



Related Party Transactions, Family Firms and Firm Performance Empirical Evidence From Turkey

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ABSTRACT

The objective of this study is to examine the relationship between related party transactions and firm performance in the presence of family ownership. The study used data of 714 public listed firms in Istanbul stock exchange for the period of 2011-2015. Utilizing regression analysis of 714 Turkish listed firms, this study shows that related party transaction has a negative influence on firm performance. In addition, the study shows that this association is stronger in the presence of family ownership. The results proposed that a related party transaction is practiced by family firms to expropriate minority shareholders rights. The result is consistent with entrenchment hypothesis and tunneling.

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INTRODUCTION

Previous studies in the area of corporate governance have examined the influence of related party transactions (RPTs) on firm performance. Nevertheless, many studies proposes that RPTs might be practically used to prop up companies to fall in financial distress (Riyanto & Toolsema, 2008). Often, controlling shareholders uses private interest to involve in RPTs activities that led to struggling companies and this could not be in the interest of minority shareholders (Peng, Wei, & Yang, 2011).

Agency theory and tunneling concept proposes that RPTs uses as a method of manipulation through transferring profits to managers and expropriate minority shareholders' interests (Jensen & Meckling, 1976; Simon Johnson, La Porta, Lopez-de-Silanes, & Shleifer, 2000). In the same way, research from different context indicates that RPTs leads to reduce minority shareholders' wealth (Bertrand, Mehta, & Mullainathan, 2002). Furthermore, studies recommend that RPTs is correlated with low market value (Cheung, Rau, & Stouraitis, 2006). This indicates that market perceives that such activities lead to minimize minority shareholders rights. The concept of tunneling is introduced by Johnson et

al. (2000) and it refers to the transfer of profits and assets out of companies for the interest of majority shareholders at expenses of minority shareholders. This indicates that RPTs exercised to transfer wealth from minority shareholders to majority shareholders.

This study relies on previous evidence and agency theory to propose that there is a negative relationship between RPTs and firm performance. In addition, this study examines the relationship between RPTs and firm performance in the presence of concentrated ownership; this is as a consequence of the prevalence of family ownership in Turkey. The idea of moderating role of family ownership is based on previous studies that investigate whether family firms are more valuable than non-family firms (Chen & Jaggi, 2000). Previous study from US for instance, Anderson and Reeb (2003) report that family firms add value to the firm whereas Holderness and Sheehan (1988) report that family controlled firms have lower value. Other studies from other markets report mixed findings (Claessens, Djankov, Fan, & Lang, 2002; Cronqvist & Nilsson, 2003). Nevertheless, the theory and previous studies proposed that family companies are more likely to be correlated with low performance because controlling shareholders are more likely to expropriate minority shareholders rights (Villalonga & Amit, 2006). The same argument is suggested by agency theory that managers over-consume perquisites, for instance, by maximize their interest at the expenses of minority shareholders, and this over-consumption da-

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mages the companies' stakeholders (Jensen & Meckling, 1976).

Variable Interest Entities (VIE) represents one of conspiring connections exercised by Enron firm through involving in RPTs in order to hide debts and create fictitious earnings. As a consequence of the possible misuse of RPTs, the U.S. FASB No. 57 states "transactions involving related parties cannot be presumed to be carried out on an arm's length basis". Therefore, this study suggests that RPTs negatively influence on firm performance for firms suffer high concentrated ownership.

This work extends corporate governance literature in many ways. First, it provides evidence from Turkey which explains that RPTs, particularly those exercised by family companies, are more likely to be exercised to minimize minority shareholders rights. Second, this paper results prove that Type II Agency Problems prevail in family companies in Turkey, regardless the potential interest of family business.

Related Party Transactions

RPTs are transactions between related parties, nevertheless of whether a price is charged. Related parties are those who have an interest that offers an important impact on the company, for instance board of directors, their associates, controlling shareholders and any firms in which they possess a substantial holding (Malaysian Accounting Standard Board, 2006).

There are both costs and benefits that correlated with RPTs. For instance, Khanna & Palepu (2000) proposed that intercompany transactions between firms inside business group may help individual firms to operate efficiently compared to other pairs that stand alone. This is because firms work inside business group could get financial support from other firms in the same group instead of external financial support, for instance, capital market. Information asymmetry represents one of the challenges that face firms to access the capital market. This is because inconsistency in the accounting information leads to inaccuracy in firm valuation. Thus, RPTs between firms inside business group may reduce this problem. Furthermore, intra-group loans are significant methods to transfer cash between firms inside business group and this method usually utilized to assist firms' needed financial support (Gopalan, Nanda, & Seru, 2007). The costs of RPTs could be illustrated in the regard of agency theory that proposed that managers will over consume perquisites, for instance be transferring out some interest to themselves, and this over-consumption harms the firm's stakeholders (Fama & Jensen, 1983; Jensen & Meckling, 1979). Johnson, La Porta, & Lopez-de-Silanes (2000) present the notion of tunneling that indicates to the transfer of profit and assets out of the company to interest of those who control them. In addition, managers might possess transactions with companies such as RPTs where the purposes behind the transactions are to transfer the profit and wealth of the firms. Instead, these transactions might be utilized to maximize majority shareholders at the interest of minority shareholders as a result of influence of

these transactions. Previous studies show that firms are more likely to involve in RPTs to expropriate minority shareholders' interests as a consequence of cash out of firms into the hands of its controlling shareholders where the company involve in offer cash support more frequently comparing to receiving cash support (Cheung et al., 2006).

To sum up, previous researchers illustrate that RPTs might possess negative and positive influence on the performance of firms. Nevertheless, this research find that majority of studies addressed RPTs proposed that these transactions might directly transfer firms' profit and assets to the related party and adversely influence firm performance (for instance, Bertrand et al., 2002; Cheung et al., 2006; Kohlbeck & Mayhew, 2004). RPTs are more likely to have adverse influence on firm performance in Turkey because of weak institutional setting and lack of minority protection. Whereas, both enforcement and law are required to protect investors from the opportunistic activities of insiders (Johnson et al., 2000), while Turkey is a civil law country, it suffers from poor law enforcement (Karaibrahimoglu, 2013). Thus, the research proposed that RPTs are more likely to reduce minority shareholders rights of a firm instead of improve firm performance. Based on above discussion the following hypothesis is proposed:

H1: There is a relationship between related party transactions and firm performance.

Family Firms

The intertwinement of family and business in family companies is the main difference between family and non-family firms. Chrisman, Chua, and Sharma (2003) report that family companies present as a result of the mutual economic and non-economic value created via the combination of business and family systems. Many studies addressed various features of femaleness value in family companies. Ensley and Pearson (2005) infer that family member occupies a position of director might improve belief capabilities, great consensus on the strategic plan of the company, a great sense of belonging to the team and less unfavorable conflict. Carney (2005) reports that family companies are more likely to be directed by efficient and effective governance systems that possess the features of particularism, personalist, and parsimony.

Many scholars suggest that the above mentioned advantages assist family companies to perform better than non-family companies (Maury, 2006; Villalonga & Amit, 2006). Generally, previous studies proposed that better understanding of the business and low agency cost lead to better performance of family companies than non-family companies (Anderson & Reeb, 2003; Maury, 2006; Villalonga & Amit, 2006). Instead, the presence of families could result to better performance of family companies. Ensley and Pearson (2005) report that better behavior practices and moral brings as a consequence of engagement of family directors in the top of management team. Thus, encourages better understand-

ding of the business.

Consistently, the effective and efficient governance systems of family companies improve the value of family companies, protect minority shareholders right and consequently reduce agency cost would be anticipated (Carney, 2005). However, family hold ownership and control leads to increase family incentive to maximize their interest at minority shareholders expenses (Anderson & Reeb, 2003; Morck & Yeung, 2003; Villalonga & Amit, 2006). That is because controlling shareholders represent their interests rather than investors interest in the company (Shleifer & Vishny, 1997). To recognize this kind of agency problem with that of between owner-manager agency problem, literature labels the agency problem between principals-agent as Type I Agency problem, whereas agency problems between majority shareholders and minority shareholders as Type II Agency Problem (Ali, Chen, & Radhakrishnan, 2007; Villalonga & Amit, 2006). It is suggested that family companies may face both kinds of agency problem, while Type I Agency Problem might be at lower level. A study by Villalonga and Amit examined Fortune 500 firms in the period of 1994 to 2000 explains that Type II Agency Problem could dominate and then controlling family get greater motivations to expropriate and monitoring (Villalonga & Amit, 2006). Ali et al. (2007) report that family firms suffer less Type I Agency Problem compared to Type II Agency Problem as a consequence of high concentrated ownership that provides them with strong incentive and ability to maximize their interest at the expense of minority shareholders. In addition, family companies are less likely to suffer from Type I Agency Problem because families have enough information about their companies and they have strong incentives to oversight management behavior. Generally, previous studies report that the presence of family companies in East Asian markets unfavorable to companies (Lemmon & Lins, 2003). Claessens et al. (2002) suggest that family companies possess disproportionate control rights over cash flow rights report low firm performance as a consequence of entrenchment influence of the control.

In constant with previous evidence, this study report that family ownership could possess unfavorable influence on performance of Turkish companies. This study suggest that if family companies in Turkey involve in RPTs, the main incentive for such transactions could be to minimize minority shareholders instead improving the firm valuation. This reasoning leads to develop hypothesis 2:

H2: The negative relationship between RPT and firm performance is contingent on family ownership.

RESEARCH METHOD

Population and sampling

The sample includes all firms listed in Bursa Istanbul (BIST). Data on RPTs and FAMI are hand collected from 2011 to 2015 of Turkish listed companies using the

annual reports. Other financial data for the same period were collected from Data Stream. However, as a consequence of missing data the final sample includes (714) firm-year observations.

RESEARCH MODEL AND MEASUREMENT:

To meet the study objectives, model1 of the study examines the relationship between RPTs, control variables and firm performance. Model1 is explained using the following equation:

$$PERFit = \beta_0 + \beta_1 RPTs_{it} + \beta_2 FAMI_{it} + \beta_3 FSIZE_{it} + \beta_4 LEVE_{it} + \epsilon_{it}$$

Model2 examines the moderating role of FAMI in the relationship between RPTs, control variables and PERF. The equation of the regression is as follows:

$$PERFit = \beta_0 + \beta_1 RPTs_{it} + \beta_2 FAMI_{it} + \beta_3 RPTs^* FAMI_{it} + \beta_4 FSIZE_{it} + \beta_5 LEVE_{it} + \epsilon_{it}$$

Where:

For each firm (i) and each year (t)

PERFit	= Firm performance measured by ROA
RPTs	= Firm involve in RPTs is coded with the value of 1, 0 otherwise.
FAMI	= Family firms is coded with the value of 1, 0 otherwise.
RPTs*FAMI	= Interaction between RPTs and FAMI
FSIZE	= Firm size is measured by total assets.
LEVE	= Leverage is measured using short and long-term debts divided by the total amount of assets.

Descriptive Statistics and Pearson Correlation

Table 1 displays the number of observation, mean, standard deviation, min and max for PERF, RPTs, FAMI and control variables (FSIZE and LEVE). Following Roudaki, Bhuiyan, and Uddin (2015) the firm performance is measured using Return on Assets (ROA). The mean ratio of ROA of the firms in the sample is 0.951 with a standard deviation of 0.544 and a minimum value of -0.444 and a maximum value of 0.490. RPTs and FAMI are measured using binary measurement. The mean of FSIZE is 5.245 (0.977 percentage of standard deviation) with a minimum of 0.699 and maximum of 8.51.

Table 1. Descriptive Statistics

Variable	Observations	Mean	Standard deviation	Minim	Maxim
ROA	714	0.951	0.544	-0.444	0.490
RPTs	714	-	-	0.000	1.000
FAMI	714	-	-	0.000	1.000
FSIZE	714	5.245	0.977	0.699	8.510
LEVE	714	24.467	46.835	0.000	44.000

The average of LEVE is about 24.467 and a range from of 0 to 44.000 with a standard deviation of 46.835. Table 2 illustrates the correlation between variables of

interest. The values of the correlation are less than 0.80 (the threshold value). This indicates that there are no multicollinearity problems between the variables and this supports by the value of Variance influence Factor (VIF) and tolerance factor (1/VIF). The VIF findings of all explained variables and control variables are less than 5 as suggested by (Hair, Black, Babin, & Anderson, 2010).

Table 2. Pearson correlation

	ROA	RPT	FAMI	FSIZE	LEVE	VIF
ROA	1.0000					1.02
RPT	-0.096	1.0000				1.06
FAMI	0.139	-0.175	1.0000			1.26
FSIZE	0.212	-0.203	0.440	1.0000		1.31
LEVE	-0.074	-0.036	0.005	0.070	1.0000	1.01

Notes: Two-tailed, bold= correlation are significant at P < 0.05

The correlation results indicate that there are a positive correlation between FAMI and FSIZE and ROA. RPT and LEVE have a negative correlation with ROA.

Tests for Random and Fixed effects Regression

This study depends on Hausman test in order to select between fixed and random effects. This is because Hausman test examines whether there is any correlation between (Ui) and the regressors (Greene, 2003). If $\text{pro} > \chi^2$ is < 0.05 (i.e., significant) the fixed effect model issued (Greene, 1997). The finding of Hausman test displays probability more than 0.05, thus the null hypothesis has been rejected and a random effect is more appropriate for estimation purpose for the study. Consequently, the individual error component is not correlated with regression variables, and then OLS estimator is consistent. As a result of the existence Autocorrelation and heteroscedasticity as characterised in panel data, this study uses Feasible Generalized Least Square (FGLS) to correct for this problem as (Wooldridge. J. M., 2002) proposed.

Results of the Models

The reported Wald χ^2 using FGLS for ROA is 80.67 and 76.66 for the Model1 and Model2 respectively (Table3). This reflects that explanatory variables illustrate about 80% and 76% of the variation in the explained variable.

This proposes that, around 80% and 76% of the variance in the firm performance is illustrated by RPTs and FAMI. The result for RPTs is negative with P-value of (0.005 & 0.000) for both of Model1 and Model2 respectively. Furthermore, the degrees of impact on ROA are 36% and 44% for both models. These findings reflect that the higher the amount of RPTs the lower the firm performance, proposing that RPTs could be utilized opportunistically to reduce minority shareholders rights and thus results in low firm performance. The findings support Hypothesis H1. Family ownership has positive

relationship with firm performance. The result for this variable is significant at 1% and 10% level of significance with P-value of (0.000 & 0.010) for both of Model1 and Model2 respectively. Besides, the degree of influence on Model1 and Model2 are 32% and 28%. This displays that an increase in family ownership might leads to an increase in Model1 and Model2 of 32% and 28%. This study argument is consistent with that of (Munir & Gul, 2011). From the result on Table 3 the relationship between family ownership and ROA displays a direct relationship indicating that for every one additional firm controlled by family, ROA will increase by 32% and 28%. The moderating relationship gives a negative influence of about 0.09 with P-value (0.000). The findings support Hypothesis H2. The results are consistent with that of Type AII agency problem, it proposed that in family companies, entrenched shareholders use RPTs with the purpose of transferring the firm profits and wealth to other firms under their control (Simon Johnson et al., 2000). Controlling shareholders could do this because they are entrenched in their position and then they got strong incentives to maximize their interest at the expense of minority shareholders (Ali et al., 2007; Morck, Shleifer, & Vishny, 1988).

Table 3. Regression Models (FGLS)

Item	Model 1 (ROA)		Model 2 (ROA)	
	Coefficient	Standard Errors	Coefficient	Standard Errors
RPT	-0.36**	0.10	-0.44***	0.10
FAMI	0.32***	0.79	0.28*	0.07
PRT*FAMI	-	-	-0.09***	0.02
FSIZE	0.52**	0.18	0.37**	0.18
LEVE	-0.09***	0.03	-0.18***	0.44
Wald χ^2		80.67		76.66
Prob > χ^2		0.000		0.000

Notes: * = significant at 10%,

** = significant at 5%

*** = significant at 1%

CONCLUSION

This study investigates the relationship between RPTs, FAMI and PERF of public listed companies in the BIST. In order to meet this study objective, this study employs cross-sectional time-series FGLS regression to controls of the issues of Autocorrelation and heteroscedasticity in a sample of 714 listed Turkish firms. This study shows that there is a negative relationship between RPTs and firm performance. The results are consistent with that of Type II Agency Problem, it proposed that in family companies, entrenched shareholders use RPTs with the purpose of transferring the firm profits and wealth to other firms under their control (Johnson et al., 2000). Controlling shareholders could do this because they are entrenched in their position and then they got strong incentives to maximize their interest at the ex-

pense of minority shareholders. The study recommends further investigations and includes more data, inclusion of other characteristics of corporate governance.

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