



A Study of Agency Costs in Filipino Family Firms

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Abstract: This study aims to provide an empirical basis for determining whether Filipino family businesses are able to mitigate their agency costs. In accomplishing this, we analyzed and compared the behavior of costs in family and non-family controlled listed Filipino firms from 1999-2009 using a panel data analysis. We used the concept of sticky costs in determining symmetry of cost behavior. We find that the average family-controlled firm displays a symmetric cost behavior with fluctuations in demand conditions while the non-family firm shows otherwise. Our result shows that family businesses do not exhibit sticky cost behavior which allows us to surmise that they are able to mitigate their agency costs.

Key Words: Agency costs; family business; sticky costs

1. INTRODUCTION

1.1 Family Businesses

Family businesses play a dominant role in the economy of many countries. For instance, in the United States, Astrachan and Shanker (2003) estimate that family firms generate 89% of total tax returns, 64% of GDP and employ 62% of the total workforce in the US. This is supported by findings studies of family businesses in other countries like the United Kingdom, Spain and Germany, to name a few.

In the Philippines, the situation is not far behind. Among the 85 listed industrial companies used in this study, 52 or 61.2% are family owned and controlled. Thus, it is surprising that prior to 1980s, there are only a few studies made regarding the specificities of family businesses. From 1990 to 2010, there are a total of 173 noted scholarly articles published compared to only 20 prior to 1990.

1.2 Agency Costs

The Principal-Agent theory (PAT) is one of the most commonly accepted theoretical frameworks in family firm studies. It describes possible problems arising from conflicts of interest and asymmetric information between two parties in a contract (Jensen and Meckling, 1976). PAT assumes opportunistic behavior of one contracting party, the agent, as he tend to behave in favor of his own interest rather than the interest of the other contracting party, the principal.

Jensen and Meckling (1976) further argues that the transaction costs incurred during the process of detecting, mitigating or preventing agency problems (for instance, control or incentive systems and governance structure) and the economic damage caused by this opportunistic managerial behavior (e.g. free-riding, mnagerial empire-buidling) is referred to as "agency costs".

On of the assumptions of PAT is that agency costs arise through the separation of firm ownership and control (Fama and Jensen, 1983a). This implies that whenever managers have equity stake in the



company, agency costs is minimized. In family owned and controlled companies, the personal ownership involvement of family executives creates a disincentive for other managers (agents) from expropriating shareholder wealth through the consumption of perquisites and misallocation of resources (Fama and Jensen, 1983b; Schulze et al, 2002). Consequently, family businesses require comparatively lower investments in control mechanisms (Daily and Dollinger, 1992). Thus, providing additional support to findings of Miller and Le Bretton-Miller's 2006 study whereby they claim that listed family businesses outperform other types of firms because they were able to mitigate agency costs.

1.3 Sticky Costs

A study by Anderson, Banker and Janakirman (2003) describes a property of cost behavior where costs respond differently to upward or downward changes in activity. These costs increase more when revenues (surrogate for activity) increase than they fall when revenues decrease by an equivalent amount. They call this "sticky costs".

According to them, sticky costs occur because there are asymmetric frictions in making resource adjustments. There are forces acting to restrain or slow the downward adjustment process more than the upward adjustment process. Anderson et al (2003) reiterates that cost stickiness is consistent with a cost behavior model where managers deliberately adjust resources in response to demand condition changes (i.e. market changes, volume). In other words, when volume falls, managers are expected to decide whether to maintain committed resources and bear the cost of operating excess capacity or reduce committed resources and incur adjustment costs of retrenching. Anderson et al (2003) claims that cost stickiness occurs because managers do not make decisions to remove resources that are not utilized when activity level falls.

However, Chen, Lu and Sougiannis (2012) suggests that cost stickiness occurs not only due to economic adjustments but also due to managerial empire building incentives caused by the agency problem. Using sales, general and administrative (SG&A) costs, their findings suggest that the empire-building problem provides a supplementary explanation for SG&A cost asymmetry. Moreover, corporate governance reduces cost asymmetry by preventing

empire-building managers from overspending SG&A costs.

For firms controlled by family members, it is expected that no such "empire-building" incentive exists among managers (agents) since owners (principal) are actively involved in resource allocation decisions. Thus, agency costs are mitigated.

1.4 Objective and hypothesis

As another contribution to the growing family business literature, this study aims to provide an empirical basis for determining whether family business in the Philippines are able to mitigate their agency costs by using sticky costs as a barometer.

In accomplishing our objective, the study tested stickiness of the discretionary costs (i.e. SG&A) against revenues of listed industrial firms from 1999 to 2009. Our premise is that if family firms exhibit symmetrical cost behavior or not sticky, then they are able to mitigate the agency costs.

2. METHODOLOGY

This study used financial data of listed Filipino family firms from 1999-2009 in analyzing the cost behavior. The dataset was constructed using data from the Osiris database as well as from the respective company financial statements. The resulting sample includes 85 listed industry firms where 52 of which are classified as family corporations.

To test the cost stickiness hypothesis among family firms, the study used a log-log model derived from the cost function based on the Cobb-Douglas production function. (Eq. 1). Panel data analysis was also used. Furthermore, the study employed the measurement choices of Anderson et al (2003).

$$\log\left(\frac{SG \& A_{i,t}}{SG \& A_{i,t-1}}\right) = \beta_0 + \beta_1 * \log\left(\frac{Rev_{i,t}}{Rev_{i,t-1}}\right) + \beta_2 * D_{i,t} * \log\left(\frac{Rev_{i,t}}{Rev_{i,t-1}}\right) + \varepsilon_{i,t} \quad (\text{Eq. 1})$$



where:

$$D_{i,t} = 1 \text{ if } \Delta \text{Rev}_{i,t} < 0 \text{ and } 0 \text{ if } \Delta \text{Rev}_{i,t} > 0$$

3. RESULTS AND DISCUSSION

Cost information is vital for firm’s decisions. Once decisions are made, cost behavior reflects the aggregate firm response to changes in business conditions. Ideally, the cost behavior reflects the optimal firm adjustments. However, the persistence of the Principal-Agency problem tempers this optimal firm response.

In this study, we find empirical support for a model of cost behavior where family firms adjust their resources symmetrically to changes in the level of activity. This means that there is no cost stickiness present among family firms. This affirms our hypothesis that family firms are able to mitigate agency costs.

Additionally, we compared this result with the cost behavior of comparable listed non-family companies and found that non-family firms exhibit sticky costs. This further affirms that family firms are better able to moderate principal-agency problems among Philippine firms.

Table 1 shows the comparative panel data analysis of family versus non-family firms.

Table 1. Panel-data Analysis Results

Fixed Effects AR(1) Model	Family-controlled	Non-Family-controlled
β_1	0.09931	0.34555
β_2	0.01548	-0.45941
$\beta_1 + \beta_2$	0.11479	-0.11386
ρ value	0.923	0.002
Interpretation	Cost not sticky	Cost sticky @ 99% significance level
No. of Observations	468	326
No. of Firms	52	33

4. CONCLUSIONS

The results of this study indicate that cost behavior of listed family firms in the Philippines do not exhibit stickiness. This means that they are able to adjust their resource commitments symmetrically with changes in demand conditions thereby mitigating the principal agency problem. By comparison, non-family firms show sticky cost behavior. Thus, we can conclude that family firms in the Philippines are able to mitigate their agency costs.

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