CHARACTERISTICS OF FAMILY BUSINESSES IN THE CZECH REPUBLIC

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Abstract

Family businesses are often considered to be different from non-family businesses because they are led or owned by family members whose aim is to continue the activities of their companies across multiple generations. According to the existing research, family businesses seem to outperform non-family businesses in terms of efficiency and financial performance. However, in the Czech Republic, the question of family business has been neglected. In this paper, we deal with basic characteristics of family firms in the Czech Republic. We also assess their financial performance and compare it with other firms using return on assets, return on equity, return on sales and labor productivity. The results are multivalent. Family businesses outperform other firms in terms of return on assets and return on equity, but other firms are more efficient in terms of return on sales and labor productivity.

Keywords: Family businesses, Characteristics, Performance

Introduction

While there is an ongoing debate on what are the roles and relationships among management of companies, their owners and other stakeholders, family businesses are often considered to be different from non-family businesses because they are led or owned by family members whose aim is to continue the activities of their companies across multiple generations. It is possible to assume a certain degree of altruism among family members which is based on the moral and normative order in almost all cultures in the world.

Family businesses represent a substantial part of the world economics. For instance, according to Anderson and Reeb (2003), family firms represent one third of all companies included in the Standard & Poor 500 index. In some collectivist cultures, for example in Asia or Latin America, family businesses represent a prevalent form of entrepreneurship (Carney and Gedajlovic, 2002).

A question which necessarily arises is that family businesses outperform non-family businesses and why. The result of family involvement in the firms is often referred to as *family effect*.

In this paper, we will deal with basic characteristics of family businesses in the Czech Republic. In the first part of the paper, we will present the existing experience with measuring performance gaps between family and non-family firms. In the next part of the paper, we will describe the data used in our analysis which will represent the basis for further research. Then, we will describe the basic characteristics of Czech family firms in terms of headcount, sales and net earnings. In the last part of the paper, we will evaluate the financial performance of family businesses using profitability ratios and compare it with the Czech economy as a whole.

Family Businesses and Their Performance

Family firms have a number of financial and non-financial goals. Some authors suggest that while the owners of family firms attempt to maximize the long-term value of their companies, managers of non-family firms concentrate to a shorter time period and focus on their personal goals (see e.g. Daily and Dollinger, 1992). The involvement of family on the ownership and management may have positive as well as negative consequences. Among the positive effects of family involvement, we may cite possible intimate relationships among managers and owners as well as other employees which may result in a better dissemination of knowledge within the firm. However, it is also possible that family businesses, especially the small ones, are not motivated to follow financial goals and are satisfied with maintaining the status quo (see e.g. Birley, 2000). Therefore, existing studies which examined the performance of family businesses present ambiguous results.

While many authors observed a better performance of family firms (Aguiló and Aguiló, 2012; Allouche et al., 2008; Cassia, De Massis and Kotlar, 2012; Coleman and Carsky, 1999; Gallo and Estapé, 1992; Maury, 2006; McConaughy, Matthews and Fialko, 2001; San Martin-Reyna and Duran-Encalada, 2012; Shyu, 2011, among others), other researches present opposite results: a negative relationship between family involvement and performance (for instance, Gallo, Tapies, and Cappuyns, 2000; Lam and Lee, 2012; Lin and Chen, 2012; Oswald, Muse, and Rutherford, 2007; Perez-Gonzalez, 2006; Westhead and Howorth, 2006). A number of other authors did not observe a significant effect of family involvement of business performance (Chrisman, Chua and Litz, 2004; Demsetz and Villalonga, 2001; Himmelberg, Hubbard and Palia, 1999; Schulze et al., 2001).

According to some researchers, family businesses outperform non-family businesses, but their performance decreases across generations. The control of firms by heirs is often associated with a lower profitability and growth of firms (Bennedsen et al., 2007; Morck, Strangeland and Yeung, 1198; Villalonga and Amit, 2006). Moreover, non-family firms often grow faster than family firms because family members attempt to maintain family ownership at the expense of growth (Birley, 2000; Daily and Dollinger, 1993).

It is also assumed that the family involvement has a positive impact on business performance, but only up to a certain level; after having exceeded a certain limit, the negative effects of family involvement may prevail. This aspect is modelled using an inverted U-shaped curve (Ernst, Kraus and Matser, 2012; Holdermess et al., 1999; Kowalewski, Talavera and Stetsyuk, 2009; Sciascia and Mazzola, 2008).

We should not omit various performance measures used in the analyses. In the majority of existing studies, the performance of companies has been measured using return on assets (ROA), followed by Tobin's q and sales growth (Machek, Brabec and Hnilica, 2013). The diversity of performance measures may have resulted in contradictory results that the studies presented.

Family Business Definitions

The definition of family business is far from being standardized. Some authors define a family business as any company in which majority ownership or control is carried out by a single family and in which two or more family members are or at some time were directly involved in the business. Leach (2007) defines family businesses as companies where family members own at least 50 percent of the business. Other authors consider a firm as a family enterprise when a family or a private person controls 20% or more of the voting rights (Anderson and Reeb, 2003), while others define family businesses as enterprises in which one or more family members are officers or directors, or own 5% or more of the firm's equity, either individually or as a group (Villalonga and Amit, 2006). Most definitions of family business vary in terms of degrees of family involvement. If follows that since the definitions of family businesses vary, most studies on performance gaps between family and non-family businesses will differ in the data sample definition, which has a fundamental impact on the results.

Basic Characteristics of Czech Family Businesses

In this section, we will present basic characteristics of family businesses in the Czech Republic. While some authors dealt with the relationship of ownership concentration and performance in the Czech Republic (Claessens a Djankov, 1999), no analyses of Czech family firms have been carried out in the past research.

The distinction of family and non-family businesses is extremely difficult, especially because of three reasons:

- There is no unique definition of family business.
- Czech companies have no legal obligation to disclose whether they are family firms or not. Such data are not available in any publicly accessible databases.
- It may be difficult to trace up the real physical owner if the ownership is realized through multiple legal persons.

We obtained the initial data set from the database "Magnus" (maintained by the Bisnode company) which contains complex information about Czech economic subjects. The time period under consideration was 2006-2012. From the available data, we had to filter out firms which can be classified as family firms.

To distinguish family firms from non-family firms, we decided to use the family name criterion. A firms has been marked as a family firms if there were multiple persons of the identical family name among

- managers, or
- owners, or
- executive boards.

During the filtration process, we took into consideration that in the Czech Republic, female family names usually end in –ová (for instance, if the husband's name is Novák, the name of the spouse is Nováková). Only firms with more than 10 employees and total turnover greater than 30 mil. CZK (ca 1.164 mil. EUR) have been included in the sample.

The resulting data set contains 5 709 family firms which operated on the Czech markets in the period under consideration.

Among the basic characteristics, we present the number of employees, total sales and total net earnings (for 2012, the dataset is not complete).

Tab. 1 Basic characteristics of Czech family businesses

	No. of subjects	**Headcount**			**Sales (1000 CZK)**		**Net earnings (1000 CZK)**	
		Total	**Average**	**Median**	**Average**	**Median**	**Average**	**Median**
2006	2617	303 468	115.96	50.00	139 180	40 139	10 928	2 038
2007	3183	331 168	104.04	47.00	149 489	44 725	14 026	2 942
2008	3578	344 819	96.37	44.00	161 392	46 047	10 886	2 140
2009	3708	338 789	91.37	40.00	149 375	40 938	11 987	1 407
2010	3811	329 587	86.48	39.00	167 648	43 354	8 389	1 701
2011	3553	314 861	88.62	40.00	195 902	48 474	12 585	2 148
2012	1093	139 725	127.84	47.00	248 690	51 089	15 329	2 026

Source: Own calculations; Magnus database.

Apparently, most of the Czech family businesses belong to the class of small and medium enterprises (SMEs) since the median of the number of employees does not exceed 50. We can also assume a positive skewness of the distribution since the average is almost two times greater than the median. The same observation applies for total sales and net earnings.

Financial Performance of Czech Family Businesses:

In order to assess financial performance, we employed frequently used profitability indicators, in particular return on assets (ROA) as the ratio of earnings before interests and taxes (EBIT) over total assets, return on equity (ROE) as the ratio of net earnings over equity, and return on sales (ROS) as the ratio of EBIT over total sales.

Further, we calculated the labor productivity as the ratio of personnel costs over value added. The comparison has been made with the sample of *all* Czech firms whose sales exceed 30 mil. CZK and number of employees exceeds 10 (this sample contains 11 782 firms).

Tab. 2 Financial performance comparison

	Family Businesses				**Czech Republic**			
	ROA	**ROE**	**ROS**	**Labor productivity**	**ROA**	**ROE**	**ROS**	**Labor productivity**
2006	0.076	0.130	0.094	0.498	0.072	0.148	0.088	0.652
2007	0.082	0.148	0.105	0.516	0.080	0.162	0.098	0.643
2008	0.067	0.110	0.084	0.540	0.064	0.120	0.081	0.687
2009	0.068	0.114	0.091	0.529	0.049	0.083	0.069	0.711
2010	0.042	0.078	0.053	0.552	0.054	0.097	0.073	0.708
2011	0.060	0.105	0.071	0.561	0.053	0.096	0.070	0.696
2012	0.070	0.113	0.075	0.514	0.050	0.088	0.060	0.719

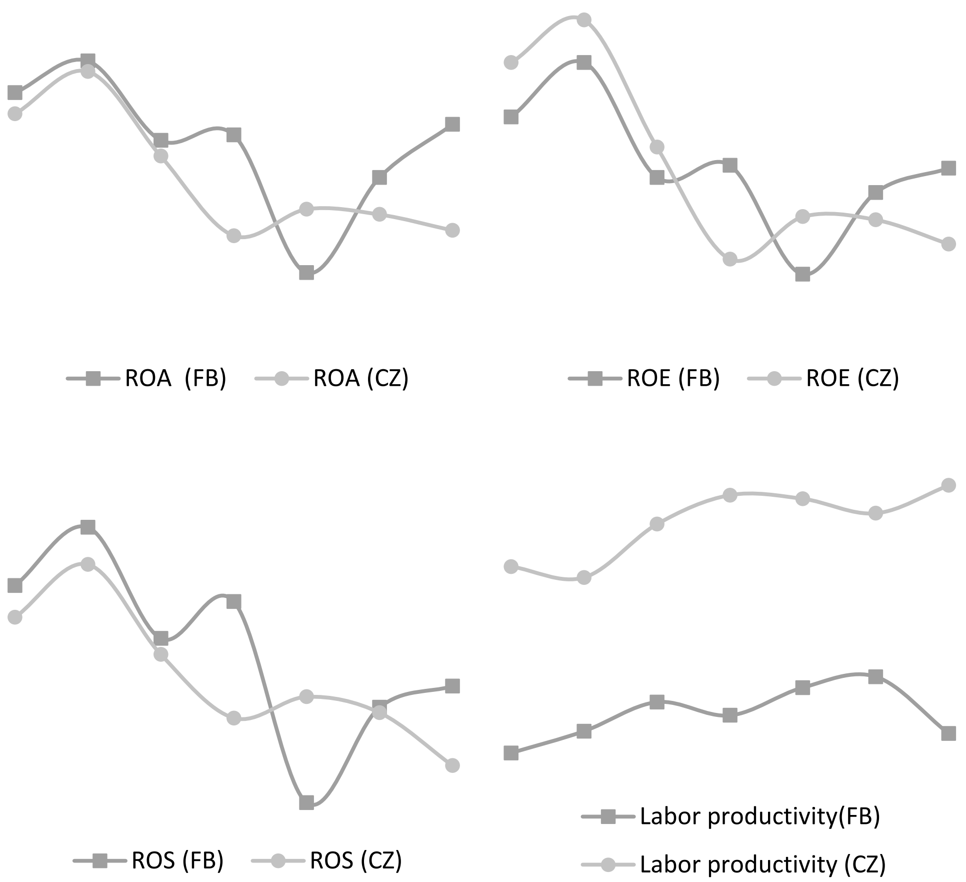
Source: Own calculations; Magnus database.

The mutual comparison can be also illustrated using the following figures (FB denotes family firms, CZ denotes Czech Republic). If we had used only ROA to evaluate financial performance (like most studies in the past did), we would observe that in the period under consideration, family businesses outperformed other firms (with the exception of 2010), while the difference was not substantial. In terms of ROS (profit margin), the findings would be analogous.

However, when taking into account other indicators, the more profitable group of firms is not clear-cut. Return on equity of non-family firms is greater than the one of family firms in 2006-2007 and 2010, while in terms of labor productivity, the average labor productivity in the Czech republic is significantly higher than the one of family businesses.

So, we are not able to determine the more profitable group of firms. However, our analysis differs in the number of evaluated subjects. While the average number of subjects in past analyses (carried out until 2013) was 947 firms (Machek, Brabec and Hnilica, 2013), the number of evaluated subjects in our analysis is of 5 709 firms. However, our time period 2006-2012 is limited. It is also important to stress the possible bias due to the data filtration method: on one hand, there may be firms which are actually non-family firms in the sample (due to a possible namesake within the firms), and on the other hand, some family firms may not be included in the sample (for instance, if the spouse decided to maintain her name after marriage).

Figure 1: Financial performance comparison



Source: Own calculations; Magnus database.

Conclusion

This article is one of the first outcomes of the project which deals with the difference of family and non-family firms. The collection of the sample of Czech family businesses is very challenging. To distinguish family and non-family firms, we observed multiple occurrence of identical family names among managers, owners or executive board members. This definition has some limitations. Firstly, it may be difficult to trace up the real physical owner if the ownership is realized through multiple legal persons. We also have to pay attention to frequent Czech family names which could possibly distort the sample of family firms. Last but not least, the family name criterion fails if two persons decide to maintain their family names after marriage. However, if we assume the above-mentioned definition to be one of the few possible ways to collect a large sample of family businesses, we can analyze their properties and compare them with other firms.

In this paper, we presented the basic characteristics of Czech family businesses in terms of number of employees, turnover and net earnings. Most Czech family businesses belong to the class of small and medium enterprises. The fact that companies with less than 10 employees have been excluded from the analysis only confirms this hypothesis.

As to financial profitability, family businesses outperformed other firms in terms of return on assets or return on sales. In terms of return on equity and labor productivity, family firms performed worse than the average of the Czech economy.

However, it is necessary to stress the possible bias due to the above-mentioned data filtration method. The future research will be focused on a more accurate definition of family business sample, as well as on refining the sample we already collected to reduce the possible bias. The performance of firms may also be measured using other indicators, such as total factor productivity or firm growth.

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