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Capital structure decision making: A model for family business

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Abstract

Most theoretical and empirical studies of capital structure focus on public corporations. Only a limited number of studies on capital structure have been conducted on small-to-medium size enterprises (SMEs), and this deficiency is particularly evident in investigations into factors that influence funding decisions of family business owners.

Theory indicates that there is a complex array of factors that influence SME owner-managers' financing decisions. Recent family business literature suggests that these processes are influenced by firm owners' attitudes toward the utility of debt as a form of funding as moderated by external environmental conditions (e.g., financial and market considerations).

A number of other factors have been shown to influence financing decisions including culture; entrepreneurial characteristics; entrepreneurs' prior experiences in capital structure; business goals; business life-cycle issues; preferred ownership structures;

views regarding control, debtâ€“equity ratios, and short- vs. long-term debt; age and size of the firm; sources of funding for growth; attitudes toward debt financing; issues relating to independence and control; and perceived risk and attitudes toward personal risk.

Although these factors have been identified, until now there does not appear to have been any attempts to develop empirically-based models that show relationships between these factors and family business owners' financing decisions. Utilizing theories derived from divergent disciplines, this study develops an empirically tested structural equation model of financing antecedents of family businesses. Participants of our study involved a random sample of 5000 business owners who were mailed a 250-item Australian Family and Private Business questionnaire developed specifically for this investigation.

Notably, our findings reveal that firm size, family control, business planning, and business objectives are significantly associated with debt. Small family businesses and owners who do not have formal planning processes in place tend to rely on family loans as a source of finance. However, family businesses in the service industry (e.g., retailers and wholesalers) are less likely to use family loans as are those owners who are planning to achieve growth through new products or process development. Use of capital and retained profits is likely for family businesses planning to achieve growth through an increase in sales but less is likely for family businesses in the manufacturing sector and lifestyle firms. In addition, debt and family loans are negatively related to capital and retained profits. Equity is a consideration for owners of large businesses, young firms, and owners who plan to achieve growth through increasing profit margins. However, equity is less likely to be a consideration for older family business owners and owners who have a preference for retaining family control.

Our findings suggest that the interplay between multiple social, family, and financial factors is complex. In addition, our findings indicate the importance of utilizing theories that also help to explain behavioral factors (e.g., owners' needs to be in control) that affect financial structure decision-making processes. Practitioners and researchers should consider the dynamic interplay among business characteristics (e.g., size or industry), behavioral aspects of business financing (e.g., business objectives), and financial factors (e.g., gearing levels) when working with and researching family enterprises.

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