The Role of Family Ownership in Business Diversification

– *Hsi-Mei Chung*

Over the years, successful family businesses often grow to become a group of firms. These may operate either in related or diverse businesses. These firms are associated through several links often forming a pyramidal ownership structure. However, little is known on how the family management and ownership structure influence the diversification and growth of the family business groups. In this study, the author analyzed data from the top 100 family businesses in Taiwan between 1988 and 2002 to assess the role of family ownership structures in business diversification. The study and its findings are succinctly presented in this summary.

Family Ownership and Diversification

Businesses diversify in order to tap emerging growth opportunities and gain advantages of scope. However, in family business context diversification is constrained on several counts:

1. Family's closed management structure: Family members are the key decision-makers responsible for managing the business. Retention of socio-emotional wealth is a key family goal due to which key management positions are generally given to family members. Thus, the diversification of a family business could be constrained by the closed management structure of the family.

2. Capabilities of family members: In many emerging markets, there are no legal requirements to have independent directors or external professionals, which may reduce the flow of new ideas or business leads. It may also limit the firm's management capabilities to the available members of family. Thus, family managements may not be able to diversify and tap an emerging business opportunity.

3. Domain familiarity: In order to retain family control and achieve family goals, decision-making process is controlled by a closed inner-group of the family, which excludes an outside perspective. Thus, family businesses mostly limit their growth to the business/industrial domains that are familiar to the family members.

4. Desire for control: The desire to keep control within the family is even stronger in a family business group as they are afraid of losing influence over several affiliate firms. Therefore, the authors posit that the more a family business group deploys family management in its affiliate businesses, the less likely it is to diversify.

Pyramid Structure and Diversification

Family ownership generates peculiar governance structures and characteristics. Often families rely on a pyramidal ownership structure to control group firms. A large holding or group company holds controlling stake in key family firms and those in turn control stakes of their subsidiaries and so on. Pyramid structure allows the family to control a large range of affiliate firms through cross holdings, thus reducing the family's direct holdings to a few firms. Family businesses also prefer pyramidal control structure as it helps the group to derive scale and scope advantages through intra-group transactions. It requires low resource commitments in terms of controlling businesses.

Pyramid structure also helps family managements in financial leverage and in managing payoff risks of a diversified business group. The structure enables the family business group to quickly float new affiliates with smaller family investments to tap emerging opportunities.

Therefore the authors posit that the more likely a family business group is to use a pyramidal ownership structure, the more likely it is to diversify.

Key Findings

The authors examined the level of diversification in top 100 Taiwanese family business groups during the period 1988–2002, family involvement in management and the groups' ownership structure. Their findings confirmed that **1.** The family business groups’ diversification decreased with the increased involvement of family management in affiliate firms; thus signaling family control constraints, and **2.** The family business groups’ diversification increased as the pyramidal ownership increased; thus signaling the ease of diversification due to lower financial requirements and higher effective family control that the pyramid structure enabled.

Practical Implications

The study has crucial implications, especially for family business groups based in emerging markets. Firstly, the family business groups need not forgo diversification opportunities by keeping themselves limited to the closed family management structure. They need to realize that benefits of tapping emerging opportunities may off-set the agency costs that may be caused in bringing in outside professionals. Secondly, even within the close family management there may be issues of principal-principal agency problems. It is better to mitigate these by setting up governance that is more effective and monitoring mechanisms that will help in improving the functioning of group firms.

Another important implication is that pyramidal structure allows family business groups to quickly float new group firms to tap an emerging business opportunity. It helps them to achieve this for a smaller financial investment by the family as other affiliate firms contribute through cross-holdings. Thus, family business groups would be able to diversify further if they adopt ownership structures that lend well to their business growth objectives.

Source: *Asia Pacific Journal of Management (2012), Vol. 30(3), pp. 871-891.*