
Finance in Family Business

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This article is an exploratory investigation of the financial issues of family business, such as capital structure, behavior towards investments and risk, and dividend policy. We also analyze the relation between these dimensions and performance. The most important findings of this research are that family businesses have low debt/equity levels, especially those family businesses that have an important market-share positions in their industry. The family businesses that have leading market-share positions have lesser financial performance than the family businesses who are followers in market share.

Introduction

One stream of research in the family-business field aims to identify differences between the family business and the non-family business, regarding aspects such as size, behavior, and performance (Daily and Dollinger, 1992; Gallo and Estapé, 1992, 1994; Gallo and García Pont, 1988; Lyman, 1991; Ward, 1983). This comparative research points out that due to differences between family business and non-family business, the valuation and solutions of business problems should be different as well.

Another stream of research builds on the implicit assumption that family businesses have particular aspects; therefore, the authors conclude that they must be analyzed as one group. The purpose is to achieve a better understanding of their strategy, behavior, and performance (Aronoff and Ward, 1991; Davis and Tagiuri, 1982; Guzzo and Abbott, 1990). There is no concluding evidence on financial issues that such differences between family business and non-family business exist. However, Churchill's work on small and medium enterprises (Churchill and Lewis, 1985, 1986) shows particular behavior of these types of firms towards financial institutions and vice versa. Although many family businesses fall in this category, the sample analyzed in this research includes family firms with annual sales between \$25 and \$350 million. This broad range of sales observed in the firm sample makes it difficult to apply the findings concerning small and medium enterprises.

This article is an exploratory research; its purpose is to make a contribution regarding the characteristics of financial issues in family business. The dimensions studied are capital structure, behavior towards investments and risk, and dividend policy. The paper also analyzes the relation between these

dimensions and performance.

The survey was conducted by The Family Business Chair at IESE during 1992. This sample was selected from IESE's database, which contains approximately 5,000 companies. Firms selected were those that fulfilled the following conditions:

- (a) More than 50% of the stock was owned by a family.
- (b) At least one family member was involved in the top management team.
- (c) The annual sales were greater than 40,000,000 pesetas.

A questionnaire regarding financial issues was sent to the chief financial officer (CFO) of approximately 1,000 family businesses located in Spain. The questionnaires were sent by mail and 104 replies were received.

The main findings of this research considered statistically significant are:

- In general, family businesses exhibit low debt/equity levels, especially those family businesses that have a leading market-share position.
- There is a statistically significant relation between the size of the firm and the diversity of its financial practices. Larger family businesses tend on the one hand to be related to more financial institutions; on the other hand, they tend to use a great variety of financial products for their financing.
- The family businesses that have a leading market-share positions have lower financial performance (measured in ROS and ROE) than those family businesses that have follower positions.
- A regression analysis verifies that the debt/equity ratio is a highly relevant factor when performance variations are analyzed.

Data

Table 1 shows the data of the family businesses in the sample regarding company age, size, capital structure, and performance. The oldest firm was founded in 1792; 43% of the sample was at least in the third generation (see Table 2).

Table 1. General Data

<i>Indicator</i>	<i>Total</i>	<i>Mean</i>	<i>Median</i>	<i>Min.</i>	<i>Max.</i>
Number of family businesses	104				
Generation involved		2.3	2	1	6
Company age (in years)		48	41	1	200
Annual sales (in million pesetas)	472,630	4,923	1,338	40	53,000
Number of employees	31,742	324	96	4	4,950
Total net assets (in million pesetas)	240,091	3,429	916	21	42,000
Debt/equity ratio		0.947	0.405	0	23
Return on sales (in %)*		8.81	6.23	-8.43	45.32
Return on equity (in %)*		27.50	18.00	-16.20	286.90

* Note: All ROS and ROE figures are before interest and taxes

Table 2. Generation Distribution

<i>Generation</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>Total</i>
Number of family businesses	22	37	34	5	5	1	104
Percentage	21.5%	35.4%	32.3%	4.9%	4.9%	1%	100%

As a whole, the firms invoice nearly 500 billion pesetas (approximately \$3.05 billion U.S.), reflecting an average of approximately five billion pesetas per family business (see Table 3).

Table 3. Sales Distribution

<i>Annual sales (billions of pestas)</i>	<i>0-1</i>	<i>1-2</i>	<i>2-3</i>	<i>3-4</i>	<i>4-5</i>	<i>5-10</i>	<i>10-20</i>	<i>20-30</i>	<i>> 30</i>
Number of family businesses	40	20	8	7	5	13	6	1	4
Percentage	38.5%	18.8%	7.3%	6.3%	5.2%	12.6%	6.2%	1%	4%

The total number of employees hired by the family businesses in the sample is 31,742 persons; 51% of the sample firms have at least 100 employees (see Table 4).

Table 4. Employee Distribution

<i>Number of employees</i>	<i>0-50</i>	<i>51-100</i>	<i>101-150</i>	<i>151-200</i>	<i>201-250</i>	<i>251-500</i>	<i>501-1000</i>	<i>>1000</i>
Number of family businesses	34	19	19	4	2	10	7	9
Percentage	32.6%	18.3%	18.3%	4%	2%	9.1%	7.1%	8.6%

Of the firms sampled, 58% occupy one of the ten positions in their respective industry, according to market-share criteria. The characteristics regarding the market-share positions of the family businesses in the sample appears in Table 5. The debt/equity ratio was calculated by dividing the coupon-bearing debt by the equity from the 1991 balance sheet. Hence salaries, taxes, or accounts payable are not included in the liability figures. No question regarding the term of the debt was asked. The results show (Table 6) that 27.4% of family businesses finance themselves with equity only. In addition, it can be seen that 85% of the firm sample has a debt/equity level lower than one and 65% lower than 0.5. The mean of the debt/equity ratio for the sample is 0.947. However, if the two outliers are taken away from the analysis (family firms in the service industry with debt/equity levels of 23 and 15), the debt/equity mean decreases significantly to 0.56. The debt to equity mean reported by the Bank of Spain during the same period for 4,702 firms is 1.53.

The performance of the family businesses, which was measured by the ROS and ROE ratios (Tables 7 and 8), shows very few cases of family businesses with losses. The ROS sample mean is 8.81% and the maximum re-

Table 5. Family Business Market Share Position

<i>Industry/Position</i>	<i>1-10</i>	<i>10-50</i>	<i>50-100</i>	<i>> 100</i>	<i>Total</i>
Agriculture, forestry and fishing	1	1			2
Power generation	3				3
Mining	8	1			9
Chemical and allied products	4	2		2	8
Fabricated metal industries	5			1	6
Food products	7	4			11
Manufactured products (not food)	15	8		1	24
Construction			1	1	2
Wholesale and retail distribution	5	6	2		13
Transportation and communication	1	2	1		4
Hotels and other services	6	3		3	12
Number of family businesses	55	27	4	8	94
percentage	58%	29%	4%	9%	100%

Table 6. Debt/Equity Level

<i>Debt/Equity Ratio</i>	<i>Equal to 0</i>	<i>0.01-0.05</i>	<i>0.51-1.00</i>	<i>1.01-1.50</i>	<i>1.51-2.00</i>	<i>>2</i>
Number of family businesses	28	39	20	5	5	7
Percentage	27.4%	37.6%	19.7%	4.4%	4.4%	6.5%

ported ROS reaches 45%. The ROE sample mean is 27.5%, with one firm recording an ROE of 280%.

It is important to highlight the performance levels reported by the Bank of Spain for the same period. The ROS mean is 3.3% and the ROE mean is 6.16%. The Bank of Spain reports do not differentiate family businesses from non-family businesses. These performance differences are in line with the findings reported by Daily and Dollinger (1992); Galve and Salas (1994); Monsen, Chiu, and Cooley (1968); and Radice (1971). But since family businesses of the sample do not trade in the stock exchange market, and because many of them are not audited regularly, it is possible that some assets are hidden for succession tax purposes. Therefore, the family firms of the sample appear with higher earnings than the firms included in the report of the Bank of Spain.

In Spanish tax law, various taxes apply to the family businesses. The income tax is approximately 35%. If dividends are distributed, the shareholder also has to pay a tax, but the tax rate varies according to the amount of dividends. This represents a double taxation of distribution earnings: a tax at the corporate level and a tax at the personal level. Furthermore there is roughly a 33% tax rate related with succession. If shares are transmitted to other person by any means, the buyer or inheritor has to pay a tax of 33% of the accounting or market value of the shares.

Table 7. Return on Sales Distribution

<i>Return on Equity</i>	<i>Negative</i>	<i>0%-4%</i>	<i>4%-8%</i>	<i>8%-12%</i>	<i>12%-16%</i>	<i>>16%</i>
Number of family businesses	2	23	39	18	6	16
Percentage	2.4%	22.2%	37%	17.2%	6.2%	15%

Table 8. Return on Equity Distribution

<i>Return on Equity</i>	<i>Negative</i>	<i>0%-10%</i>	<i>10%-20%</i>	<i>20%-30%</i>	<i>30%-40%</i>	<i>>40%</i>
Number of family businesses	4	22	41	14	10	13
Percentage	4%	21.6%	39.2%	13.6%	9.4%	12.2%

Analysis and Results

We use correlation analysis to identify the existing relations among size, age, market-share position, capital structure, financial policy, and performance variables. To analyze the statistical significance of these relationships, we perform a linear regression between each pair of variables, using “p” parameters associated to the “F” parameters (see Table 9). Although there are more powerful tests to make this assessment, such as Bonferroni or Scheffé tests (Johnson and Wichern, 1982), we chose a correlation and regression analysis for two reasons. First, given the precision level needed, a regression analysis is more suitable. Second, a regression analysis provides clarity and avoids needlessly technical analysis.

This section of the paper is divided into three parts. First, to identify those factors that have a strong relation to the debt level, we analyze the debt level of the family businesses in the sample and its relation to the other variables. Second, we analyze the financial policies of the family businesses. On the one hand, the paper analyzes the commercial links between family businesses and financial institutions. Attention is centered on the number of financial institutions to which family businesses are related, and the variety of financial products purchased from them. On the other hand, to identify the criteria followed by the family businesses to determine their dividend policy, we examine the dividend policies of the sample’s family businesses through its relation with other variables. Finally, the analysis studies the relation of the performance variables (ROS and ROE) to other variables. The goal is to identify which variables have greater impact on family business performance.

Debt Level

The low debt level observed in the sample’s family firms challenges family-business owners’ typical claim that lack of additional funding constrains their growth objectives. Comparing the debt levels of our sample’s family businesses with those from the Bank of Spain sample, it appears that family businesses

avoid obtaining additional funds from financial institutions. The personal and social bankruptcy costs that family-business owners face by applying for external financing can limit their aggressiveness regarding capital structure policies. The identification between the family and the business (Sonnenfeld and Spence, 1989) leads family-business owners to perceive that a business bankruptcy is the same as a personal one. Among other factors (such as the family reputation), the personal guarantees and the possibility of losing everything represent high personal and social costs that family-business owners do not want to bear.

However, financial institutions' decision-making also represents a factor in this low debt/equity level. The bank's credit underwriting policies concentrate on ownership wealth instead of analyzing the repayment capability of the family business. The debt level should be related to the equity or with the future cash flows that the business projects it will generate. The firm's ability to obtain credit should depend on how profitable the business is. In addition, Churchill and Lewis's (1986) work on bank lending indicates that "Banks' relations with small companies of any size are, in general, more profitable than those with large companies ... Deposits kept by small businesses are the key to this greater profitability."

In this research it is clear that those banks that have relations with family businesses do not follow that criterion. It appears that almost all of the firms have very good profit margins, but have debt/equity ratios considered below reasonable levels.

The previous arguments suggest that on financial issues, family businesses need to distinguish the family from the business. In addition, it indicates that banks should give greater importance to the future cash flows of the business instead of to the personal wealth of the family owner. In these instances, more successful commercial relationships could be built between financial institutions and family businesses and both parts could be winners.

Regarding capital structure, in addition to the low debt/equity level mentioned earlier, family businesses' future objectives should be highlighted. The tendency of most of the firms is to maintain or even diminish their debt/equity levels.

- Medium term objectives of family businesses that have no debt (27.4% of the sample):
 - No debt acquisition 90.91%
 - Debt acquisition 9.09%
- Medium term objectives of family businesses that have debt (72.6% of the sample):
 - Diminish the debt level 58.18%
 - Maintain the debt level 25.45%
 - Increase the debt level 16.36%

Table 9. Correlation Matrix Between Variables

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Debt/equity level	1.00															
2. Industry	-0.094	1.00-														
3. Market share	-0.168	-0.242 ^a	1.000													
4. Generation	0.093	-0.232 ^a	0.124	1.000												
5. Company-age	0.142	-0.203 ^a	0.009	0.832 ^c	1.000											
6. Return on sales	-0.117	0.187 ^a	-0.373 ^c	-0.088	-0.149	1.000										
7. Return on equity	0.631 ^c	0.125	-0.178	-0.005	-0.025	0.265 ^a	1.000									
8. L _n (sales)	-0.081	-0.085	0.337 ^b	0.221 ^a	0.203 ^a	-0.254 ^b	-0.189 ^a	1.000								
9. L _n (assets)	-0.028	-0.179	0.228 ^a	0.325 ^c	0.318 ^b	-0.102	-0.282 ^a	0.877 ^c	1.000							
10. L _n (employees)	-0.064	-0.149	0.372 ^a	0.359 ^c	0.354 ^c	-0.335 ^b	-0.144	0.852 ^c	0.754 ^c	1.000						
11. NFI	0.134	0.081	0.119	0.133	0.103	-0.148	-0.060	0.358 ^c	0.381 ^b	0.365 ^b	1.000					
12. VFP	0.083	0.062	0.229 ^a	0.128	0.064	-0.120	-0.005	0.392 ^c	0.417	0.266 ^c	0.248 ^a	1.000				
13. Dividends	-0.089	-0.089	-0.002	0.199	0.021	0.158	-0.023	0.084	0.166	0.010	-0.079	0.136	1.000			
14. Asset turnover	0.012	0.100	0.051	-0.154	-0.070	-0.238 ^a	0.099	0.192	-0.197	0.066	-0.094	0.149	-0.188	1.000		
15. Sales/employees	-0.052	0.118	-0.190 ^a	-0.193	-0.206 ^a	0.208 ^a	0.052	0.120	0.051	-0.329 ^b	-0.101	0.203 ^a	0.182	0.137	1.000	
16. Investment risk	0.059	0.040	-0.152	-0.004	0.077	-0.048	-0.137	0.159	0.276	0.137	0.203 ^a	-0.061 ^a	0.108	-0.075	-0.101	1.000

^a = $p < 0.10$, ^b = $p < 0.01$, ^c = $p < 0.001$

Notes:

Debt/equity level:	Debt/equity ratio	NFI:	Number of financial institutions the FB is related to
Market share:	Industry position according to market share	VFP:	Number of different financial products purchased by the FB
L _n (sales):	Natural logarithm of sales	Asset turnover:	Sales/net assets
L _n (assets):	Natural logarithm of net assets	Investment risk:	Average risk of investments perceived by the FB
L _n (employees):	Natural logarithm of employees		

In Table 9 one can see that the only statistically significant relationship involves the ROE variable. This is logical since the debt/equity mean of the family businesses of the sample is low—as long as this ratio is increased (assuming that the interest rate is smaller than the ROA rate), the ROE will be larger.

In this firm sample, the variables such as industry, generation, and company age do not have any statistically significant relation to the debt/equity ratio variable. This means that the low level of family-business debt will be observed in any case, regardless of the factors that usually influence the capital structure. This contrasts with the generally accepted view that, for example, a higher debt/equity level is observed in firms in the construction and service industries.

This low debt/equity level is stronger when market-share positions are analyzed, as in Table 10. This table shows the debt/equity mean relevant to the family businesses' market-share positions. The leading firms appear to have a significant lower debt level than the followers. The latter have nearly four times the debt/equity level of the leaders and nearly double the debt/equity mean of the total sample.

Table 10. Debt/Equity Mean According to the Market Share Position

<i>Position</i>	<i>General</i>	<i>1-10</i>	<i>10-50</i>	<i>50-100</i>	<i>>100</i>
Mean	0.947	0.53	2.13	1.37	1.70

This finding supports the proposition that the bank, when making a lending decision, analyzes the personal wealth of the owner rather than the repayment capability of the family firm. If this were not the case, firms would have relatively similar debt-level ratios.

Another explanation for this could be that those family businesses that have reached an important market-share position do not need to grow in the short term. Consequently, they follow the “natural” tendency of having a low debt level, as verified in this research. At the same time, the “follower” family businesses acquire debt to attempt to take advantage of growth opportunities.

As Table 9 indicates, there is no statistically significant correlation between generation and the debt/equity variables. However, when the analysis is done only with second, third, and fourth generation family businesses, we see that not only does the correlation increase (the coefficient is 0.288), but it also becomes statistically significant ($p < 0.05$). That is to say, first-generation family businesses do not follow any clear debt/equity policy, but once these businesses survive the first generation they tend to increase the debt/equity level.

Financial Policies

To identify possible financial policies of family businesses, we included several questions regarding these issues in the questionnaire. The study asked for the number of financial institutions with which the family businesses work, and for the different type of financial products purchased.

The first financial policy issue analyzed is the "Number of Financial Institutions." Table 9 shows that the number of financial institutions correlates strongly with the size variables of the firm (sales, assets, employees). That is, as the family business grows in size, it will work with more banks. This is reasonable, since a firm that grows has to invest in assets, which usually translates into additional financial needs. In addition, most of the financial institutions tend to operate with firms that reach a significant size. Therefore, the firms finally have relations with a larger number of financial institutions.

An increase in sales implies an increase in accounts receivable and inventories. At the same time, an increase in the number of employees could be due to an increment in the fixed assets (plant and machinery). In short, every growth in investments needs financing. To obtain the additional funds, relations with more financial institutions must be developed, unless the growth need is slow, in which case the business is financed by the firm's net cash flow.

Another explanation for this situation could be that family firms, like other businesses, shop around for the best rates and services. So, the larger the firm, the more it will shop. But this increased shopping power does not necessarily mean that the firm will deal with a more banks. Bargaining power reduces rates and enhances service levels, but should not be directly related with the number of financial institutions.

The relation between the number of financial institutions and the average risk of investments (risk as it is perceived by the family businesses in the sample), has a limited statistical significance ($p < 0.10$). This relation can be explained: As long as a family business runs larger risks due to an aggressive investment policy, banks need to hedge the risk that the firm represents for them. Family businesses take this into account by means of relating with various financial institutions.

The second financial policy analyzed is the "Variety of Financial Products." This is the number of different financial products that family businesses purchase from financial institutions. As in the number of financial institutions, there is a correlation between the variety of financial products and the size variables of the firm (sales, assets, employees) that is statistically significant and positive. This means that as long as the family business gets larger, it uses a greater variety of financial products. Following a similar reasoning to the one used before for the number of financial institutions, increased size correlates with a greater need (and possibility of obtaining) long-term loans for the financing of the fixed assets. At the same time it is necessary to obtain larger credit lines to finance an increase in production, credits for exportation, factoring, and so on.

Regarding the correlation between the average risk perceived for the investments and the variety of financial products observed in Table 9, the strong relation is not easily explained. A greater variety of financial products does not reduce the risk that the investments represent. Nevertheless, the negative sign appears to be logical. When the family-business risk level surpasses a reasonable limit, the financial institutions will tend to hedge; banks will start reducing their relations with the firm by not renewing certain product contracts.

Another statistically significant relation is the one between the sales/employee and the variety of financial products variables. This positive correlation may stem from the fact that an increase in the “numerator” (sales) is obtained by giving delayed payments to customers, which leads to a greater number of financial operations. It also could be because the decrease of the “denominator” (number of employees in the firm) is reached with larger investments in plant and machinery, or focusing the firm towards the service industry. Both points make necessary a greater variety in the kind of operations.

Dividend Policy

A very important point concerning dividend policy can be deduced from Table 9. Here, the variables that typically influence the dividend policy of a firm do not have any strong influence in the policy-making for the family businesses in the sample.

The seminal work of Miller and Modigliani (1961) on dividend policy states that shareholder wealth will be unaffected by management's decision concerning dividend policy. The return to the shareholder will be the same regardless of whether management distributes earnings in the form of dividends or retains them in capital. Further contributions of theories on optimal dividend policy include signaling (Ross, 1978), agency costs (Rozeff, 1982), and taxation (Masulis and Trueman, 1988). Although none of these theories are completely satisfactory, together they seem to shed some light on why and how corporations pay dividends. Still, the underlying assumption on these types of earnings payoffs (dividends or capital) is that in the case of capital earnings, shares are traded in a fluid stock market. Clearly, for family businesses, this assumption is not always valid, and therefore the shareholder will perceive important differences if the earnings generated by the firm is distributed in dividends or retained in capital.

To be sure, current and future objectives should be taken into account when deciding the amount of dividends (e.g., cash flows, EPS, growth objectives, future opportunities). Something that especially stands out in this research is that there is no strong correlation between dividends and the return on sales and/or on equity variables, since the dividends usually are referred to as a percentage of the ROS or ROE. As long as the ROS or ROE increases, there will be more support for larger dividends. Still, these are not indicators followed by the family businesses of the sample.

The double tax imposition could be cited as the main reason for the lack of dividends payout, but the lack of a clear criteria for the dividend policy is contrary to “market laws.” This means that as employees receive a salary for their work, the owners should receive dividends. Confusing the generation and distribution of cash flows leads to the fact that the family business will easily fall into one of the critical “traps” (Gallo, 1991). This can lead owner-family members who do not work in the family firm to consider selling their stock or confronting the management. In short, such actions contribute to a lack of harmony and significant disunity between family and firm. In addition, the lack of clear criteria on dividend policy can cause problems when the family business requires additional financing, either through an increase of equity, an increase of external participation, an initial public offering, or simple negotiation of a long-term loan.

Performance

In Table 9, the correlation among the sales, assets, and employees variables and the market-share position variable is statistically significant. It is known that as long as a firm reaches a larger market share, it will usually also have a size increase.

Nevertheless, Table 9 shows that there is a strong, negative correlation between the ROS variable and the market-share position variable. The statistical significance shown by the “p” parameter ($p < 0.001$) reflects the negative trend that when the family business reaches the leading market-share position, the ROS decreases. In addition, the correlation between the ROE variable and the market-share position variable, although not statistically significant, follows the same negative tendency. Thus, it can be affirmed that when the family businesses in the sample reach a larger market share, their performance decreases. Although factors such as the industry to which family businesses of the sample belong, or the nature of the questions asked, do not show if the generic strategy pursued by the firms is a overall cost leadership or differentiation strategy (Porter, 1980), it is reasonable to conclude that a larger market share could be reached through a margin decrease, which would lead to lower earnings. Scale economies due to the large size, however, can have an effect on the margin by means of reducing the costs and therefore increasing the earnings.

ROS and ROE ratios can be viewed as accounting identities. However, the ROS ratio can suffer important interindustry variations. Consequently, important lessons might be drawn from the analysis of both. Looking at the relation of ROS to market-share position, the variation in the debt/equity level mean according to the market-share position, and the statistically significant relation between the debt/equity and ROE variables, we can conclude that the family businesses in this sample have different capital structure policies according to their market-share position, and these policies have a negative im-

pact in their performance.

Yet market-share position is related to size. It is commonly accepted that due to scale economies, size can be the basis for a lower/better cost structure, and therefore large firms reach a higher profitability (Buzzell, Gale, and Sultan, 1975). Also, if the firm has become larger through related diversification, scope economies can be achieved that are also translated into a higher profitability (Rumelt, 1974, 1982). Nevertheless, contrary to this literature, in our family-business sample a larger firm does not mean higher profits. This may be due to the lower prices mentioned before, or to the fact that managing a family business of a larger size needs appropriate management systems. In particular, management control systems and structure redesign in which the autonomy of decision making is given to a greater number of persons. As has already been proved, family businesses have difficulties in developing both points (Davis and Tagiuri, 1982; Davis, 1989).

Debt Level and Performance

To clarify the impact that debt level has on the performance of the family businesses in our sample, we analyze a simple linear regression between these two variables (see Table 11).

According to the data in Table 11, both variables are highly dependent ($p \leq 0.0001$) and they are strongly related ($t = 6.71$). In addition, the R^2 is close to 40%, that is, that the debt level explains 40% of the ROE variations.

The regression in itself does not examine the direction of dependence or a causal relation between variables. Consequently, it does not imply that a greater debt/equity level leads to a higher ROE or, on the contrary, that the family business with a high ROE has the opportunity to have a higher debt/equity level because banks would offer more financial alternatives.

The Modigliani and Miller theory (1958) indicates that up to a certain

Table 11. Linear Regression

Dependent variable is: ROE

104 total cases of which 32 are missing

R squared = 39.9% R squared (adjusted) = 39%

s = 35.27 with 70 - 2 = 68 degrees of freedom

<i>Source</i>	<i>Sum of Squares</i>	<i>df</i>	<i>Mean Square</i>	<i>F-ratio</i>
Regression	56053.7	1	56053.7	45.1
Residual	84597.5	68	1244.08	
<i>Variable</i>	<i>Coefficient</i>	<i>S.e. of Coeff.</i>	<i>T-ratio</i>	<i>Prob</i>
Constant	17.6346	4.490	3.93	0.0002
Debt/equity	9.64484	1.437	6.71	≤ 0.0001

debt level (assuming that the interest rate is smaller than the ROA), a higher debt level will lead to a higher ROE. Taking this into account, the regression analysis adds empirical evidence to this theory and shows the direction of relation. In addition, it is important to consider the coefficient value (9.64484) of the dependent variable (debt/equity). This means that when the debt/equity ratio is increased in one unit, the ROE will increase 9%. For example, if a family business (with similar characteristics to the family businesses in the sample) that has no debt and has an ROE of 18% increases its debt/equity ratio to one (debt and equity equal), usually considered acceptable, it will increase its ROE up to 27% (50% of its ROE rate).

Implications

Important conclusions can be drawn from this research. The low debt/equity level observed in this family-firm sample is explained by the strong identification by the business owners between the family and the business systems. By not distinguishing the family and the business in the case of financial issues, higher personal and social bankruptcy costs emerge when family businesses consider additional funding from financial institutions.

Banks, however, do not help family business to pursue this distinction between family and business systems. Instead of studying the repayment capability of the family business, the credit-underwriting policies of the financial institutions still overlook ownership wealth. Almost all the firms in the sample have very good profit margins, but have debt/equity ratios that are considered as below reasonable levels.

If family businesses try to isolate family from business when confronting finance issues, and if banks give greater importance to the future cash flows of the business rather than to personal wealth of the family owner, then more successful commercial relationships could be built between financial institutions and family businesses—and both parties would be winners (Churchill and Lewis, 1986).

The reasons for the lower performance ratios observed in the leading market share family firms are twofold. On one side, it has been observed that the lack of additional funding leads to a lower ROE. On the other side, achieving higher market shares by means of lower margins leads to a lower ROS. A suitable capital structure in addition to an appropriate development of management control systems would enhance the performance ratios when larger market shares are pursued.

Assuming that the strategy “engines” of a firm are growth and change (Poza, 1995), and knowing that the lack of additional funds in family businesses is typically given as the main explanation for a lack of aggressive growth and change, this research verifies that the debt level of the family businesses may be increased significantly until levels that are usually considered to be reasonable are reached. Thus it is appropriate to encourage family businesses

with very low debt/equity levels to develop debt-financed growth and change strategies. This conclusion is warranted because the debt/equity ratio is a relevant factor when performance variations are analyzed. And, regarding the family businesses' dividend policy, clear and stable criteria should be developed. In the medium and long terms, the development of growth and change strategies could be financed with equity increments, institutional external participation, or through public offers if stable dividend policy criteria exists.

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