Why Family Firms Lack Analyst Coverage

Widely-held cultural views shape securities analysts' assessment of family firms.

In a way, securities analysts are in the business of predicting the future. As such, they deal with uncertainty. And with uncertainty comes risk. Unsurprisingly, studies on how securities analysts decide which companies to follow have shown that they are chiefly concerned about the risks of making assessment errors and disappointing investors. They may thus avoid firms they deem risky due to the difficulty of acquiring data or the perceived potential for a conflict of interest between majority and minority shareholders.

But even as they make these complex risk assessments, analysts are also human beings whose values and decision-making patterns are influenced by the broader culture in which they live. This has nothing to do with personal prejudice or biased intentions. It simply means that as human beings we function in societies whose laws, customs and practices reflect and uphold certain beliefs. For instance, business isn't conducted the same way in every country.

When it comes to corporate governance systems, two main systems – or logics – have been revealed by research. In countries such as the United States, the United Kingdom and Canada, it is common to expect public firms to be owned by a large pool of outside investors and managed by professionals for the sake of maximising shareholder value. This is called shareholder logic.

Elsewhere, such as continental Europe and many Asian countries, another system – the stakeholder logic – prevails: Public firms are expected to be owned and controlled by stakeholder groups which contribute to and are affected by the firms, with the view to enhance, in a balanced way, the long-term collective gains of stakeholders.

These two distinct governance logics can determine how family firms are perceived. It is easy to see how family firms, with their concentrated ownership and family involvement in management, deviate from the guiding principles of shareholder logic. However, they remain compatible with those of stakeholder logic, as family governance is characterised by long-term commitment and insider control.

Different perceptions of risk

In our paper "**In the Eye of the Beholder: Global Analysts' Coverage of Family Firms in an Emerging Market**", Yong-Chul Jeong of Concordia University, Chi-Nien Chung of National University of Singapore and I showed that publicly-listed family firms are less likely to be covered by global analyst firms from shareholder-based countries than by those from stakeholder-based countries. This finding remained robust after controlling for all factors that could potentially influence a firm's quality or the level of investor interest. Our data show that coverage decisions are influenced by what a given society deems appropriate in terms of corporate governance.

For our analysis, we assembled and hand coded a unique data set. It combined all publicly listed firms on the Taiwan stock exchange and their coverage by global analyst firms (as documented by the Nelson Information's Directory of Investment Research). Our study included 92 analyst firms from 16 countries which followed publicly-listed Taiwanese companies between 1996 and 2005. About half of these analyst firms were headquartered in shareholder-focused countries, the rest in stakeholder-focused countries.

We controlled for all variables that prior studies have suggested affect analyst coverage. These included firms' size and age, return on assets (ROA), trading volume, stock volatility and governance factors such as the different types of ownership, the presence of independent directors, etc.

We found that, all things being equal, Taiwanese firms with greater family control were less likely to be covered by global analysts than non-family firms. However, this under-coverage wasn't significant in the stakeholder camp, whereas family ownership had a strong negative impact on shareholder-based coverage.

This gap was even starker in the case of family firms that lacked transparency and thus presented a higher risk for analysts trying to assess value accurately. For instance, the more a family firm deviates from the "one share, one vote" principle, the more it will be shunned by analysts from shareholder-logic countries. Deviation from this principle is seen in arrangements, such as stock pyramids and cross-ownership structures, which provide an owner with supersized control rights with comparatively little investment. Analysts from the shareholder-logic countries view this as a red flag as it means a higher risk of tunnelling – the illegal transfer of profits or resources to a private firm at the cost of minority shareholders, hence further avoiding family firm coverage. In contrast, steering away from the "one share, one vote" principle is not always viewed negatively by stakeholder-based analysts and does not significantly reduce coverage from them.

What analysts, family firms and investors should know

In emerging markets, corporate governance logics shape coverage decisions by influencing risk perception. It would be important for analysts, especially those from shareholder-logic countries, to recognise their tendency to perceive family firms as riskier vs. non-family firms *with otherwise similar profiles*. Such an awareness may reduce their risk of missing out on firms with high growth potential.

Family firms that hope to attract investments from the stock market should also be aware of potential analyst bias and strategically prepare for it. They need to understand that analysts from shareholder-logic countries will be more negative towards them. Accordingly, they might benefit by taking measures to manage the negative perception of these important market intermediaries.

First, family firms must take a cost/benefit view of matters of ownership. Ownership is not only who owns the company; it also involves the selection of a chief executive and the succession plan. For instance, family firms must realise that the chief executive doesn't always need to be a family member, especially if the competence of the person can be called into question by external evaluators.

Second, family firms need to consider how deviation from the "one share, one vote" principle worsens shareholder-logic analysts' negative perceptions. Of course, not all family firms will be open to diluting their control, but they at least need to be aware of the trade-off it involves. If their goal is to raise public funds, they need to carefully assess the cost/benefit ratio of their governance structure. By managing the perceptions of analysts and receiving coverage, family firms can be given more credibility, attract more investments and fully realise their potential.

Investors also need to be aware of this potential for cultural bias in the analyst reports they read. They should not think of analysts as completely neutral and objective intermediaries. By relying strictly on shareholder-logic analyst reports, investors may miss opportunities, since these analysts may ignore family firms – of equal value, size, return on assets, etc. – due to cultural bias. For this reason, investors would do well to diversify their sources of information.

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