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Dividends and family governance practices in private family firms

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Abstract Intra-familial principal–principal conflict are a relevant agency problem in privately held family firms. These conflicts of interest commonly occur between active and passive family shareholders, and require remedies different from those that deal with principal-agent conflicts. This article empirically examines whether or not firms use dividends as instruments to cope with conflicts of interest between active and passive family shareholders and how family governance practices moderate this relationship. The results show that the existence of an intra-familial conflict of interest results in a higher propensity to pay dividends and that the use of family governance practices strengthens this relationship. Additionally, the findings suggest that using family governance practices leads to a more efficient dividend policy.

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1 Introduction

As from the seminal paper of Miller and Modigliani (1961), a lot of theoretical and empirical research aims at finding explanations why firms pay dividends. In this stream of research, the influence of family ownership on dividend policies attracted the attention of many researchers (e.g., Chen et al. 2005; Farinha 2003; Gugler 2003; Pindado et al. 2011; Setia Atmaja et al. 2009; Yoshikawa and Rasheed 2010). Yet, almost none of these studies focuses on privately held family firms. According to allegations of traditional agency theory, dividends are indeed assumed to be irrelevant in these firms because of the absence of a principal-agent conflict of interest and a strong natural alignment of incentives between family shareholders (Michaely and Roberts 2012).

However, in reality, many privately held family firms do pay out dividends regularly (Gallo 2004; Gersick et al. 1997; Hoy and Sharma 2010; Poza 2009; Ward 1997). An explanation for the existence of dividends, despite their so-called irrelevance, lies in a specific type of conflict that may occur in the specific context of private family firms*: the intra-familial principal–principal conflict* (Gersick et al. 1997;

Schulze et al. 2001; Stewart and Hitt 2012). We will focus in this paper on a specific type of an intra-familial principal–principal conflict of interest that is particularly interesting when studying dividends, namely the one between active (employed by the family business) and passive family shareholders (not employed by the family business), who may have diverging interests due to their different role in the firm. Passive family shareholders often prefer to receive dividends, for example in order to reduce the free cash flow available for the active family shareholders, whereas the active shareholders generally prefer to reinvest cash in the firm (Gersick et al. 1997). This incongruity of interests between active and passive family shareholders can have detrimental effects for the family firm and is thus a potentially important agency problem (Eddleston and Kellermanns 2007) and, consequently, an important but unexplored determinant of the incidence of a dividend policy in private family firms.

In addition, the mechanisms for making dividends a solution to potential principal–principal problems are clearly different in privately held vis-à-vis publicly held firms. Controlling shareholders in publicly held firms face a trade-off between, on the one hand, their preference to maintain control of corporate resources and, on the other hand, a significant decline in the market valuation of the firm when this preference is mirrored in a no or low dividend policy (Faccio et al. 2001). Hence, the stock market will play a disciplining role by forcing controlling managers to abstain from expropriation behavior and to pay out (high) dividends when they want to avoid such a decline in stock price. However, privately held family firms lack the disciplining role of the stock market, which raises the intriguing question which governance forces could take over this role. We will argue in this paper that family governance mechanisms in private family firms can take over the disciplining role of the stock market in persuading the active family shareholders to adopt a dividend policy when a potential intra-familial principal–principal conflict of interest may occur. Whereas the disciplining stock market may be considered as a formal governance mechanism, family governance mechanisms, such as for example family councils or family charters, could be labeled as relational governance mechanisms, which are based on the creation of social controls for the promotion of social interaction, the creation of a shared vision, and the preservation of trust and mutual commitment (Mustakalio et al. 2002; Poppo and Zenger 2002; Uhlaner et al. 2007).

Indeed, strong trusting relationships among family stakeholders are considered as one of the main sources of competitive advantage for family firms (Steier 2001; Sundaramurthy 2008). However, maintaining high mutual trust among family members is particularly challenging when family firms evolve across generations and family ownership disperses (Bammens et al. 2008). Therefore, high levels of open communication among family members are essential in sustaining trust and a shared vision within later generational family firms (Sundaramurthy 2008). From this perspective, family governance mechanisms are "systematic communication forums that are critical to positive family culture and also enable family firms to reinvest in interpersonal trust as the firm's family and business grows" (Sundaramurthy 2008, p.97), thereby preventing or reducing harmful conflicts among family stakeholders such as potential conflicts about dividend policy.

Despite the fact that intra-familial principal–principal conflicts may exist within private family firms (e.g., He et al. 2012; Hoy and Sharma 2010; Poza 2009; Ward 1997), this type of conflict has long been excluded from the corporate governance discussion (Li and Srinivasan 2011) and empirical studies on the topic are rare (Siebels and Knyphausen-Aufseß 2012). Given these observations, the purpose of this paper is to study the relationship between active versus passive family shareholders in private family firms and the incidence of a dividend policy. In addition, this study takes into account whether and how family governance practices (namely the family charter and family forum) moderate the relationship between these agency conflicts and the propensity to pay dividends. Using a sample of 244 Belgian privately held family firms, this study indeed shows that the presence of passive family shareholders results in a higher propensity to pay dividends[1] and that family

[1] In this paper, we investigate the *propensity* to pay dividends, and we thus do not examine the *amount* of dividends that are being paid out, for two reasons. First, the rather limited sample size and the rather small percentage of firms that are paying out dividends does not allow for detailed analyses of the dividend payout *rate*. Second, the objective of this paper is to investigate the *presence* of a dividend *policy*, which can be measured via the propensity to pay dividends.

governance practices appear to be an important facilitating mechanism to avoid or mitigate conflicts among family shareholders by paying out dividends. Additionally, post hoc findings suggest that using family governance practices results in a more efficient dividend policy.

This paper makes contributions to the finance, governance as well as general family business literature. First, analyzing dividend policy in the context of *private* instead of *public* firms allows for a cleaner measurement of the effects of (family) ownership structure on dividend policy because there is no external factor (such as, for example, the stock market) that is influencing the dividend policy. This paper thus builds further on the findings of Michaely and Roberts (2012), who found that private firms with dispersed ownership have a different dividend policy than public firms with the same characteristics, suggesting that ownership structure and incentive conflict are important when studying dividend policy. Next, given that prior research on the intra-familial conflict of interest, as well as on family governance practices and dividend policy in private family firms, is mainly anecdotal and case based, this article goes a step further by empirically testing the moderating impact of family governance practices on the relation between agency conflicts and the propensity to pay dividends. As such, the article responds to recent calls for empirical research on these topics (Siebels and Knyphausen-Aufseß 2012).

The remainder of this article is organized as follows. Section 2 reviews relevant previous literature and formulates hypotheses. Subsequently, Sects. 3 and 4 cover the methodology and the results. Section 5 discusses the results and concludes.

2 Theory and hypotheses development

2.1 Dividends and intra-familial principal–principal conflicts

While businesses find dividends obvious, economists seem to find the existence of dividends mysterious (Easterbrook 1984). Modigliani and Miller (1961, 1958) declare dividends to be a trivial issue that one can easily ignore, because shareholder wealth will be unaffected by management's decision concerning dividend payouts. Regardless of whether management retains earnings as capital gains or distributes them in the form of dividends, the return to the shareholder will be the same. However, in the real world, most firms pay out dividends regularly (DeAngelo and DeAngelo 2007), even despite the fact that dividends are less favorable than capital gains because of taxes. This occurrence of dividends, despite their costs, has led academics to a search for explanations.

The finance literature offers several explanations for the existence of dividends, such as signaling, clientele, agency conflicts, catering, and investment opportunities (Baker and Wurgler 2004; Bhattacharyya 2007; Easterbrook 1984; Ross 1973; Rozeff 1982). Although none of these theories are entirely satisfactory in explaining why firms pay dividends, recent empirical studies are mainly supportive for the agency cost explanation of dividends (Denis and Osobov 2008; La Porta et al. 2000; Mancinelli and Ozkan 2006). On the one hand, dividends may mitigate the owner–manager agency conflict because they reduce the firm's free cash flow. Thus, paying out dividends will reduce the plausibility that managers will waste the firm's excess cash flow by making low return investments that provide private benefits for managers at the expense of the shareholders (Easterbrook 1984; Jensen 1986; Rozeff 1982). On the other hand, dividends can also mitigate intra-shareholder conflicts because they reduce the possibility of expropriation of corporate wealth by insiders (Faccio et al. 2001; La Porta et al. 2000). In other words, dividends can be a self-imposed disciplining mechanism because they transfer wealth from the discretion of the (owner-) manager to all shareholders on a pro-rata basis (Brav et al. 2003; Faccio et al. 2001).

Additionally, several authors investigate the impact of ownership structure (Hu and Kumar 2004; La Porta et al. 2000; Michaely and Roberts 2012; Rommens et al. 2012; Short et al. 2002). Concerning the impact of family ownership, most studies seem to agree that family firms are more inclined to pay dividends and have higher payout ratios because they use them to alleviate minority investors' concerns over wealth expropriation (Chen et al. 2005; Gugler 2003; Pindado et al. 2011; Setia Atmaja et al. 2009; Yoshikawa and Rasheed 2010). These last mentioned studies all focus on publicly held (family) firms and the challenge of mitigating the owner–manager as well as the controlling-minority shareholder conflict of interest, while overlooking privately held family firms and the challenge of within-group alignment. After all,

according to classical agency theory, family involvement in both ownership and management should align the interests of owners and managers and thus will lead to minimized, or even zero, agency costs in private family firms (Ang et al. 2000; Fama and Jensen 1983; Jensen and Meckling 1976). Therefore, assuming the absence of agency conflicts in private family firms, dividends will be irrelevant because they are more costly to the firm than retaining capital (in terms of taxes) and thus will be useless.

However, in the last decennium, several authors (e.g., Chrisman et al. 2007; Lubatkin et al. 2005; Schulze et al. 2003a, b; Schulze et al. 2001) introduced new insights into the agency problems of private family firms as the "combined influence of private ownership and family management results in a web of incentives that undermine a family firm's governance and raise the agency cost of fractional ownership" (Schulze et al. 2003a, p. 182). Furthermore, in contrast to what is assumed in classical agency theory, family shareholders are a heterogeneous group, whose members have different interests and goals (Sharma et al. 1997). While some shareholders are employed by the firm and perhaps actively participate in management (hereafter: active shareholders), others do not work in the family business (passive shareholders) (Gersick et al. 1997). These different roles and responsibilities can shape their point of view on the family firm objectives and development, and can give rise to intra-familial principal–principal conflicts (Gersick et al. 1997; Stewart and Hitt 2012).

Although less recognized than the principal–principal conflict of interests in public family firms, these conflicts are argued to be very common in privately held family firms, as indicated by several theoretical contributions in the family business literature (Gersick et al. 1997; Poza 2009; Stewart and Hitt 2012). For example, passive family shareholders are generally less tolerant for financial risk and uncertainty than active family shareholders, because the latter may be prepared to sacrifice personal needs to those of the business, whereas the former may not (Dreux 1990). This intra-familial principal–principal conflict may aggravate as time passes, and ownership becomes more dispersed because active and passive family shareholders are then likely to have a different degree of identification with and involvement in the family firm (Ward 1997). Thus, even when the firm has no outside (i.e., nonfamily) shareholders and the firm's equity is distributed among family members, conflicts between active and passive family shareholders may arise (Schulze et al. 2003a). Empirical studies on this topic are rare, with the exception of Vilaseca (2002), who finds evidence of the existence of a conflict of interests and diverging objectives among family business shareholders (nonemployed versus members of the management team).

According to anecdotal and case-based literature, dividends may be an instrument to mitigate these intra-shareholder conflicts in private family firms (e.g., Thomas 2002; Ward 1997; Ang 1992; Gallo 2004; Gallo and Vilaseca 1996). After all, active family shareholders may take exorbitant salaries or excessive perquisites, or invest in low return showcase projects that will advance their career perspectives, at the expense of passive family shareholders. This threat could cause the passive shareholders to insist on greater dividend payouts, even if this is not advantageous from a taxation viewpoint (Ang 1992; Ward 1997; Ayers 1990). Another reason for passive family shareholders to demand dividend payouts is the fact that they consider them as a legitimate reward of their family membership (Gersick et al. 1997). Additionally, passive family shareholders will perceive important differences if the earnings generated by the firm are distributed in the form of dividends or retained in capital, because the shares are not traded in a fluid stock market, and thus, dividends are the only means of satisfying their structural liquidity needs (Gallo and Vilaseca 1996; Neubauer and Lank 1998).

In sum, conflicts of interest between active and passive shareholders likely occur in privately held family firms and dividend policy is likely to reflect these potential conflicts of interest. Thus, the first hypothesis expects a higher propensity to pay dividends when passive family shareholders are present, in order to mitigate potential intra-familial principal–principal conflicts.

Hypothesis 1: Private family firms with both active and passive family shareholders have a higher propensity to pay dividends than private family firms with only active family shareholders.

2.2 Family governance practices as a moderating variable

Controlling shareholders generally prefer to keep power over corporate resources which a lower

propensity to pay dividends likely reflects. However, when vulnerability to expropriation problems is high, rational minority shareholders in publicly held firms will demand dividend payouts in order to address these agency problems. When these dividend calls remain unanswered, minority shareholders will attach a lower value to the firm and the share price may drop significantly (Faccio et al. 2001). Consequently, the stock market plays a prominent role in convincing the controlling shareholders to pay out dividends. The absence of a disciplining stock market for privately held family firms raises the question whether social controls aimed at sustaining trust and a shared vision could replace the stock markets' role in convincing controlling shareholders to commit to a dividend policy. This paragraph introduces family-centric governance solutions as an answer to this question and discusses whether and how these family governance mechanisms moderate the relationship between potential principal–principal conflicts of interest and the propensity to pay dividends.

Intra-familial principal–principal conflicts require different remedies than those that deal with the traditional principal-agent conflict or the ownership-based principal–principal conflicts (between majority and minority owners) in public family firms (Stewart and Hitt 2012; Young et al. 2008). The governance of a family firm consists of two interacting subsystems: the firm governance and the family governance system (Storey 1994; Westhead and Cowling 1998). Apart from the supervision and control of management, private family firms need to establish distinct governance structures that consider the multiple roles that family members play within the family and the firm, which is necessary to prevent or reduce harmful conflicts among family shareholders (Bartholomeusz and Tanewski 2006; Mustakallio et al. 2002; Neubauer and Lank 1998). By doing so, these specific family governance structures help to create a shared vision between active and passive family shareholders (Berent-Braun and Uhlaner 2012; Hoy and Sharma 2010; Mustakallio et al. 2002; Suáre and Santana-Martin 2004; Vilaseca 2002). Family governance practices (hereafter: FGP) can be both formal and informal and may vary overtime in line with the generational stage of the family firm (Neubauer and Lank 1998; Suáre and Santana-Martin 2004).

A dividend policy is often a topic that leads to disunity and family in-fighting (Gallo 2004). FGP provide an excellent opportunity to alleviate conflicts between active and passive family shareholders by enhancing the communication between shareholders and creating a shared vision among them. By doing so, the firm can turn passive family shareholders into well-informed, committed partners (Gallo and Vilaseca 1996; Vilaseca 2002). A family forum (also referred to as family meeting or family council), for example, can be a catalyst for developing a dividend policy, which satisfies the needs of both active and passive shareholder groups. A *family forum* can occur in different compositions, but its main goal is to promote communication among the family shareholders (Brenes et al. 2011).

Additionally, the forum provides a platform on which present and emerging family conflicts can be discussed and resolved before they affect the firm (Brenes et al. 2011; Gersick et al. 1997; Habbershon and Astrachan 1997; Poza 2009). Family members can express their different values, expectations, and opinions, which are afterward presented to the top management team (Gersick et al. 1997; Poza 2009). As such, a family forum can help in discussing the desired balance between the family and the firm and between reinvestment and liquidity needs (Poza 2009). For example, whereas a family forum gives the opportunity to passive shareholders to express their liquidity needs, it also gives the opportunity to active shareholders to clarify present investment opportunities and thereby indicating what constitutes realistic dividend expectations. Additionally, a *family charter* (also referred to as family constitution or family code of conduct) can facilitate the development of a formal dividend policy as it documents principles and guidelines regarding the relationship of the family to the business. The charter can thus disclose reinvestment requirements and a ratio of reinvestment to distribution in the form of dividends (Poza 2009). The development of a family charter is usually a highly participatory process involving the entire family (Berent-Braun and Uhlaner 2012; Brenes et al. 2011; Suáre and Santana-Martin 2004). As such, the charter represents an important asset to family unity and transparency and helps with developing a patient capital culture (Poza 2009).

In conclusion, FGP can facilitate the discussion over dividend policies. Therefore, whether the existence of an intra-familial principal–principal conflict indeed leads to a dividend payment may depend on the

establishment of FGP in the firm. After all, as a result of a potential intra-familial principal–principal conflict of interest, shareholders are likely to put their own agendas before anything else and they may exhibit the behaviors of greedy and ungrateful heirs (Poza 2009). Active family shareholders may try to use excess cash for private benefits and perquisites, or they might favor reinvestment in the firm, as this will probably be more advantageous to them. So as to prevent this rent extraction, passive family shareholders will prefer to receive dividends. However, active family shareholders usually have decision power over corporate resources, and the absence of a liquid market for shares tends to take away one of the main disciplining governance mechanisms in establishing a dividend policy. Therefore, the existence of a potential intra-familial principal–principal conflict as such will not necessarily lead to dividend payments. Without any family governance system that enables communication between family shareholders and thus without the development of a shared vision about what is best for the family firm, dividend payments will rather be the result of who has most power to push through his/her preferences. As the use of FGP assists in creating a shared vision between family shareholders (Mustakallio et al. 2002), FGP will facilitate the development of a dividend policy, which is satisfactory for both passive and active family shareholders. Dividend payments are, therefore, more likely to occur in firms with FGP as a result of the shared vision and the desire to mitigate existing or potential family conflicts and consequently also reducing the threat of shareholder exits. Therefore, we postulate:

Hypothesis 2: Family governance practices will positively moderate the positive relationship between passive family shareholders and the propensity to pay dividends.

3 Methods

3.1 Sample

The primary source of data is derived from a wider cross-sectional survey, conducted during the period 2002–2003. This survey explores general firm characteristics, as well as board and management composition, strategic, succession, and governance issues in Belgian family businesses. In our study, firms are characterized as family firms when they meet one of the following requirements: (1) at least 50 % of the shares are owned by family members and the family is responsible for the management of the business, or (2) at least 50 % of the shares are owned by family members, the company is not family managed but the CEO perceives the firm as a family business.

The survey was mailed to CEOs of 3,400 firms, randomly selected from a family business database, all of them being privately owned, independent, and employing at least five people. The final response rate was 9.2 % or 311 companies, of which 295 contained sufficient data to be included in the analysis. This response rate is in line with previous studies of privately held firms that target CEOs (Bammens et al. 2008; Berent-Braun and Uhlaner 2012; Cruz et al. 2010; Uhlaner et al. 2007). After removing cases with missing values, and removing two cases that have a venture capitalist, our analyses are based on a final sample of 244 privately held family businesses. The possibility of a nonresponse bias is tested using Kruskal–Wallis and χ^2 tests, which compare several key firm characteristics (such as firm size and sector) between sample and population. No statistically significant differences are found, which suggests that the sample is representative for the population.

The secondary source of data is the 2003 Bel-First database by Bureau Van Dijk, which contains accounting statements of all Belgian firms. By using two different sources of data, the risk of common method bias is mitigated, since the dependent variable (dividend payout) and several control variables (firm size, leverage, cash, growth, and sector) result from a database external to the survey.

3.2 Measures

3.2.1 Dependent variable

Consistent with previous empirical research investigating the propensity to pay dividends (DeAngelo et al. 2004; Denis and Osobov 2008; Fama and French 2001; Henry 2011; Sharma 2011), this study uses a binary dependent variable, the likelihood of paying dividends (DIV), which equals one when the firm has paid out a dividend in 2003, and zero if the firm has not.

3.2.2 Independent variables

The dummy variable *Passive* equals one when the firm has family shareholders who do not work in the firm, and zero when all the family shareholders are active, that is, working in the firm. In order to capture the existence of family governance mechanisms in the firm, the dummy variable *FGP* equals one when the firm has established a family forum and/or a family charter, and zero otherwise.[2]

3.2.3 Control variables

Consistent with prior finance research, the analysis includes several firm characteristics that might influence the propensity to pay dividends. First, as higher profits have proven to be positively associated with payout (e.g., DeAngelo et al. 2004; Fama and French 2001; Sharma 2011), the variable *ROA* controls for a firm's profitability. ROA (return on assets) is measured as the income before interest, tax, depreciation, and amortization, divided by total assets. The natural log of total assets (*Assets)* is included in the model as a proxy for firm size, because larger firms tend to have a higher propensity to pay dividends (Fama and French 2001; Fenn and Liang 2001; Sharma 2011).

According to Jensen's (1986) free cash flow hypothesis, higher cash holdings should be positively related to dividend payouts (DeAngelo et al. 2006; Farinha 2003). The variable *Cash* contains a firm's cash holdings as a fraction of its total assets. The model controls for long-term leverage, measured via long-term debt divided by total assets (*Leverage*), as debt may negatively impact dividends because the firm needs cash to pay for interests (DeAngelo et al. 2004; Sharma 2011). Additionally, debt covenants and restrictions imposed by debtholders can limit the firm's ability to pay out dividends (Baker 1989; Farinha 2003; Hu and Kumar 2004; Jensen and Meckling 1976). The natural logarithm of firm age (*Firm Age*) is included as a proxy for a firm's maturity. Older firms are typically in later growth phases, which gives rise to excess cash, and are thus more likely to pay dividends (Sharma 2011; Yoshikawa and Rasheed 2010).

A firm's investment or growth opportunities are expected to be negatively related to the propensity to pay dividends because these opportunities give a firm a strong incentive to retain cash and thus not to pay out dividends. Consistent with prior research (Carney and Gedajlovic 2002; Denis and Osobov 2008; Fama and French 2001; Naceur et al. 2006), growth rate of assets in 2003 (dA_t/A_t) is a proxy for a firm's investment opportunities (*Growth*), because greater growth indicates superior investment opportunities (DeAngelo et al. 2004). As the generational phase of a family firm might influence the decision to pay dividends (Lubatkin et al. 2005), a dummy variable *Generation* is included, which equals one for a first-generation family firm and zero for later generations. Although our sample does not include any firms in which a venture capitalist is involved, we should control for the possible influence of other nonfamily shareholders on the firm's dividend policy. Therefore, we include the dummy variable *Nonfam Share,* which equals one when the firm has active nonfamily shareholdings (managers who do not belong to the family but have shares of the firm) and zero otherwise. Finally, in order to control for sector effects, four sector dummy variables are included: *Manufacturing*, *Construction*, *Wholesale,* and *Service*.

4 Results

4.1 Descriptive statistics and univariate analysis

Table 1 reports average characteristics of the full sample and of the subsample of dividend payers and nonpayers. About 18 % of the sample firms are dividend payers. This percentage corresponds to the study of Rommens et al. (2012) whose sample consists of 19 % dividend-paying private firms in Belgium. The sample firms have an average dividend payout ratio of 1.09 % (if measured as dividend to assets) or 18.67 % (if measured as dividend to earnings). About 34 % of the sample firms have passive family shareholders, and 15 % of the firms have some sort of FGP in place. On average, the sample firms have assets of 4.9 million euro and are 40 years old, and about 79 % of the firms are second- and later-generation firms.

[2] We use this dummy ("and/or") as a proxy for family governance practices because the fairly small sample size does not allow for a more detailed breakdown in sorts and numbers of family governance practices.

Table 1 Descriptive statistics: dividend payers versus nonpayers

	Full sample ($n = 230$)		Nonpayers ($n = 192$)		Payers ($n = 38$)		Differences	
	Mean	SD	Mean	SD	Mean	SD	t value[b]	z value[c]
DIV	0.18	0.38						
Payout1	0.01	0.05						
Payout2	0.19	1.90						
Passive	0.34	0.48	0.32	0.47	0.47	0.50	1.84**	1.83*
FGP	0.15	0.36	0.14	0.35	0.19	0.39	0.69	0.69
ROA	6.51	7.50	5.42	7.36	11.58	5.92	5.14***	5.95***
Assets[a]	4,913.87	11,850.07	4,037.25	8,038.51	9,011.51	21,981.67	2.53***	2.62***
Cash	0.14	0.16	0.21	0.14	0.24	0.20	4.83***	4.14***
Leverage	0.02	0.04	0.03	0.04	0.01	0.01	−3.18***	−3.70***
Firm Age	40.11	37.97	36.58	27.48	56.63	66.37	3.20***	2.13**
Growth	0.04	0.21	0.03	0.21	0.07	0.20	1.04	2.02**
Generation	0.21	0.41	0.22	0.41	0.16	0.37	−0.82	−0.82
Nonfam Share	0.06	0.23	0.05	0.21	0.12	0.21	1.84**	1.83*
Manufacturing	0.34	0.48	0.35	0.48	0.33	0.47	−0.28	−0.28
Construction	0.14	0.34	0.14	0.35	0.12	0.32	−0.40	−0.40
Wholesale	0.36	0.48	0.37	0.48	0.30	0.46	−0.82	−0.82
Service	0.16	0.37	0.14	0.35	0.26	0.44	1.80**	1.79*

$N = 244$

FGP family governance practices

*, **, *** Significant at a probability level below 0.10, 0.05, or 0.01 level (two-tailed); Payout1 = dividend to total assets; Payout2 = dividend to earnings

[a] in 000 EUR

[b] t value based on a two-sample t test

[c] z value based on a two-sample Wilcoxon rank-sum (Mann–Whitney) test

The last column presents tests of mean differences between dividend payers and nonpayers. Consistent with prior literature, the dividend payers in our sample tend to be more profitable, larger, and older and have higher cash holdings compared to nonpayers. They also tend to have a lower degree of long-term leverage. Firms of the service sector and firms with nonfamily shareholders appear to have a higher propensity to pay dividends. Dividend payers also appear more often to have passive family shareholders than nonpayers, which corresponds to Hypothesis 1 (on a univariate level). The mean differences between dividend payers and nonpayers for *FGP* and *Generation* are not statistically significant. This last result is not surprising as the generational proxy is a crude measure for agency effects that are already measured more directly by our passive family ownership variable.

Table 2 reports the correlations among the variables of interest in this study. The dependent variable, *DIV*, is significantly and positively correlated with *Passive*, *ROA*, *Assets*, *Cash*, *Firm Age*, *Nonfam Share* and is significantly and negatively correlated with the firm's *Fin. Leverage*. The highest absolute correlation between the explanatory variables is 0.54, which is well below the 0.80 threshold above which multicollinearity threats could arise (Gujarati 2003). Additionally, in all regressions, the highest VIF score is 1.99, again considerably less than the 10 threshold (Gujarati 2003). Consequently, multicollinearity is not likely to be a concern in this study.

4.2 The impact of passive family shareholders on the propensity to pay dividends

Table 3 displays the results of the regression models. The models represent a multivariate logit model where the probability of paying out a dividend is estimated using the functional form $f(z) = \frac{e^z}{1+e^z}$ where $z = \text{DIV}$.

Table 2 Pearson correlations

Variable	1	2	3	4	5	6	7	8	9	10
1. DIV	1.00									
2. Passive	0.12*	1.00								
3. FGP	0.04	0.03	1.00							
4. ROA	0.35***	−0.00	−0.01	1.00						
5. Assets[a]	0.18***	0.00	0.26**	−0.01	1.00					
6. Cash	0.30***	0.07	−0.02	0.35***	−0.06	1.00				
7. Leverage	−0.20***	0.09	−0.10	−0.18***	−0.54***	−0.16**	1.00			
8. Firm age	0.16**	0.11	0.13**	−0.07	0.25***	0.01	−0.15**	1.00		
9. Growth	0.07	0.02	0.05	0.05	0.14**	0.01	−0.08	−0.01	1.00	
10. Generation	−0.05	−0.02	−0.10	0.00	−0.10	−0.03	0.06	−0.28***	0.16**	1.00
11. Nonfam share	0.12*	−0.03	0.04	−0.05	−0.03	−0.01	0.06	0.23***	−0.02	−0.08

$N = 244$

FGP family governance practices

*, **, *** Correlation is significant at a probability level below 0.10, 0.05, or 0.01 level (two-tailed)

[a] Natural logarithm

Model 1 captures the impact of passive family shareholders on the propensity to pay dividends, while controlling for firm characteristics and sector. The Nagelkerke pseudo R^2 is 31 %, and the model χ^2 is significant at $p < 0.001$. Of the control variables, firm performance, cash, and nonfamily shareholders have significant positive coefficients, while long-term leverage has a significant negative coefficient.

The results show that the presence of passive family shareholders has a significantly positive effect on the probability of paying dividends, supporting Hypothesis 1.

4.3 The effect of family governance practices

The variable *FGP* enters in the second model in Table 3. The results indicate that the use of family governance practices has no significant direct effect on the propensity to pay dividends. This result is in line with the results reported in Tables 1 and 2 (no significant difference of FGP between payers and nonpayers and no significant correlation between DIV en FGP). Thus, the use of FGP does not directly influence the dividend decision. However, as argued in Hypothesis 2, the use of FGP assists in creating a shared vision among active and passive family shareholders (Mustakallio et al. 2002), thereby facilitating the development of a dividend policy which solves potential intra-familial conflicts of interest. FGP are thus expected to *indirectly* affect the relation between the presence of passive family shareholders and the firm's dividend policy.

In order to capture this potential moderating effect of FGP on the relation between passive family shareholders and the propensity to pay dividends, the third model introduces a moderating variable *Passive*FGP*. According to Baron and Kenny (1986), this situation, where the moderator variable is uncorrelated with the dependent variable, is beneficial for the interpretation of the interaction term. Model 3 presents the regression model, with a Nagelkerke pseudo R^2 of 33 % and a model χ^2, which is significant at $p < 0.001$.

The beta coefficient of *Passive* becomes nonsignificant in model 3. However, the direct effect of the moderator is not relevant to testing the moderator hypothesis (Baron and Kenny 1986), and we should therefore only consider the coefficient of the interaction term. The coefficient of the interaction variable, which consists of the dummies *Passive* and *FGP*, is significantly positive. This finding supports Hypothesis 2, which indicates that FGP do not directly affect the propensity to pay dividends, but that they rather are a mechanism that facilitates dividend payouts in alleviating the potential intra-familial principal–principal conflict of interest in private family firms.

These results thus support the outcome hypothesis in that private family firms with passive family

Table 3 Binary logit regression analysis of the propensity to pay dividends

	Model 1	Model 2	Model 3
Constant	−7.2904***	−.3927***	−6.8374***
	(2.2604)	(2.3323)	(2.4033)
Hypotheses			
Passive	0.8636**	0.8684**	0.34644
	(0.4399)	(0.4409)	(0.5041)
FGP		−0.1080	−1.6662
		(0.6027)	(1.1365)
Passive*FGP			3.0465**
			(1.4230)
CONTROLS			
ROA	0.1615***	0.1613***	0.1509***
	(0.0363)	(0.0363)	(0.0370)
Assets[a]	0.2584	0.2733	0.1848
	(0.2218)	(0.2369)	(0.2444)
Cash	2.3996*	0.24140*	2.9665**
	(1.2325)	(1.2371)	(1.3344)
Leverage	−30.1559**	−30.0613*	−28.7833*
	(15.0732)	(15.0857)	(15.2055)
Firm age[a]	0.4515	0.4502	0.5075
	(0.3330)	(0.3330)	(0.3513)
Growth	0.6099	0.5863	1.2976
	(1.1643)	(0.1728)	(1.1974)
Generation	−0.1641	−0.1713	−0.1342
	(0.5861)	(0.5874)	(0.6005)
Nonfam share	1.8202**	1.8338**	1.6899**
	(0.8101)	(0.8119)	(0.8530)
Construction	−0.2757	−0.2555	−0.3866
	(0.7150)	(0.7224)	(0.7632)
Wholesale	0.3262	0.3360	0.5023
	(0.5233)	(0.5261)	(0.5487)
Service[b]	1.0667*	1.0662*	1.1500*
	(0.6022)	(0.6028)	(0.6119)
Model LR χ^2	71.6	71.29	76.81
Nagelkerke pseudo R^2	0.3136	0.3138	0.3380

$N = 244$

Standard errors in parentheses

FGP family governance practices

*, **, *** Significance at a probability level below 0.10, 0.05, and 0.01, respectively (two-tailed)

[a] Natural logarithm

[b] Manufacturing industry is the suppressed sector comparison category

shareholders are more likely to pay out dividends to their shareholders when family governance practices (FGP = 1) are present than firms without any family governance mechanism.

4.4 Robustness tests

We also executed several robustness tests. First, in our analyses, we use a 1-year dividend as the dependent variable. However, one could argue that whether or not a firm pays out a dividend in one particular year may also be the result of some specific event that occurred during that year. Therefore, as a robustness test, we re-performed the analysis using a proxy that covers 3 years (dummy equals one when the firm has paid out a dividend in the period 2000–2003, and zero otherwise). The results again show a significantly positive interaction variable, confirming the robustness of our results (results not reported).

Second, an important explanatory factor for our results may be the existence of a potential passive ownership threshold. To test whether the interaction variable "*passive ownership* × *FGP*" becomes only positive when passive ownership reaches a certain threshold, we estimated several additional models in which we used different ownership thresholds (which measure total ownership by passive shareholders): 10, 25 and 50 %. The dummy variable *Passive10 %* equals one for firms who have at least 10 % passive ownership and zero otherwise (analogous for *Passive25 %* which equals one for firms who have at least 25 % passive ownership and *Passive50 %* which equals one for firms who have at least 50 % passive ownership). Table 4 reveals that all passive ownership threshold levels show similar effects to those reported in Table 3 (a positive significant interaction term "*passive ownership* × *FGP*"), regardless of the level of passive ownership.

Third, since the variable *Nonfam Share* is significantly positive in all models, we performed an additional robustness test in order to check their influence. We removed all firms with nonfamily shareholders from our sample (14 in total), so that our sample consists of family firms with only family shareholders. Table 5 reveals that the results remain unchanged, confirming the important impact of passive family shareholders and family governance on a firm's dividend policy, regardless of the presence of other nonfamily shareholders.

Table 4 Robustness test: using ownership thresholds instead of a dummy variable for passive shareholders

	10 %	25 %	50 %
Constant	−6.2300***	−6.4419***	−6.9615***
Hypotheses			
Passive10 %	−0.0544		
Passive25 %		0.2116	
Passive50 %			0.1384
FGP	−1.6335	−1.0560	−0.6025
Passive*FGP[c]	3.0651**	3.1254**	3.2590**
Controls			
ROA	0.1455***	0.1528***	0.1553***
Assets[a]	0.1314	0.1708	0.2174
Cash	2.9640**	2.7323**	2.5327**
Leverage	−26.9482*	−28.3160*	−29.3605*
Firmage[a]	0.5210	0.4870	0.5574
Growth	1.4718	1.3381	1.0892
Generation	−0.1891	−0.1408	−0.1121
Nonfam share	1.1656	1.5067*	1.5123*
Construction	−0.2748	−0.4552	−0.5671
Wholesale	0.3815	0.3233	0.2259
Service[b]	1.1592*	1.0384*	1.1193*
Model LR χ^2	73.72	76.01	74.17
Nagelkerke pseudo R^2	0.3244	0.3345	0.3264

Binary logit regression analysis of the propensity to pay dividends; $N = 244$

Standard errors in parentheses

The interaction variable is Passive10 %*FGP for the first model, Passive25 %*FGP for the second model, and Passive50 %*FGP for the third model

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*,**,*** Significance at a probability level below 0.10, 0.05, and 0.01, respectively (two-tailed)

[a] Natural logarithm

[b] Manufacturing industry is the suppressed sector comparison category

Table 5 Robustness check: firms with nonfamily shareholders excluded

	Model 1	Model 2	Model 3
Constant	−7.3518***	−7.3881***	−6.8345
Hypotheses			
Passive	0.7713*	0.7725*	0.3134
FGP		−0.0522	−1.1134
Passive*FGP			2.7335*
Controls			
ROA	0.1582***	0.1580***	0.1484***
Assets[a]	0.2703	0.2762	0.1923
Cash	1.9639	1.9672	2.5241*
Leverage	−31.38*	−31.3022*	−29.1422*
Firmage[a]	0.4516	0.4509	0.4934
Growth	0.7342	0.7265	1.3580
Generation	−0.1359	−0.1398	−0.1143
Construction	−0.1691	−0.1606	−0.2306
Wholesale	0.5460	0.5480	0.6624
Service[b]	1.2212	1.2194	1.2948*
Model LR χ^2	60.56	60.57	64.73
Nagelkerke pseudo R^2	0.2937	0.2938	0.3139

Binary logit regression analysis of the propensity to pay dividends; $N = 230$

Standard errors in parentheses

FGP family governance practices

*,**,*** Significance at a probability level below 0.10, 0.05, and 0.01, respectively (two-tailed)

[a] Natural logarithm

[b] Manufacturing industry is the suppressed sector comparison category

Finally, one could argue that the use of family governance practices might have the same effect as having independent nonexecutive directors on the board. In order to rule out this reasoning, we re-estimated all models, replacing the dummy variable *FGP* by a dummy *BoD*, which equals one when the firm has independent nonexecutive directors on its board, and zero otherwise. Here, the interaction variable (*Passive*BoD*) shows no significant effect, as opposed to the original interaction variable (*Passive*FGP*). This analysis indicates that formal contractual governance mechanisms do not have the same effect on a family firm's dividend policy than the use of family governance practices (results not reported).

4.5 Post hoc analyses

Building on the reasoning behind the second hypothesis, FGP may not only increase the propensity to pay dividends, but meanwhile also lead to an optimal dividend policy in the sense that dividends will be more aligned with the firm's growth opportunities. For example, when the family firm has very profitable investment opportunities, FGP are the ideal forum to

discuss these opportunities among family members and to convince passive family shareholders that the use of the available cash for these new investment opportunities will be more optimal than paying out dividends. However, when no new profitable growth opportunities are available, active shareholders have less reasons or arguments in favor of keeping excess funds in the firm and a dividend policy could be accordingly agreed upon. In sum, active as well as passive family shareholders might be more willing to reach a shared vision concerning the best use of available funds when they discuss these issues in FGP.

The regression models in Table 3 already contain a variable that controls for growth opportunities. While the coefficient of this variable is insignificant, Table 6 presents a test of mean differences in order to find out whether a firm's dividend policy is more related to its growth opportunities in the presence of FGP. Because perfectly capturing a firm's future growth opportunities in one single measure is impossible (DeAngelo et al. 2004), the analysis uses two proxies as a measure for growth opportunities: *average growth rate* of assets in the period 2000–2003 (results reported in Table 4) and *asset growth* during 2003 as a measure for growth opportunities (results not reported but similar to results reported in Table 6) (Carney and Gedajlovic 2002; DeAngelo et al. 2004; Fama and French 2001; Naceur et al. 2006).

Table 6 gives a preliminary indication that the reasoning behind Hypothesis 2 might be plausible: firms with FGP show a lower propensity to pay dividends when the growth opportunities are high and a higher propensity to pay when the growth opportunities are low (i.e., an optimal dividend policy). Firms without any FGP show an opposing trend (i.e., a suboptimal dividend policy). In sum, FGP thus can align family and business incentives in ways that reduce the intra-familial conflict of interest while encouraging efficiency in decision-making. Despite the small amount of observations in each group, and thus the limited statistical significance, these results indicate that the reasoning above is plausible. Also, according to a recent literature study of Siebels and Knyphausen-Aufseß (2012), theory on FGP lacks testable hypotheses and calls for research that exhausts the potential of empirical data in order to develop new propositions. Therefore, an explorative empirical research strategy as the one applied above is legitimate in this context and thus might raise some important issues that future research may explore in more depth on a larger sample.

Table 6 Additional analysis: link between dividends and growth opportunities for firms with passive family shareholders

	Growth opportunities[a] for…		Tests of mean differences
	Nonpayers	Payers	t value
Firms with **passive** family shareholders and **with FGP** ($n = 14$)	0.09	−0.06	−1.61*
Firms with **passive** family shareholders and **without FGP** ($n = 70$)	0.05	0.10	1.56*

Analyses repeated with asset growth in 2003 as a proxy for a firm's future growth opportunities gave the same results

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* Significance at a probability level below 0.10

[a] Growth opportunities are measured as the average growth rate of assets in the period 2000–2003

5 Discussion and conclusions

This paper focuses on why and in which cases privately held family firms pay out dividends. After all, according to traditional agency theory, dividends are supposed to be irrelevant in this type of firms because of the absence of a principal-agent conflict of interest, but yet these firms do pay out dividends regularly. This study therefore aims at filling two gaps in the finance and governance literature. On the one hand, past research in finance neglects privately held family firms in the dividend discussion. On the other hand, prior governance research largely ignores an important conflict in privately held family firms: the intra-familial principal–principal conflict of interest between active and passive family shareholders. In an attempt to fill these gaps in literature, we investigate whether FGP have a moderating impact on the ability of dividends to mitigate possible conflicts of interest between active and passive family shareholders.

The results of our empirical analyses on a sample of Belgian privately held family firms support the argument that the presence of passive family shareholders, implying a potential intra-shareholder conflict of interest, increases the propensity to pay dividends.

Additionally, the use of FGP strengthens this relationship. This finding suggests that FGP can be seen as a facilitating mechanism for dividend payouts to alleviate the potential intra-familial principal–principal conflicts of interest. Furthermore, additional exploratory analyses indicate that FGP might also lead to an optimal dividend policy that is in line with the firm's growth opportunities, in contrast to firms without FGP.

Dividends are not always an obvious solution to potential principal–principal conflicts of interest. In the absence of a disciplining stock market, whether the privately held family firm pays out dividends is likely to be the result of a voluntary action of active family shareholders who usually have decision power. Therefore, the findings indicate that FGP appear to be an important facilitating mechanism to avoid or mitigate conflicts among family shareholders by paying out dividends. Thus, passive family shareholders seem to be successful in demanding dividends in privately held family firms when FGP are present. According to La Porta et al. (2000), dividends can be considered as substitutes (substitute hypothesis) or outcomes (outcome hypothesis) of corporate governance mechanisms. Our results support the outcome hypothesis in the case of private family firms: Therefore, we can consider FGP to be a mechanism that facilitates dividend payouts as an instrument to alleviate potential intra-familial conflicts of interest between active and passive shareholders.

Prior family business research concluded that FGP play an essential role in maintaining strong cohesion, high mutual trust, and commitment among family members, which are key resources for the family firm, leading to a competitive advantage (Steier 2001; Sundaramurthy 2008) and superior firm performance (Uhlaner et al. 2007; Berent-Braun and Uhlaner 2012). Hence, FGP "not only enhance the effectiveness of the business-owning family, but also the business it owns" (Berent-Braun and Uhlaner 2012, p. 104). Our study adds another perspective from which FGP may benefit the business system. The usual dream of the founder to perpetuate the firm over family generations is often reflected in a longer time horizon, resulting in patient financial capital which is a very valuable asset for family firms (Sirmon and Hitt 2003). The occurrence of passive family shareholders may make the continuation of capital to remain patient a real challenge in family firms. Passive family shareholders may demand a dividend policy, even when there are several value-enhancing investment opportunities that cannot be financed with external financing sources. Indeed, private family firms usually have limited or no access to traditional capital markets (Sirmon and Hitt 2003), which makes internal financial resources very important for these firms (López-Gracia and Sánchez-Andújar 2007). Consequently, paying dividends when interesting investment opportunities need to be financed may not be an efficient decision.

The findings of our additional exploratory analysis suggest that FGP will increase the efficiency in decision-making concerning dividend payouts since firms with FGP pay out dividends only when it is appropriate to do so, that is, when the growth opportunities are low. This finding suggests that FGP indeed are a useful tool for openly discussing dividend and reinvestment preferences while simultaneously aligning the interests and creating a shared vision between active and passive family shareholders. Contrarily, when reinvestment in the business is needed, that is, when growth opportunities are high, FGP will be an excellent instrument to express the importance of these opportunities to the passive family shareholders. After all, FGP are found to have a positive effect on creating a shared vision on what is best for the future development of the firm (Mustakallio et al. 2002). This way, passive family shareholders will feel involved in the decision-making process, and they are more likely to understand the need to keep the money in the firm, compared to the case without FGP. These results suggest that family governance mechanisms are an essential tool in developing a dividend policy that is efficient in both aligning the interests of active and passive family shareholders, as well as efficient in terms of adapting to the firm's growth opportunities, thereby keeping financial capital patient.

Our results also contribute to the debate whether formal/contractual governance (e.g., the board of directors) and relational governance (e.g., family governance practices) are substitutes or complements (Poppo and Zenger 2002). Although we did not formally test for substitution effects, the fact that we find significant effects for FGP and not for a board of directors (see Sect. 4.4 Robustness tests) suggests that FGP and a board of directors may be substitutes that are in line with the findings of Gnan et al. (2013). Although contractual governance institutions such as a board of directors have a formal role in approving the family firm's policy, FGP are much more effective in

translating family member's opinions, visions, and values into collective plans and actions. FGP may therefore play a pivotal role in reaching family unity concerning important business topics such as dividend policy, which can be easily approved by the board afterward. From this perspective, FGP perform important roles usually executed by the board of directors (Eckrich and McClure 2012; Gnan et al. 2013).

Several practical implications can arise from our findings. As our results indicate that FGP are a facilitating mechanism for dividend payouts to alleviate the potential intra-familial principal–principal conflicts of interest, private family firms should be encouraged to establish FGP. Based on our sample, FGP are only installed by a minority of private family firms. However, it can help mitigate conflicts of interest between active and passive shareholders that potentially threaten the long-term continuity of the family firm. Moreover, as our results suggest that FGP may tailor dividend payout to the firm's growth opportunities, FGP can help to keep sufficient internal financing sources in the firm, taking into account the often limited availability of external finance. Therefore, family firms can seize the opportunity to grow.

This study has some limitations, which could provide opportunities for further research. First, using longitudinal data instead of cross-sectional data will allow researchers to investigate the moderating impact of FGP on dividend policy overtime, which might provide additional interesting insights. Second, the sample consists only of Belgian privately held family firms. Even though this might seem a limitation of the study, the sample gives us the advantage of having accurate, objective financial data on privately held firms (obtained from the Bel-First database of Bureau Van Dijk), which is uncommon in most countries. Third, data from a more detailed survey and a larger sample of family firms could build further on the findings of this study. Future research might then, for example, empirically investigate whether FGP indeed reduce family conflicts and thus reduce the threat of continuation. Finally, the results give an indication that FGP increase the efficiency in decision-making concerning dividend payouts. This result could inspire many future research directions, for example, investigating the impact of FGP on decision-making efficiency in other areas such as keeping the firm focused on an entrepreneurial and innovative strategy and avoiding resistance to change.

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