Financial Characteristics of Family Businesses and Financial Aspects of Succession

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Abstract: Family businesses are special in many respects. By examining their financial characteristics one can come to unique conclusions/results. This paper explores the general characteristics of the financial behavior of family businesses, presents the main findings of the INSIST project's company case studies concerning financing issues and strategies, and intends to identify the financial characteristics of company succession. The whole existence of family businesses is characterized by a duality of the family and business dimensions and this remains the case in their financial affairs. The financial decisions in family businesses (especially SMEs) are affected by aspects involving a duality of goals rather than exclusively profitability, the simultaneous presence of family and business financial needs, and the preferential handling of family needs at the expense of business needs (although it has to be said that there is evidence of family investments being postponed for the sake of business, too.

Keywords: Family Business, Family Business Finances, Succession, Bootstrapping, Trust.

I. INTRODUCTION

Family businesses, beyond their actual effectiveness, are guided by individual goals like securing living standards, ensuring workplaces for family members, stability of operation, preservation of the company's good reputation, and keeping the company's size at a level that the immediate family can control and manage. The INSIST project's company case studies revealed some interesting traits of family business finances like the importance of financial support from the founder's family during the establishment of the company, the use of bootstrapping techniques, the financial characteristics of succession, and the role of family members in financial management. Combined research methods were applied in the IN¬SIST research project. Project team members carried out desk-top analysis based on the existing (national) literature and conducted empirical research in order to provide a detailed picture of the importance of family business in the particular economies, focusing on such issues as the economic weight of family businesses, the socio-cultural and financial-legal environment of family firms, the succession process, and some psychological aspects of managing family enterprises. In order to gain a deeper insight into the succession process and to understand the company- and family-level micro-mechanisms shaping ownership and management transfer practices, each participating country had to carry out two company case studies with the succession in focus. The company case studies were based on semi-structured, problem-oriented in-depth-interviews with different stakeholders (owners/employers and also employees) of family businesses, dealing with issues like rules of entry and exit, commitment of the next generation, management practices, etc. The Hungarian team compiled three, the Polish team five and the British team two case studies (Makó et al., 2015). As reported by the European Family Business Barometer (2014), financing their operations and growth is not an issue for family businesses. 80% of them confirm that they do not have difficulties with funding. Keasy et al. (2015) also point out that the majority of business owners prefer to raise finance via debt rather than dilute their position via equity. They highlight that young family firms are typically characterized by the presence of the founder, who may be reluctant to dilute family control given their long-term perspective.

TABLE I: Bootstrapping And Intermingling In Family Businesses

BOOTSTRAPPING		
INTERMINGLING	**Use of owner resources to benefit the business** Loans from relatives Cash from relatives Personal savings Use of personal credit card Household property used as collateral for business loans Family labour receives no pay or below-market rates Manager works another job and takes no pay from business Manager foregoes pay for a time Business uses home space and utilities	**Use of business resources outside the business** Loans from business to relatives Business cash used to help household cash-flow problems Business purchases items used by family Business pays family at higher than market rate Business assets used as collateral for family loans Drawings by owner
	Business strategies related to customer / supplier / community resources Accounts receivable management methods (e.g. speed up invoicing, choose customers who pay quickly, cease business with late or non-payers) Sharing or borrowing resources from other firms (shared space, equipment, employees) Delaying payments (suppliers, tax and employees) Minimizing of resources invested in stock through formal routines Use of subsidies	

The emotional attachment of the founder to its business also explains family firms' refusal to opt for equity financing. Peters and Westerheide (2011) examined the financial behaviour of German family and non-family businesses. They have found that family businesses are prepared to accept higher financing costs in order to preserve their financial independence and flexibility. This particularly applies to family businesses that are larger and generally more creditworthy, which confirms that for family businesses independence from external capital providers has central importance. The literature review has shown that family businesses have peculiar financial characteristics. In the pages that follow, the authors will examine the finance-related topics of the INSIST project company case studies. The next chapter of the paper has been divided into five parts. The first part deals with the importance of the founder's family for financial support, the second part examines the bootstrapping techniques found in company case studies. We consider the questions: which are the most preferred alternate financing techniques and how are family businesses using them? The third part reviews the family businesses' behavior examined in period of tough (crisis) times which is followed by an overview of the financial aspects of succession, with the questions: how does the financial health of the business affect succession decisions and what are the most important aspects of financial management of succession? Finally, the last part analyses the importance of trust and its effect on family business finances. The following table summarizes the main financial issues of small family businesses, their peculiar features and the family business' characteristics that affect the firms' financial behavior (Table 2).

TABLE II: Financial Peculiarities Of Family Businesses

Issue	Special financial features	Family business characteristics
Parallel financing of family and family business, and financing succession.	• intermingling of family and business financing • using family assets as collateral • the family business represents a significant portion of the owner family's wealth • succession requires careful financial planning and preparation	• Desire to keep the family business ownership and management within the family. • Commitment. • Long-term approach. • Ensure the family's financial independence. • Importance of preserving a good reputation. • Risk avoidance. • Paternalism. • Intermingling of family and business affairs. • family dominance in the management of the business • Refusal to employ non-family managers. • nepotism
Financial management, borrowing and indebtedness.	• avoiding financial risks • Less sophisticated financial management. • Preference of debt financing over equity financing. • lower debt ratio than in non-family firms	
Source of capital, raising external (non-family) capital, selling the family business.	• maximum usage of family resources • rejection of raising external (non-family) capital • defining the value of family business is difficult	

A. Finance-Related Findings of the INSIST Research Project

The INSIST research project team compiled 10 company case studies. As mentioned earlier, the Hungarian team compiled three, the Polish team five, and the British team two case studies. The Table 3 summarizes the main characteristics of the company cases investigated (Table 3.).

TABLE III: Summarizes The Main Characteristics Of The Company Cases Investigated

	Country	Year of establishment	Number of employees	Sector/Activity	Markets	Succession
Parodan	UK	1984	27	Engineering (design and manufacturing)	National	*
Podiums	UK	1977	30	Fabricating	Regional	*
DOMEX	Poland	1989	20	Real estate	Regional	**
Plantex	Poland	1981	81	Horticulture	Domestic / International	*
Pillar	Poland	1980s	70	Construction	Local	***
WAMECH	Poland	1989	77	Manufacturing (automotive)	International	***
WITEK	Poland	1990	260	Retail trade (furniture)	Regional	*
Fein Winery	Hungary	1991	4	Food (wine production)	Domestic / International	**
BI-KA	Hungary	1991	103	Logistics	Domestic / International	*
Quality Meat	Hungary	1992	45	Food (meat processing)	Local	**

The companies examined are at different stages of the succession process with different strategic aims. Although the main purpose of the case studies is to reveal the special features of the succession process, valuable findings about the financial features of family businesses and family business succession can be discovered.

B. Sources Of Starting Capital

In the early days after their founding, most businesses have incomplete financial data and plans, the available collateral is insufficient and so it is very common that at the beginning, the only source of finance for family businesses are the prospective owners and their families. Gere (1997) in her research has shown that almost 90% of family businesses used the family's savings to get started, and it was also typical that sale of family property and loans from relatives provided the initial capital. Based on Czakó's (1997) research, 70% of the Hungarian family businesses founded in the early 90's needed additional financial sources for starting up. One-fourth of them used bank loans and two-thirds used households' savings as initial financial sources. The INSIST project's company cases confirm the importance of the founder's family financial support in establishing a new family business. In the examples the main financial supporter of the founder is usually the nuclear family which can be explained by the high-level of trust and emotional ties between nuclear family members.

C. Bootstrap Financing Of Family Businesses

Bootstrap financing or the creative acquisition of resources by a business is considered one of the most effective financing methods (Tomory, 2014). Bootstrapping techniques are considered an important element of modern financial management, but the motivation behind their use is not only the pursuit of efficiency, but especially in case of small businesses, which are not creditworthy, the necessity of finding an alternative for debt financing (Béza et al., 2013). Family businesses, due to their general rejection of external financing, usually rely heavily on bootstrapping techniques. In their work Helleboogh et al. (2010), point out that the use of bootstrapping techniques does not depend on the family business owner's education; it is rather a skill absorbed from self-employed parents or during the owner's prior work and management experience. The INSIST project's company case studies confirm family businesses' preference towards bootstrap financing. In the Table 4 based on Winborg and Landström's (2001, p. 251.) work, we collected some examples of when the family businesses examined employed bootstrapping techniques (Table 4).

TABLE IV: Family Businesses Examined Employed Bootstrapping Techniques

Bootstrapping Methods	Example from the INSIST project's company cases	References
Seeking out best conditions possible with supplier(s)	The company was set up from savings and in the early period they tried to operate by keeping costs very low.	Szentesi, I. (2015, p. 14.) Quality Meat Ltd., Hungary.
Withholding manager's salary for shorter/longer periods.	Agreed equal remuneration for father and sons, the suspension of payments at times of crisis has developed the sense of responsibility and solidarity among them.	Gorowski, I. (2015, p. 8.) Pillar Ltd., Poland.
Obtaining capital via manager's assignments in other businesses.	At the foundation of the company, Sofia had been on maternity leave with her two children and Peter Sr. retired and became passive. The founder-manager, Tamás wanted to give a job to Peter, thus he financed the operation of the family vineyards and Peter managed it. In this period the founder-manager worked as economist, vintner, corporate leader, bank account manager.	Gubányi, M. (2015, p. 1-2.) Fein Winery, Hungary
Obtaining loans from relatives/friends.	Further, in times of hardship, such as during the recession, the Wood parents and Paul put all their personal resources into the business to keep it going and avoid reducing staff numbers. Indeed, the parents invested their home and pensions against the business to ensure its survival for the next generation.	Wymer, P. (2015, p. 8.) Parodan Engineering, UK.

D. Family Businesses' Resilient Behaviour In Tough (Crisis) Times

The financial performance of family businesses differs from non-family ones. Kachaner et al. (2012), highlighted that during good economic times family companies have slightly lower earnings, but during downturns they outperform non-family businesses. They argue that the reason for this characteristic feaure is family businesses' focus on resilience, not short-term performance, which influences the following strategic choices: family businesses are frugal in both good times and bad; carry little debt; keep the bar high for capital expenditures; and acquire fewer companies. Furthermore, they are diversified, internationalized, and good at retaining talent.

E. Financial Aspects Of Succession

Succession, i.e. the act of transferring the business itself to the next generation, is a very important event in the life of family businesses. Wiktor (2014) points out that family business owners that are planning business succession need to focus on timing, transition and tax¬es. One can view a family business in two ways: as an 'investment asset' or an 'operating entity' (Isaac, 2014). In most cases the family business is the main source of family wealth and it is the family's largest investment (Wiktor, 2014). For these reasons it is important for family business owners to consider their company as an asset, and an investment which is particularly relevant at the time of a transfer of ownership. Small and medium sized family business owners usually do not pay too much attention to the value of the family firm. Defining the value of a family business can be a challenging task but there are moments when it is inevitable. In the life of a family business, succession or 'generational transfer' can be one of these moments. Family business owners may decide on the sale of the family company rather than succession to family members. Vecsenyi (2009) states that the main reasons for selling the family business can be: fatigue, developmental pressure, an emergency, a good offer or a good opportunity. If the owners decide to sell the company, a reliable business evaluation is absolutely necessary. Defining the value of a family business is a particularly difficult task. The additional value created by the founder and the owner's family is hard to define. A very important question is how much the family business is worth without the family.

F. Trust And Family Business Finances

If we want to get deeper insight into the structures and peculiar company cultures built up by the private individuals founding family businesses, we need to have a closer examination of the trust which defines the degree of spontaneous sociality in general in society, which in turn will have an impact on company cultures and also on organisational structures (Fukuyama, 2007). The trust developed between individuals is very important because later it will function as the keystone of co-operation and the motivation for meeting each other's expectations. Thanks to family bonding the level of trust in family businesses does not 'start from zero', however when misused it may head in the wrong direction or result in a passive, aloof stance in the business and family communities. Trust can be further inceased by empathy and the appropriate communication, whereas the lack of trust can cause a lot of problems and conflicts (between business and client, manager and subordinate, and even between family members). This can result in a tense atmosphere at the workplace and also within the family, and may ultimately lead to the termination of the business and the breakup of the family (Karmazin, 2011). In the course of the INSIST project, among the benefits of employing family members, a parallelism between a greater degree of trust and a more intensive level of control was revealed, especially with closer family members (Makó et al., 2016). However, this approach may bring about favouritism or a „glass ceiling" effect, which may restrict the advance of non-family members within the business (Surdej, 2015).

II. CONCLUSIONS

In the INSIST research project combined research methods were applied. Project team members carried out desk-top analysis based on the existing (national) literature and empirical research. In order to gain a deeper insight into the succession process and to understand the company- and family-level micro-mechanisms shaping ownership and management-transfer practices the Hungarian team compiled three, the Polish team five and the British team two case studies. The literature review indicated that the peculiar features of family business financing are most importantly reflected in their refusal of external equity funding and the intermingling of family and business finances. Family businesses are comparatively conservative in the type of financing they use. Their most important sources of funding are internal financing from cash flow, shareholders credit and bank loans. The size of the family business may influence the presence of the above-mentioned unique financial characteristics. While in micro and small family businesses their occurrence can be more significant, in case of medium-sized and large family businesses a more professional organizational structure, operation and decision-making processes can overshadow them. Further research into family businesses' bootstrapping techniques, the role of trust in family business financial management, and the family members' role in family business financing, as well as mapping areas that family businesses tend to keep for themselves may also yield interesting new insights.

III. REFERENCES

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