The Dominance of Family-Owned Business Groups in the Philippines

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ABSTRACT

Family-owned business groups have long dominated the East Asian corporate landscape. This paper looks at the dominance of business groups in the Philippines and tries to explain their dominance by their role as filling the institutional voids left by government due to decades of political and economic instability. The paper also discusses the applicability of agency theory in the country. Finally, the paper looks at the downside to this common form of corporate organizing and how family businesses reflect the oligarchical nature of the country's stratified society.

KEYWORDS: Business groups, family businesses, institutional voids, agency theory, corporate governance, developing economies

BACKGROUND

The private sector of the Philippines is largely dominated by family-owned conglomerates or business groups (Granovetter 2001, Claessens et al 2000) and small family-run businesses. Indeed, ownership and control is rarely separated in the Philippines. The dominance of the family permeates throughout the private sector from the large listed corporation to the corner store. This paper relates the evidence of business groups and their attitude towards listing and corporate governance.

METHODOLOGY

Compared to previous research that have in large part been quantitative and qualitative case studies surveys into Philippines corporate governance, this research uses the ethnographic method to discover the profound impact of corporate governance reforms on family-owned firms. The design of my research was qualitative in order to gain a richer, profound and wider understanding that mere statistics could not unveil. Indeed, Claessens et al (2000) quantitative study provides an indication but not an explanation of why concentration of family corporate ownership in the Philippines and other parts of East Asia are high.

Forty interviews were conducted in 2007 in situ in the Philippines with senior executives of the country's listed and owners of unlisted corporations supplemented by participant observation and local media content analysis as part of a broader research into the impact of corporate governance reforms in the country. In particular, the research sought to answer the following question: "What was the impact of corporate governance reforms in the country?" and whether such reforms were happening in form and/or substance. These reforms were based upon the OECD Principles of Corporate Governance (1999, 2004) formulated for listed companies who have widely dispersed owners in developed countries. In the Philippines, the business environment is the opposite - most listed companies are partially listed and owned by major blockholders such as families, and the country's institutional framework is still underdeveloped and the political environment is unstable Throughout the data collection, inductive aspects of the research sought to uncover reasons for the divergence and the limitations of Anglo-American corporate governance reforms. The dominance of family-owned businesses in the country mean corporate governance reforms and their pragmatic application must be taken into the context of this situation.

The interview data (mostly face-to-face with some lasting up to three hours long) were transcribed and inputted in the NViVo Qualitative Research Program. Nodes were done in an inductive manner and some 50 nodes were generated covering issues relating to family businesses. The screenshots below shows the free nodes relating to family-owner issues such as 15 nodes for business groups:

<INSERT DIAGRAM 1 HERE>

For ease of search, free nodes were used in the NViVo program instead of tree nodes. For the business group nodes, 12 nodes were exclusively related to family-owned business groups while the rest were for non-family and theoretical aspects of business group theories. The tree chart below is a summary of the categories of 15 business group nodes:

<INSERT FIGURE 1 HERE>

THE DOMINANCE OF FAMILY-OWNED BUSINESS GROUPS

Family-owned business groups are the dominant form of economic organisation in the Philippines:

> "Most of the businesses in the Philippines are controlled by single family groups. This, of course, poses challenges to an effective overall corporate governance framework." – holding company interviewee

Granovetter's definition of business groups is applied here:

> "One can consider as business groups those collections of firms bound together in some formal and/or informal ways, characterised by an 'intermediate' level of binding." (2001: 69)

In the case of South Korea and indeed the Philippines, business groups are so defined as:

> "…they are the outcome of investments by a single family or small number of allied families who, once having acquired the component companies, keep them together as a coherent group among which personnel and resources may be shifted as needed. Yet the individual companies continue to keep some separate identity." (2001: 70)

Or more intimately as one put it

> "…the company is the extension of the family" – private sector interviewee

Family owned business groups in a weak state have the advantage over other forms of economic organizing due to the speed in which decisions are made:

> "The advantage [of family corporations] is quick decisions are made faster. The view is long term and not short-term decisions. There is closer coordination with exceptions…In the Asian culture, if you look at which are the successful entities, most of the successful ones are family owned corporations. They decide fast, they look long-term. If you're [not family run], you tend to look on the short term, short-term return/run. If you're a family corporations, you look in 5 years, 10 years time. You can't compare developed countries and developing countries." – holding company

> "The nature of family corporations here, to what extent is it cultural to have family corporations practice? US theory tend to look down on family corporations. The tendency to assume that family corporations or family controlled firms are necessarily inferior to other forms overlooks the evolution of corporate forms and management practice that they're superior to." - academic

Thus, in this work, the umbrella term 'business groups' cover other colloquialisms such as family corporations (FAMCORs) and commercial industrial groups (CIGs). Business groups in the Philippines are characterised by kinship ties with ownership dominated by one owner and/or one family. Some business groups have history and generational legacy on their side, others are new entrepreneurs. The phenomenon of old money versus new money is not unfamiliar in the Philippines:

> "The Sys founded and grew [their business]. This is the same with the Gokongweis. They started from below. The Ayalas have always been there for long, long time now. New players such as Andrew Tan, Lucio Tan, George Ty. Ty's family wasn't poor as he built from previous wealth, invested it and spin-off its growth. Jo Concepcion (RFM) was there after the war – a spin-off from a separate organisation." – private sector (2)

The following table from Forbes Asia shows the richest 25 individuals/families in the country with their business interests and/or affiliations:

<INSERT TABLE 1 HERE>

The business group structure in the country is vertically integrated reflecting a great degree of control by owners:

> "...groups in the Philippines are far more vertically integrated than groups in India and far more involved in financial services than groups in Thailand." Khanna and Yafeh (2007: 333)

Indeed the Philippine experience is the norm with the corporate landscape of East Asia dominated by business groups:

> "[The Philippine business groups is] not dissimilar to family corporate entities with the exception of Japan and Korea. Most of the region has companies where control is in one large company. [We] mimic models of publicly listed companies, when control blocks [are] put together (such as Hutchinson Whampoa Kai Sheng), the Philippines is no exception – the Ayalas, SMC. What is underlying [this] is the ability of families to recognise developments." – private sector

> "business groups will continue to be important vehicles for the sustained future growth of this region." (Chang 2003: 414)

Why business groups should exist, evolve and be the common form of private sector organising in the region has been a source of rigorous debate. Different theories proffer different perspectives to their enduring existence as the table below that has been adapted from Chung (2005) summarises:

<INSERT TABLE 2 HERE>

In the case of the Philippines, as a developing economy, the above table does provide several indicators why business groups should dominate the economic landscape in the country. The Philippines has less than satisfactory regulatory institutions. With a dominant public sector and executive, business groups create a form of organising that tries to mitigate uncertainty. The Philippines has a developing capital market, and the lack of trust in judicial remedy is widespread. By being part of a business group, transaction costs between affiliated companies are lower theoretically. However this could be up-ended should a dominant shareholder seek to use these relationships for other uses than business efficiency. The might of business groups and conglomerate power also allows competitive advantage over single firms. As business groups dominate industries, being affiliated with a business group allows a company access to the network and resources available within that group. Being part of a business group builds up and consolidates the social capital amongst members.

APPLICABILITY OF AGENCY THEORY

The common principal-agent problem common in Anglo-American countries are not present in the Philippines as most owners are they themselves part of management. In most cases, the control of business groups has not been decoupled from the owners. For some agency theorists such as Villalonga and Amit (2006), they argue that in lieu of the principal-agent problem, Agency Problem II therefore exists – between that of the controlling shareholder and minority shareholders where:

> "The large shareholder may use its controlling position in the firm to extract private benefits at the expense of the small shareholders. If the large shareholder is an institution such as a bank, an investment fund, or a widely held corporation, the private benefits of control are diluted among several independent owners. (2006: 387)

Thus, while the common agency theory is overcome in that managers are kept on a tight leash by owners in a family owned business group, agency theory II provokes the problem of minority shareholder expropriation as the majority owners are so dominant.

In Anglo-American corporate governance, a blockholder or major shareholder is considered to be one who owns around 5% of total ownership. In the Philippines, a 5% ownership is considered a very minor stake. Most groups would have a blockholder that would own at least over 50% of the company so control is supreme. Thus in the Philippines, the Anglo-American agency problems on corporate governance between principal-agent is rarely an issue. Agency theory can only be applied in companies where there is widely dispersed ownership, not concentrated ones:

> "To balance the major shareholder's interests of shareholder intent is realistic - it's human nature. Agency corporate governance Issues here are different. It is important in the US [the] the principal-agent problem. There's no agency problem here. There's no situation here where the biggest shareholder owns 5%. It doesn't happen. There's a controlling shareholder, a block ownership and minority shareholders." – economist

Most of my interviewees spoke about the major owners and the percentage of ownership they have. Seen from an Anglo-American context, the extent of their control is staggering:

> "The dominant family is the Montinolos. They have 40% ownership of the shares, the next is the SM Corporation (Henry Sy) which has 24%. There are foreign investors and although they would like to invest in FEU there are not many shares available." – FEU

> "We have two main shareholder groups: Hong-Kong based First Pacific (private investment group) and Japan's NTT Comm (landline) and Docomo (wireless) NTT representatives are here as well with NTT within advisers within the company in an advisory capacity. Our notable shareholders are Philippine Telecoms, Metro Pacific, SSS, NTT Comm, NTT Docomo, JP Morgan." – PLDT

> "Ayala Corporation is 51% owned by the holding company of the Ayala Family named Mermac. 10% owned by Mitsubishi. The rest is owned by the public. There are foreign investors: 20% of outstanding shares, around 15-20%" – Ayala

> "[T]here are two major shareholders at 40% each and the remaining 20% is widely distributed among individuals, firms, Filipino or foreign." – Petron

As one pointed out, having big blocks mean a great deal of control and influence is exercised:

> "Once you get that size, a shareholder block of around 35% the block is still in control due to the sheer amount of money involved. We are still a relatively small company so if we list at all the number of shareholders will be spread out. One shareholder has a 20% ownership but there isn't one shareholder that has control. They are all buddies. We're generating money on our ROI so we can't access it (the shareholder value) the capital requirements that we have." – unlisted company

Classical agency theory is not supported in the country's corporations as ownership and control are- in fact - the same, but there is some support for what Villalonga and Amit's call agency problem two.

Business Groups as Filling the Institutional Void

In the Philippines, business groups have filled the institutional void normally reserved for government. A weak government with a limited amount of resources which does not have the efficiency to apply them to its utmost effectiveness, does not have the capability to fulfil all its institutional and infrastructure obligations:

> "More generally, due to their broad scope, business groups can facilitate development by internalizing public infrastructure in regions where the provision of public goods is poor (Fisman & Khanna, 2004). For example, India's largest business groups have created self-contained

> industrial cities providing their own essential infrastructure such as roads, telecommunications, electrical power, schools and medical facilities. The strategy offers access to low cost factors of production (land, labor) and in turn catalyzes economic development in the surrounding area." (Carney 2008: 598)

In Manila, business groups have visibly filled this institutional void in the development of the central business districts of Makati and Mandaluyong. Indeed, several comments were made to me during my fieldwork compared and contrasted how the landowners developed these two business districts with minimal contribution from the state. However, while they fulfil part of the institutional void, business groups themselves are not substitutes for government nor do they wish to be substitutes for government. A sentiment I would hear include comments such as "We are doing what government is suppose to be doing. This is suppose to be their job, not ours." Business groups and their owning families - at least the ones I interviewed – showed little desire to rule the country even though their economic interests rival that of the state.

Business Groups – Paragons or Parasites?

The mixed view of business groups as paragons or parasites were expounded upon by Khanna and Yafeh in their 2007 provocative article. However, the authors show that business groups' behaviour cannot be generalised. As business groups are also a reflection of the owning and controlling family's values, opinions vary. It is not as black and white as the title of their article suggests. The murky developing environment of the Philippines opens up the compelling shades of grey and battles between good and the not-so-evil are often represented.

Which business groups are worthy of trust and investing in, and which ones are dominated by a family or founder and where insider trading dominates? Which ones practice good corporate governance and which ones do not?

The business group paragons are the ones who have a good reputation premium and practice good corporate governance. (Carney 2008: 597) The parasitic business groups practice not so good corporate governance and depend largely on the largesse of their political connections to sustain the viability of their companies.

Downsides to this Dominance

There is a downside to the dominance of business groups in the Philippines. The private sector is an uneven playing field between affiliated companies and unaffiliated companies overlooked by government which enforces rules and regulations haphazardly and inconsistently:

> “Certainly there is an uneven playing field. It remains a serious problem. This family-based form of economic power translates into familial politics. It’s an issue of control that’s why the stock market hasn’t developed. There are conglomerate problems: walls dividing various aspects of investment and banking not followed.” -academic

The domination of business groups also deters continuous investment and deters competition:

> “Most companies are owned by families, there is limited liquidity.” – private sector (1)

> “There is no way to do business [in the Philippines] without working with family business. Look at Metrobank. Schools , colleges are owned by families – other than religious orders. No sector in this economy that is not dominated by a family business. It makes us difficult to move, to grow. [Their] size makes you work with family networks and connections.” -academic interviewee

For foreign entrants, if they have not been deterred by the ownership restrictions, they face an uphill challenge to enter sectors which are dominated by certain business groups:

> “The top oligarchies here of which there are 12 organisations are diverse in their holdings, so for a large foreign group to challenge that, it’d be difficult.” – consultant

Affiliating and allying with a business group allows them a foot in the door. Indeed, that was an observation made to me on how to do business in the country. The business groups are reflective of the oligarchic nature of the country:

> “People who affect the life of the country (political intellectual circle) is very limited. Elitist.” – private sector (1)

Internally, a business group structure of inter-affiliated companies fosters a culture of insider information. This is an obstacle to transparency which makes it difficult for the capital market to function properly:

> “Guys who own company have superior information (owners are insiders – unlike Anglo American – the insiders are managers). [You need to] increase the right information provided to make an informed judgement and not be taken for a ride.” – private sector (2)

Therefore, corporate governance in the country is limited and promoted by the interests of business groups. The business groups which make up the majority of the real economy of the Philippines still resolutely hold and control the power in their companies.

CONCLUSIONS

This paper sought to relate the dominance of business groups, their role in filling institutional voids and the applicability of agency theory in the country. For the foreseeable future, business groups will continue to dominate the private sector landscape of the country and corporate governance in the Philippines will be applied, altered, supported (or not) and shaped by the owners of these groups.

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Diagram 1: Screenshot of Business Group Nodes in NVivo version 8.0

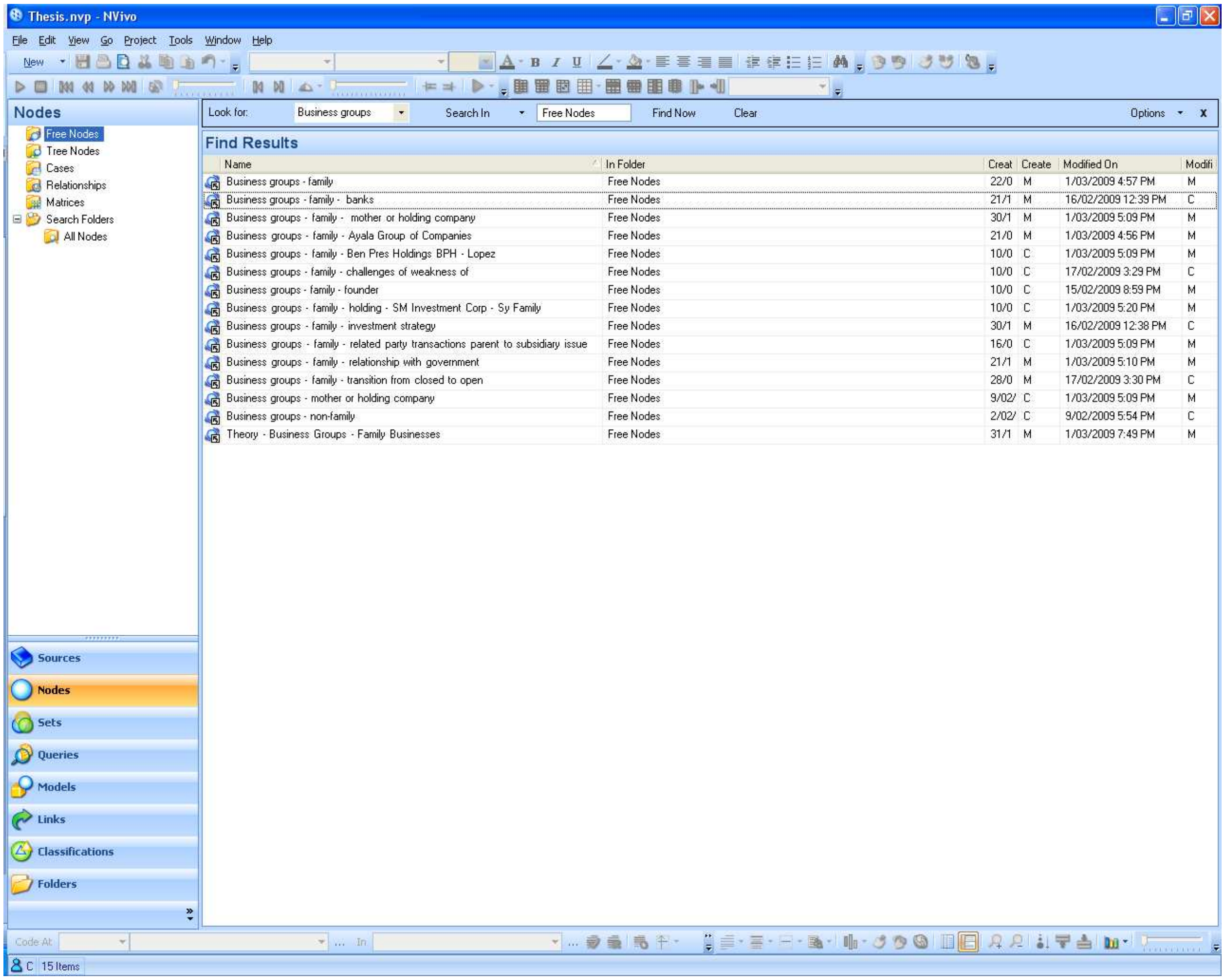

Figure 1 Business Group Nodes categorised

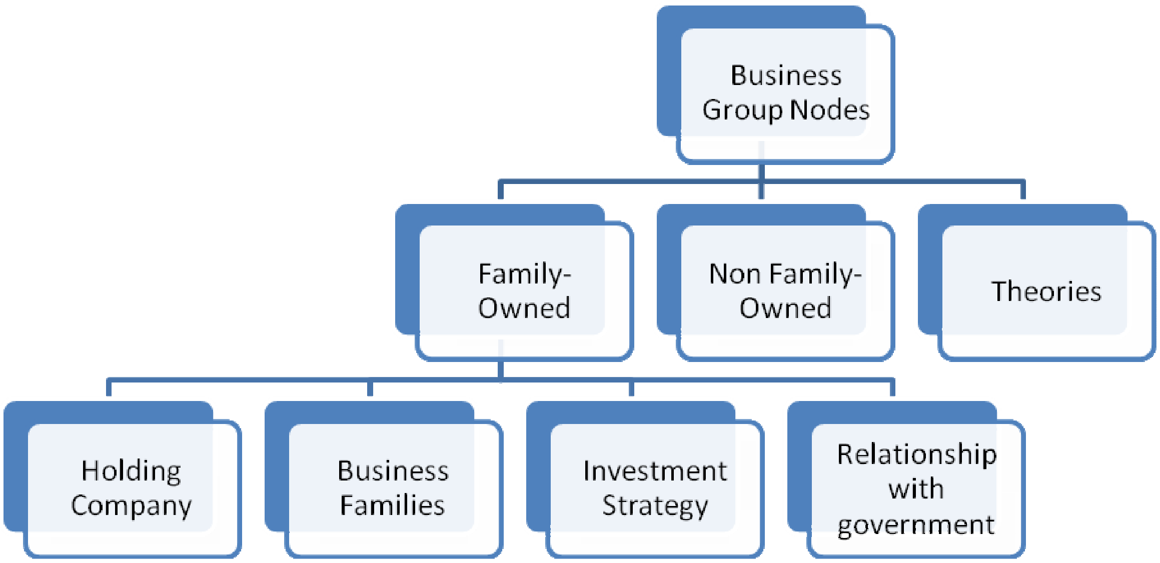

Table 1: 25 Richest Individuals/Families in the Philippines in 2009[1]

Rank	Name	Business Group Affiliation / Interests	Net Worth (USDM)
1	Henry Sy	SM Investment Corporation	3800
2	Lucio Tan	PNB, PAL, Asia Brewery	1700
3	Jaime Zobel de Ayala	Ayala Corporation	1200
4	Andrew Tan	Alliance Global Group, Megaworld	850
5	John Gokongwei	JG Summit	720
6	Tony Tan Caktiong	Jollibee Foods	710
7	Eduardo Cojuangco Jr	San Miguel Brewery	660
8	Enrique Razon Jr	Container Terminal Services	620
9	Manuel Villar	Vista Land; Philippine Senate President	530
10	George Ty	Metrobank	515
11	Emilio Yap	Philtrust Bank	510
12	Iñigo & Mercedes Zobel	Mermac	440
13	Beatrice Campos	Unilab	410
14	Vivian Que Azcona	Mercury Drug	390
15	Oscar Lopez	Lopez Group	350
16	Andrew Gotianun	FilInvest Development	310
17	David Consunjui	DMCI Holdings	300
18	Robert Coyiuto Jr	Oriental Petroleum and Minerals	290
19	Alfonso Yuchengco	Yuchengco Group of Companies	230
20	Mariano Tan	Unilab	180
21	Menardo Jimenez	GMA Network	160
22	Gilberto M. Duavit	GMA Network	159
23	Felipe Gozon	GMA Network	135
24	Jon Ramon Aboitiz	Aboitiz Equity Ventures	125
25	Betty Ang	Monde Nissin	120

[1] Forbes (2009) The Philippines' 40 Richest, Forbes Asia, August 25, http://www.forbes.com/lists/2009/86/philippines-billionaires-09_The-Philippines-40-Richest_Rank.html accessed 19 October 2009

Table 2: Different theoretical perspectives on development of business groups in developing economies (adapted from Chung 2005: 67)

Institutional theory	Institutional theory asserts that highly diversified BGs create value by compensating for a nation's inefficient capital, labor, and product markets (Clague 1997; Coase 1937, 1998; Harris et al. 1995; Leff 1978; North 1990).
Market failure theory	Market failure theory, concurring with institutional theory, argues that external markets can fail due to inefficient market mechanisms, legal impediments, and lack of trust (Collis and Montgomery 2005; Klein et al. 1978).
Transaction cost theory	Transaction cost theory argues that internal business transactions lower transaction costs because they avoid costs associated with contracts, negotiations, and contract enforcements (Chang and Hong 2000; Choi et al. 1999; Hill 1995; Khanna and Palepu 1997, 2000).
Resource based theory	Resource-based theory asserts that BG-affiliated companies have opportunities to acquire and accumulate valuable resources, such as industry entry skills, trained employees, managerial skills, export-related skills, and others, giving them resource advantage over non-affiliated companies (Amsden 1989; Amsden and Hikino 1994; Guillen 2000).
Social capital theory	Social capital theory proposes that intra-firm networks such as BG companies are social capital that can facilitate value creation (Alder and Kwon 2002; Baker 1990; Das and Teng 2002; Portes 1998; Tsai and Ghoshal 1998).
Agency theory	Agency theory argues that because BGs are owned and managed by founder families, agency problems are minimized between professional managers and shareholders.


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