A Framework on Delineating Family-Controlled Businesses (FCBs) from Nonfamily-Controlled Businesses (NFCBs): A Sri Lankan Approach

D.K.T.N.Gunadeera

Department of Finance, Faculty of Management and Finance

P. Dharmadasa

Department of Marketing, Faculty of Management and Finance

Defining the object of study is the first and most obvious challenge in many social sciences and it is commonly applied to family-controlled business (FCB) studies as well. Although some scholars have made many contributory efforts to resolve the definitional problems of FCBs (e.g., Westhead and Cowling, 1999; Astrachan, Klein and Smyrnios, 2002; Miller, Le Bretton-Miller, Lester, and Cannella, 2007; Mroczkowski and Tanewski, 2007), the problem still remains. Miller et al (2007) stress that lack of definitional clarity remains in FCBs because they can range from mom and pop shops to large conglomerates. Shanker and Astrachan (1996) underline that though people intuitively recognize FCBs, even the experts in the field find difficulty in precisely defining FCBs. Astrachan et al. (2002) suggest that one way of overcoming this problem, especially in empirical research, is to specify levels and types of relationships as well as kinship ties of involved persons and another way is to provide from the outset a clear and concise definition of what is meant by a family. Allouche, Amann, Jaussaud and Kurashina (2008) hold the view that a consensus definition may not represent a pertinent research goal because, by nature, FCBs are contingent on the institutional and legal contexts, which differs from country to country. However, the absence of consensus regarding the definition of a family business makes it difficult or impossible to compare different family business studies in particular in an international context where families and cultures differ not only across geographical boundaries but also over time (Astrachan et al., 2002) and researchers seek more studies to resolve this lack of definitional clarity (Chua, Chrisman and Sharma, 1999).With this in mind, this study aims to address the lack of definitional clarity by exploring the ownership pattern of Sri Lankan businesses using Sri Lanka Accounting Standards.

With regard to Asia, Khan (2003) highlights that the predominant form of large and medium scale enterprises in developing Asia are family-controlled or family-owned. Similar evidence was found in Sri Lanka by Senaratne and Gunaratne (2007) that the ownership structure of Sri Lankan companies is largely characterized by family-controlled, pyramid, cross-holdings, with the controlling shareholder usually being another corporate entity. Listed companies in the Sri Lankan share market were used for the study.

Ownership control is a catalyst factor in delineating family controlled businesses from non-family controlled businesses. Existent literature suggests that a company is considered to have a controlling shareholder if a company or an individual directly or indirectly holds 20% or more of its shares (La Porta et al., 1999; Claessens et al., 2000). Sri Lanka Accounting Standards (LKAS) 28 also assumes that if a company owns 20% of shares in another company the former is presumed to have a significant influence over the financial and operating decisions of the latter. The idea behind using this threshold level is that this is usually enough to have effective control

of a firm (Senaratne and Gunaratne, 2007), but at this level of ownership a company could have a single controlling owner or multiple controlling owners. Accordingly, three main shareholders can be identified in Sri Lankan companies at 20% threshold level, namely: Family, closely-held and nonfamily firms. However, prevalence of control-enhancing mechanisms highlights the hazardous problem of using ownership as a sole criterion for defining a FCB. The problem of ownership led to the development of a concept of "Control" ((Mroczkowski andTanewski, 2007). According to LKAS 27, control is the power to govern financial and operating policies of an entity so as to obtain benefits from its activities and it is presumed to exist when the parent owns directly or indirectly through subsidiaries, more than half of voting powers of the entity or exceptionally by four means as specified in the standard. This gives rise to the concept of Power over Control (POC) of the firm which clarifies the means of achieving the ultimate control of it either directly or indirectly.

According to Mroczkowki and Tanewski (2000), participation of a dominant individual in the FCBs is an important aspect when the definition on FCB is based on the concept of "control" which is the capacity to dominate in decision making. Cyert and March argued that Dominant coalition (DC) is intended to include the powerful actors in an organization who control the overall organizational agenda (as cited in Chua, Chrisman and Sharma, 1999, p.18).Therefore, it is essential to identify the party who is exercising POC of the firm through a DC which is a group of shareholders who exert significant influence over it. In this process, family closely-held and nonfamily firms with significant influence are thoroughly investigated in order to trace their ultimate controlling parties under the concepts of POC and DC so that they can be grouped either as FCBs or NFCBs subsequently.

According to Chua, Chrisman and Sharma (1999), the list of controlling owners includes an individual (I), a nuclear family (NF), two persons unrelated by blood or marriage etc. and those definitions that are based on family ownership unanimously consider ownership by a nuclear family to be a qualifying ownership pattern. However, still some remarkable studies have defined firms as Family Business when there are individuals (For instance, Miller et al., 2007; Srear amd Thesmar, 2007; Villalonga and Amit, 2006 etc.) and even extended families (EFs) (For instance, Yammeesri, 2004).Thus, controlling owner of a FCB may be three folds: I/I(s), NF/NF(s) or EF/EF(s). The defining framework is shown in Figure 1.

Keywords: Family Businesses, Definitional Problem, Ownership, Control, Framework

Figure 1: Framework on Delineating Family Controlled Businesses from Non Family Controlled Businesses