have effectively achieved a relevant level of diversification.

The last result, regarding the performance of firms associated to their degree of diversification and how this differs according to the level of ownership concentration, deserves some explanation. We may think that even though some family firms have decided to diversify, many time they do so as a result of finding moral support rather than a more formal analysis of market opportunities and firms’ strengths. This brings to the discussion the findings García-Ramos and García-Olalla (2011) that show that in many FLFB founders seem to want no more assistance from boards than formal approval. And they appear no to want opinions more diverse than those provided by subordinate family members or close advisers who can be trusted to raise no fundamental questions about the direction in which the founder is taking the business. A different situation seems to take place in non-family firms where the advice of directors in the board are more solidly grounded.

6. Conclusions

External directors in Mexican boards of listed family firms are not capable to promote greater diversification, as Jones et al. (2008) finds for the US case when considering the participation of affiliates. However the findings of this work provides some relevant role that these externals undertake when they advise firms where the level of family ownership concentration is significant. Their support, more moral than technical, may serve as a mechanism to mitigate socioemotional wealth of the larger shareholders.

However, in order to explain better and broadly these results, research must inquire also into the family characteristics of the owner, such as size and complexity of the family, and more precise information about the generation in charge, and not to rely only on the years that firms have been functioning.
Another important limitation of this study that is common to many of the studies that have focused on strategies of diversification has to do with temporal stability issues. As Ramanujan and Varadarajan (1989) reminded us some years ago, researchers need to be cautious in specifying the time-frame of their studies (for instance, whether recessionary or expansionary), qualify their finding to reflect the possibility of temporal effects, and perform periodic replications. Difficult, as they are to design and execute, longitudinal studies of diversification are vital but unmet in this stream of research, and must be attempted.

This work is an initial attempt to provide some knowledge on the particular situation of the functioning of boards on family businesses in a developing country such as Mexico, considering in this case diversification strategies. Particular aspects, such as the presence of monopolies in Mexico, have been able to contextualize some of the findings in this work. The relationship between diversification strategies and lower level of market performance of family firms is an important warning for firms when selecting their board members. The more competitive and openness of the markets worldwide will demand from those firms to structure government bodies with better knowledge and capacities to support businesses’ decision making.
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