Reply

Response to discussion of “Ownership structure, contingent fit, and business-unit performance: A research model and empirical evidence”

Johnny Jermias\textsuperscript{a,*}, Lindawati Gani\textsuperscript{b}

\textsuperscript{a}Faculty of Business Administration, Simon Fraser University, Burnaby, British Columbia, Canada V5A 1S6
\textsuperscript{b}School of Accountancy, Faculty of Economics, University of Indonesia, Jakarta, Indonesia

1. Introduction

Our paper investigates the moderating effects of contingent fit on the relationship between ownership structure and business-unit performance. We argue that closely-held companies tend to have limited access to financial resources, professional executives, and use more family-oriented management style as compared to their widely-held counterparts. Consequently, widely-held companies will outperform their closely-held counterpart but contingent fit will mitigate the performance advantage. Zarzecki (2005) raises several legitimate concerns about the paper. His comments and suggestions can be summarized into six issues. First, the conceptual ground for the performance advantage of widely-held companies over closely-held companies. Second, the reliability of the results given that the study relies solely on responses to questionnaires sent to respondents. Third, the use of performance index which consists of more than one variable to represent business-unit performance. Fourth, the method used to classify our sample firms into product differentiation and cost leadership strategy. Fifth, the assumption that each contextual variable contributes independently toward the contingent fit construct. Finally, the results of our study that might be affected by factors other than those identified in our paper. The following are our responses to each issue raised by the discussant.

* Corresponding author. Tel.: +1 604 291 4257; fax: +1 604 291 4920.
E-mail addresses: jjermias@sfu.ca (J. Jermias), safjak@bit.net.id (L. Gani).
2. Performance advantage of widely-held companies over closely-held companies

Zarzecki (2005) argues that despite higher mortality rates in the population of small companies, many of them have substantially higher returns than larger ones. He concludes that closely held companies (usually small businesses) would outperform widely held firms (usually larger businesses). This argument is consistent with Jensen (1993) who proposes that managerial share ownership helps align the interest of shareholders and managers resulting in superior performance (also known as the convergence of interest hypothesis). It follows that since owners of privately-held companies are usually those who manage the business, the conflict of interest between shareholders and managers in privately-held companies tends to be lower than those in widely-held companies. Consequently, privately-held companies will perform better than their widely-held counterpart.

Recent empirical studies, however, found that increasing level of managerial ownership has negative effects on firm performance (Kole, 1995; McConnell & Sevaes, 1990; Morck, Shleifer, & Vishny, 1988; Short & Keasey, 1999). Short and Keasey (1999), for example, argue that the increasing level of managerial ownership can transfer additional risk to managers (i.e., owner–manager) beyond their non-diversifiable human capital which might lead to risk-avoiding behavior on the part of management that is not in the best interest of shareholders. In a similar vein, Zahra (1996) argues that managers’ unwillingness to engage in risky but strategically important projects might jeopardize a firm’s sustainable competitive advantage. Therefore, excessive risk carried by managers in closely-held companies tends to have a negative effect on the performance of the companies.

The empirical findings are consistent with the arguments mentioned in the paper that widely-held companies tend to perform better than their closely-held counterpart due to factors such as superior access to financial and human resources, better equipped to develop their marketing acumen and embrace changes in technology, and more willing to engage in risky but profitable projects due to limited risk beyond their non-diversifiable human capital.

Zarzecki (2005) also suggests comparing the performance of widely-held and closely-held companies in terms of return ratios. Following this suggestion, we perform a univariate comparison between widely-held and closely-held companies in terms of return on investment\(^1\) (the only return ratio that we have in our performance variables). Table 1 shows the results of this procedure.

Table 1 indicates that the mean ROI of 3.49 of widely-held companies is significantly higher than the mean ROI of 3.08 (\(t=2.512, p=0.006\)). This result is consistent with those using all nine performance indicators reported in the paper. That is, widely-held companies outperform their closely-held counterparts.

3. Reliability of results that are based solely on responses to questionnaires

We acknowledge the limitation of the study due to its exclusive reliance on self-report measures. As in any studies using questionnaires to gather data, possible bias due to

\(^1\) The return on investment in our study is measured based on managers’ assessment of the difference between actual and budgeted ROI multiplied by the relative important of ROI to the business unit.
subjective responses to questionnaires may occur. Despite this limitation, the method enables us to explore the richness of reality by obtaining information that is not publicly available. Furthermore, given that our study investigates the impact of contingent fit on business-unit performance, the information that we need is not publicly available. Public information regarding performance measures of companies is usually available only in aggregate forms and does not contain detail information about performance of each business unit in the companies. Govindarajan and Gupta (1985) argue that since many performance variables critical to the success of a product differentiation strategy such as new product development, personnel development, and market development, are not available publicly, the use of publicly available measures to evaluate performance of every business unit regardless of its strategic choice violates one of the fundamental axioms underlying contingency research that include strategy as a contextual variable. We also believe that the results of the reliability test and procedures performed prior to administering the questionnaires as discussed in the “research method” section in the paper give us sufficient confidence in the appropriateness of the method used in our study.

4. The use of performance index which consists of more than one variables to represent business-unit performance

Our study assesses business unit performance based on a multiplication of nine performance dimensions with their respective relative importance perceived by the business unit. Govindarajan and Gupta (1985) argue that the use of a multivariate approach with criterion weights is particularly appropriate in a context where, by definition, different strategic missions imply quite different sets of priorities. Therefore, we believe that the measure of business-unit performance in the form of a comparison between actual and budgeted performance, and multiply the result with the degree of importance perceived by the business unit is suitable for our study because managers’ a-priori expectations of business-unit performance are likely to consider the anticipated impact of the strategy adopted by the business unit.

5. The method to classify our sample firms into product-differentiation and cost-leadership strategy

We use a mean-split approach to classify our sample firms into their strategic orientation. As suggested by the reviewers of this journal, we also performed two alternative approaches for this purpose. First, we use a one-half standard deviation above
(below) the mean of the competitive strategy scores to represent product-differentiation (low-cost) strategy. Second, we use factor analyses by creating a dummy variable of strategic choice to group the strategic variable into product-differentiation and low-cost strategy. Given the results of the two alternative approaches are consistent with those of the mean-split approach, we believe that the results reported in the paper are robust to different approaches used to classify firms into their strategic orientation.

6. The assumption that each contextual variable contributes independently toward the contingent fit construct

We agree with Zarzecki’s (2005) concern that the assumption of independent contribution of each contextual variable toward the overall fit value is an idealization. In a system with \( N \) contextual variables, the fit contribution of one variable may often depend upon the other \( N-1 \) remaining variables. One method to deal with the dependency among variables is by multiplying their fit contributions. Kauffman (1993) argues, however, that, in general, we almost have no idea what might be the mutual influences of the contextual variables on the overall fit of the system, and if the mutual contributions are affected by a large number of variables, the interacting variables are mostly unknown. Since the inter-relationship among contextual variables and their effects on fit are not known yet, we leave this for future research.

7. The results of our study might be affected by factors other than those identified in the paper

We thank Professor Zarzecki for his many useful suggestions regarding factors that might be considered to extend our study such as using publicly available information to minimize subjectivity, using data from other industry and/or other countries, and using other key operational variables that distinguish closely-held from their widely-held counterparts. We will take advantage of these comments and suggestions in our future work and also hope that readers of the paper might utilize those advices when analyzing the paper. We do believe, however, that the method used and results reported in our paper can be applied to other settings.

References


