

Impact of Family Involvement on the Bank Performance and Risk Taking Behavior: Evidence from Islamic Countries

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Abstract:

The study aims to investigate the impact of family involvement, measured by two dimensions: family involvement in ownership (FIO) and family involvement in (FIM) on financial performance (FP) and risk taking behavior (RTB) of financial institutions. The study analyses FP as well as RBT of family owned banks in four Islamic countries (Pakistan, Jordan, Turkey and Malaysia) over the period of 2009 to 2016. The data are collected from twenty family owned banking institutions from the said countries i.e. seven banks from Jordan, four banks from Turkey, four banks from Malaysia and five banks from Pakistan. FIO (FIM) shows positive (negative) impact on bank financial performance and risk taking behavior simultaneously. The study recommends increasing FIO and decreasing FIM in family owned sampled banks for improving the FP and RTB. The study supports the agency theory as well as corporate governance's separation of ownership and control theorem.

Keywords: Family Owned Banks, Islamic Countries, Financial Performance, Risk Taking Behavior, Agency theory

Introduction

The phenomenon of the family business has attracted great attention in the last decades. Family businesses are acting as a backbone for the economies. It is considered as one of the most popular form of business. Family members play many roles in the business such as owner, manager and employee. Organizations that are governed by the families deliver greater return on investment, efficient arrangement and utilization of resources and well managed capital structure. Family businesses have a "family language" that lets them to communicate freely and share their

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ideas and information with greater confidentiality (Tagiuri and Davis, 1996, p.199). A main characteristic of family owned business that permits the probe of family firms is relation between family ownership and family control. It is most of the time observed in the family firms that there is a blending of ownership and control in the form of family managers (Schulze, Lubatkin and Buchholtz, 2001, p.99). Even if the ownership is in the form of participation in equity shares and members of family are not involved in daily business matters, they keep in touch with “their” businesses through managerial positions, frequent visits (Blumentritt and Astrachan, 2007, p.321). This closed association among family members and the firm creates a robust emotive relation between them (Zellweger & Astrachan, 2008, p.347).

Family involvement is measured through two dimensions; ownership and management, and it is a major factor that influences the governance of family controlled firms. When ownership is concentrated into few hands, it brings into line the interests between management control and ownership. Moreover, it reduces the agency costs (Berle and Means, 1932). It is pertinent to mention here, when a manager holds a large numbers of shares in the form of ownership, it creates ideal corporate governance and coalition of shareholders and manager’s goal is automatically generated (Jensen & Meckling, 1976, p.305).

Previous research on the financial performance of family controlled companies produces mixed results. Some studies find family firms produce outclass results (Villalonga and Amit, 2006, p.385; Anderson and Reeb, 2003, p.1301), while some researchers find them with poor performance (Claessens, Djankov, Fan and Lang, 2002, p.81), and other researchers find no difference between the performance of family and non-family concerns (Astrachan and Shanker, 2003, p.211). When ownership is concentrated in few hands; it results in lower agency costs. Particularly, the regulatory power and motivations of key stakeholders diminishes information asymmetries between managers and owners. It mitigates the risks of using firm resources to fulfill their own objectives. These benefits of lower cost are lacking or even negated when the family members act as manager in a firm. Family managers may agree to use the properties of the business for the specific advantage of their own families and most of the time they dominate smaller shareholders. Family members are also less experienced and less skilled than outsiders as they are comparatively less knowledgeable than experts. Briefly, there are some valid reasons for understanding that ownership and control have contrasting effects on performance (Jensen and Meckling, 1976).

Risk is an important and fundamental topic and has been used in research for many decades. Owners, managers, directors and administrators try to develop methods for evaluating risk. It is the common phenomena that every person has different attitude toward risk and behave differently under parallel internal and external conditions, various people and companies draw different risk pictures. When firms are not achieving their targets they may increase risk taking behavior to retain the firm performance and to compete within the industry (Zribi and Boujelbene, 2012, p.19). Banks risk taking behavior plays an important role in defining bank performance. An appropriate level of risk is necessary to make decisions in banking operations. However, excessive risk taking behavior leads to financial crises. The managers sometimes have different objectives than owners and have different risk taking behavior. They most of the time avoid to take risk due to their employment concerns. Consequently, managers are not willing to take risk at any cost. Family owned banks take higher risk than non-family owned banks (Saunders, Strock and Travlos, 1990, p.643).

The family involvement in banking industry of Pakistan sustains a major transformation during the last three decades. In the mid-1970s, the domestic banks were nationalized by the government. As concerns to the family owned banks in Pakistan, a higher performance is observed. In Pakistan the ratio of family owned financial sector is less. Most of the time family owned groups make alliances with the major banks and contribute a major portion in bank equity. The family owned banks play vital role in the economic development of Turkey. Family Business Association is the institution that is established to sustain the development of Turkey's family owned firms. The Jordanian banks like many other countries of the world are considered as a main pillar of the Jordanian economy. The Jordanian banking industry currently consists of 26 bank, 15 of them are listed on the Amman Stock Exchange (ASE). More than 50 percent GDP of Malaysia is based on working of family firms. For accelerating the Malaysian economic growth, the role of family firms cannot be ignored. Past studies recognize that family controlled firms contribute up to 80% of the overall firms listed in Bursa Malaysia.

The objective of the study is:

- To check the relationship between family involvement in ownership (FIO) and financial performance (FP).
- To investigate the association between family involvement in ownership (FIO) and risk taking behavior (RTB)

- To analyze the impact of family involvement in management (FIM) on financial performance (FP).
- To examine the effect of family involvement in management (FIM) on risk taking behavior (RTB).
- To provide useful suggestions and recommendations to policy makers and bank regulators to improve financial performance.

Literature Review and Hypotheses Development

Family involvement in management, which allows an active control of the firm, becomes central. Indeed, active family control improves firm financial performance, while passive family control is associated with superior performance. Our aim in this section is to survey key studies related to the effect of family involvement on banks' performance and risk taking behavior.

Family Involvement in Ownership, Firm Performance and Risk Taking Behavior

Burkart, Panunzi and Shleifer (2003, p.2167) examined the various types of ownership structures and investigated which ownership variables were important in improving firm performance. The sample of Korean firms listed in Stock Exchange of Korea for the period of 1990 to 2000 was used. He concluded that ownership-performance relation was assumed to be bilateral. He said that Institutional ownership had a convex relation to firm performance. Yurtoglu (2000, p.193) analyzed the basic features of structural ownership of Turkish listed companies. He presented information on the complex and pyramidal ownership structures within business groups. Structural ownership was highly concerted in Turkey as the family members hold prevailing positions and was major shareholders. He found that concentrated ownership had negative impact on financial performance. Anderson and Reeb (2003, p.1301) analyzed the association between firm performance and family ownership. They said that family ownership was both predominant and substantial as they occupied the major portion of the economy. They showed a nonlinear relationship between performance and family ownership. Onder (2003, p.181) highlighted the association between performance and structural ownership on the basis of firm size. He said that high sized firms were associated with higher ownership concentration. Above discussion leads to construct first hypothesis as:

H₁: *There is a positive association between family involvement in ownership and financial performance.*

Jeung (2003) provided a theoretical and empirical inquiry of banks' capitalization and risk taking behavior. He observed that well capitalized banks showed less inclination towards asset risk. He also

studied risk taking behavior of family managers and found a significant association between family involvement in management and risk taking behavior. Marco and Fernandez (2008, p.332) investigated the factors of taking risk in the Spanish financial sector by considering size of the entities and structure of ownership. They analyzed that larger control of stockholders in the commercial banks induced them to take larger risks in positive situations. Chua, Chrisman and Chang (2004, p.37) investigated the impact of bank risk taking behavior on ownership structure. He used non-performing loan ratio to measure the bank risk. He claimed that when the ownership was concentrated in few hands, bank performance was higher. Whereas when owners were dispersed at various levels, risk was increased that resulted in reducing the bank performance. He also concluded that ownership concentration improved bank performance and mitigated the risk. Hammami and Boubaker (2015, p.271) explained the effect of structural ownership of banks on risk-taking behavior. They said that there was a significant and positive impact of family involvement on bank risk taking behavior. This leads to develop the second hypothesis as:

H₂: There is a positive association between family involvement in ownership and risk taking behavior.

Family Involvement in Management, Financial Performance and Risk Taking Behavior

Wang and Poutziouris(2010, p.370) studied that how involvement of family members in managerial affairs of business influence the financial performance of companies listed in the London Stock Exchange (LSE) from the period of 1998 to 2008. They found a non-linear interaction between firm performance and family ownership. Charbel, Elie and Georges (2013, p.30) considered the role of family involvement in Lebanese firms. They collected primary data by using a quantitative method. They found a strong association of firm performance with ownership and management. Gallucci, Santulli and Calabro, (2015, p.155) said that involvement of family members in managerial affairs of business worked with a superior commitment because of the view that the firm well-being is their own well-being. They were more productive and efficient than outsider managers and have a “family language” that permitted them to interconnect more professionally and created outclass environment for their workers. The above studies produced mixed results and lead to propose the following hypothesis:

H₃: *There is a significant impact of family involvement in management on financial performance.*

Haw, Ho, Hu and Wu (2010, p.485) studied the relationship among state regulations, bank operating features, and legal and centralized control in the banks of Western Europe and East Asia. They analyzed that ownership concentration resulted in lower cost, high return, bad performance and higher insolvency risk. They concluded that the relationship between concentrated ownership and bank operating features were curvilinear. Laeven and Levine (2009, p.259) said that concentrated ownership was allied with risk-taking behavior. Shehzad, de Haan, and Scholtens (2010, p.399) investigated the effect of concentrated ownership on credit risk measured by non-performing loans ratio. They observed that concentrated ownership caused to decrease the non-performing loans ratio. However, other researchers (Anderson and Reeb, 2003, p. 1301; Laeven & Levine 2009, p.259) originated that family owned firms were pointedly less varied, and therefore riskier, than non-family firms. Above discussion allows constructing fourth hypothesis as:

H₄: *There is an impact of family involvement in management on risk taking behavior.*

Theoretical Framework

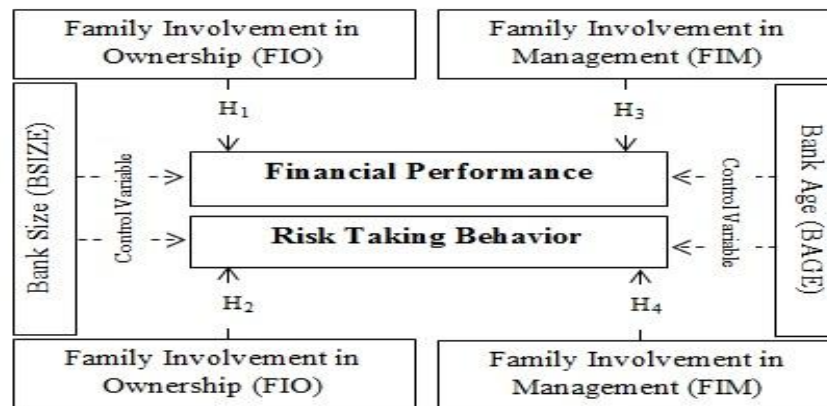


Figure 1: Theoretical Framework

In the above theoretical framework, Family Involvement in ownership (FIO) and Family Involvement in management (FIM) are independent variables which have an impact on financial performance and risk taking behavior (dependent variables), while the bank size (BSIZE) and bank age (BAGE) are control variables.

Data and Methodology

The research was conducted on the family owned banking organizations of four different Islamic countries: Pakistan, Jordan, Turkey and Malaysia. Focus of the study was to investigate the family owned (family controlled) banks; the family owned banks which fulfilled all the characteristics of the study were selected as sample. A total of 20 family owned banks were selected from four different countries; 7 banks from Jordan, 4 banks from Turkey, 4 banks from Malaysia and 5 banks from Pakistan. The data ranged from 2009 to 2016 of family controlled banks listed in Bursa Malaysia, Central Bank of Turkey, Jordanian Central Bank and State Bank of Pakistan, were collected. The data were extracted from the published financial reports of selected banks.

Variables Description

Three types of variables were used in the study and summarized in Table 1

Table 1: Variables Description

Variable Name	Variable Description
Dependent Variables	
a. Financial Performance (FP)	
i. Return on Assets (ROA)	i. (Net Income after Taxation /Total Assets)*100
ii. Return on Equity (ROE)	ii. (Net Income after Taxation /Total Equity)*100
b. Risk Taking Behavior (RTB)	
iii. Non-Performing Loans (NPL)	iii. Non-Performing Loans/Total Loans
iv. Capital Adequacy Ratio (CAR)	iv. Capital/Risk Weighted Assets
Independent Variables	
v. Family Involvement in Ownership (FIO)	v. Percentage of Equity Shares Held by Family Members
vi. Family Involvement in Management(FIM)	vi. (Number of Family Directors on Board/Total Number of Directors)*100
Control Variables	
vii. Bank Size (BSIZE)	vii. Natural Logarithm of Total Assets
viii. Bank Age (BAGE)	viii. Number of Years Since the Bank was Incorporated

Model Specification

In the present study while determining the impact of family involvement on banks' financial performance and risk taking behavior, the study used multiple regression models on the data of selected banks and developed following models to test the hypothesis:

$$ROA = \alpha_0 + \alpha_1(FIO) + \alpha_2(FIM) + \alpha_3(BSIZE) + \alpha_4(BAGE) + e \dots \dots \dots 1$$

$$ROE = \beta_0 + \beta_1(FIO) + \beta_2(FIM) + \beta_3(BSIZE) + \beta_4(BAGE) + e \dots \dots \dots 2$$

$$NPL = \lambda_0 + \lambda_1(FIO) + \lambda_2(FIM) + \lambda_3(BSIZE) + \lambda_4(BAGE) + e \dots \dots \dots 3$$

$$CAR = \varphi_0 + \varphi_1(FIO) + \varphi_2(FIM) + \varphi_3(BSIZE) + \varphi_4(BAGE) + e \dots \dots \dots 4$$

Where; ROA is Return on Asset, FIO is Family Involvement in ownership, FIM is Family Involvement in management, BSIZE is Bank Size, BAGE is Bank Age, ROE is Return on Equity, CAR is Capital Adequacy Ratio, NPL is Non-Performing Loans, $\alpha, \beta, \lambda, \varphi$ are coefficients and e is the error term.

Results and Discussions

This section reports the descriptive statistics, correlation analysis and regression results to check the impact of family involvement on financial performance and risk taking behavior.

Descriptive Statistics

Table 2 shows the outcomes of descriptive statistics of all the family owned banking firms of different Islamic countries in the world. The mean value of ROA was 0.0200 with minimum and maximum values of 0.0017 and 0.2000 respectively. Mean value of ROE was 0.1344. The mean value (standard deviation) of NPL was 0.0525 (0.0408), ranged from 0.0050 to 0.1650. FIO had the average value of 0.3918. The standard deviation of FIM was 2.9461. The mean value (standard deviation) of BSIZE and BAGE was 12.246 (9.2821) and 3.3977 (0.9045) respectively.

Table 2: Descriptive Statistics

Variables	ROA	ROE	NPL	CAR	FIO	FIM	BSIZE	BAGE
Mean	0.0200	0.1344	0.0525	0.1572	0.3918	0.4859	12.246	3.3977
Median	0.0143	0.1357	0.0392	0.1531	0.4070	0.2307	17.880	3.6109
Maximum	0.2000	0.3020	0.1650	0.2399	0.9267	37.500	22.643	4.4543
Minimum	0.0017	0.014	0.0050	0.0830	0.0770	0.1250	0.0000	0.4332
Std. Dev.	0.0260	0.0736	0.0408	0.0288	0.2333	2.9461	9.2821	0.9045

Correlation Analysis

Table 3 describes the coefficients of Pearson Correlation of all the variables under study. There was a positive and strong correlation between BSIZE and NPL. The extremely weak correlation was found in between FIM and CAR and BAGE and NPL. There was a negative and moderate correlation between BAGE and FIO. All the other variables had weak correlation.

Table 3: Correlation Matrix

Variables	ROA	ROE	NPL	CAR	FIO	FIM	BSIZE	BAGE
ROA	1							
ROE	0.2136	1						
NPL	0.2657	-0.3573	1					
CAR	0.0761	0.1446	0.1683	1				
FIO	0.1116	0.0335	0.1324	0.0515	1			
FIM	-0.0161	0.1105	-0.0933	-0.0091	-0.0765	1		
BSIZE	0.1753	-0.1460	0.6694	0.1867	0.3705	-0.1011	1	
BAGE	0.0804	0.3689	-0.0164	0.0405	-0.5187	0.0327	0.1123	1

Regression Analysis

Table 4 displays the outcomes of regression analysis for the impact of family involvement on banks financial performance and risk-taking behavior. In model 1, there was a significant and positive association between family involvement in ownership (FIO) and financial performance (Coef.= 0.0432, p= 0.0000). It means that one percent increase in family involvement in ownership caused to increase bank performance by 4 percent. The outcomes confirmed the first hypothesis of the study and were consistent with Onder (2003, p.181)but inconsistent with Yurtoglu (2000, p.193). The family involvement in management (FIM) also had a significant but negative impact on financial performance at a significance level of 0.05 (Coef.= -0.0341, p= 0.0291). The third hypothesis was accepted. The results were similar with Charbel, Elie and Georges (2013) and Gallucci, Santulli and Calabro (2015, p.155). The relationship between return on assets (ROA) and age of bank (BAGE) was also found significant at the significance level of 0.01.

As for the model 2, FIO had significant positive interaction with performance (Coef.= 0.1260, p= 0.0000). The relationship was significant at 1% level of significance. It means that one percent increase in family involvement in ownership caused to increase financial performance by 12 percent. The first hypothesis was also accepted in model 2. There was a significant association among bank size, bank age and bank performance.

In model 3, a direct interaction between FIO and bank risk taking behavior was found (Coef.= 0.0495, p= 0.0004) which supported the second hypothesis of the present research. The positive coefficient of FIO shows that one percent increase in family involvement in ownership caused to take higher risk which would ultimately increase the bank performance. These results were consistent with Marco and Fernandez (2008, p.332) and Hammami and Boubaker (2015, p.271). There was a significant negative connection between BAGE and NPL and significant positive relationship between BSIZE and NPL.

A significant positive relationship between BSIZE and risk taking behavior was also found in model 4. All the other independent variables had no impact on financial performance and risk taking behavior.

Overall speaking, there was positive and significant impact of family involvement in ownership on banks financial performance. These findings mirrored the prior evidence in the field that emphasized the positive links between family ownership and performance of listed firms (Villalonga and Amit, 2006, p.385; Anderson and Reeb, 2003, p.1301; Lee, 2006, p.103). Justification behind these findings was the fact that family ownership might lead to reduce agency problems (Anderson &Reeb, 2003, p.1301; Dyer, 2006, p.401) and it enhanced the stewardship attitudes (Uhlener, Wright and Huse, 2007, p.225; Miller and Breton-Miller, 2006, p.73), which could, in turn, improve performance.

Table 4: Regression Analysis

Independent Variables	Dependent Variables			
	Financial Performance		Risk Taking Behavior	
	Model 1	Model 2	Model 3	Model 4
	ROA	ROE	NPL	CAR
Constant	-0.0434 (0.0021 ^{***})	-0.0556 (0.0667 [*])	0.0698 (0.0000 ^{***})	0.1502 (0.0000 ^{***})
FIO	0.0432 (0.0000 ^{***})	0.1260 (0.0000 ^{***})	0.0495 (0.0004 ^{***})	-0.0014 (0.9170)
FIM	-0.0341 (0.0291 ^{**})	0.0021 (0.2087)	-0.0003 (0.6467)	8.6102 (0.9125)
BSIZE	0.0001 (0.6039)	-0.0033 (0.0000 ^{***})	0.0037 (0.0000 ^{***})	0.0006 (0.0439 ^{**})
BAGE	0.0120 (0.0000 ^{***})	0.0552 (0.0000 ^{***})	-0.0133 (0.0001 ^{***})	6.6987 (0.9842)

Note: Above table shows the coefficients and (p-values) of all the variables.

***, **, * indicates significance levels at 1%, 5% and 10% respectively.

The family controlled banks were significantly linked with higher risk. Present study clarified the fact that family owned banks seemed to be managed with the intention to transfer the risk to next generation. Accordingly, they might be able to undertake heavy project investments compared to other banks. Family owned banks tend to have relatively higher risk levels compared to non-family owned banks.

Conclusions and Recommendations

In the viewpoint of the speedy growth of Islamic banks in all over the world and their resilience during the recent global crisis, numerous issues highlight with regard to the performance as well as risk taking behavior and their impact on economic indicators of a company. The study depicts empirical evidences from four Islamic countries like Pakistan, Malaysia, Turkey and Jordan and investigates the relation between family involvements on performance (FIP) along with risk taking behavior (RTB). The data are collected from twenty family owned banking institutions from the said countries i.e. seven banks from Jordan, four banks from Turkey, four banks from Malaysia and five banks from Pakistan over the period of 2009 to 2016. All banks in the sample are working under the instructions of their central bank of their country.

The results reveal a positive and significant impact of FIO on financial performance of sampled banks and accepts the hypothesis-1. One percent increase in FIO causes four percent inclination in financial performance. These findings in line with the previous studies like Anderson and Reeb, 2003, p.1301; Dyer, 2006, p.401; Miller and Breton-Miller, 2006, p.73. Justification behind these findings is the fact that family ownership might lead to reduce agency problems and support the agency theory and it enhances the stewardship attitudes that in turn, improve performance (Jensen and Meckling, 1976). Similarly, FIO shows statistical significant impact on RTB and accept our hypothesis-2. Ownership of family controlled banks might have a better position to take risk than their contemporary banks. In fact, owners (principals) seem to be more courageous than agents are in the current study supports again the agency theory.

Diametrically opposite of above said views, FIM shows negative impact on financial performance and reject our hypothesis-3. Decreasing one percent in explanatory variable might incline financial performance 3.4%. It might be the fact that managers do not perform well as become the owner. This phenomenon supports the separation of owner manager tasks and in line with non-duality concept of corporate governance and separation of owner and control (Claessens, Djankov and Lang, 2000, p.81). Similarly, FIM contributes negative impact on risk taking behavior of family owned banks and accept the hypothesis-4. Again, this phenomenon supports the agency theory and indicates formal conventional approach of management as not to take risk without additional fringe benefits.

Emerging Issues in Economics and Finance

The study investigates the relation among FIO, FIM, financial performance and risk taking behavior of family banks in four Islamic countries. The empirical results support clearly to increase in family involvement ownership (FIO) than family involvement in management (FIM). The study recommends the professional behavior of management in banks over the non-professional. The owners should not take part in the managerial decisions making which require sound judgment and professional approach.

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