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The Influence of Age and Size on Family-Owned Firms' Financing Decisions: Empirical Evidence Using Panel Data

Zélia Serrasqueiro, Paulo Maçãs Nunes, Jacinto Vidigal da Silva

Based on four samples of Portuguese family-owned firms — i) 185 young, low-sized family-owned firms; ii) 167 young, high-sized family-owned firms; iii) 301 old, low-sized family-owned firms; and iv) 353 old, high-sized family-owned firms — we show that age and size are fundamental characteristics in family-owned firms' financing decisions. The multiple empirical evidence obtained allows us to conclude that the financing decisions of young, low-sized family-owned firms are quite close to the assumptions of Pecking Order Theory, whereas those of old, high-sized family-owned firms are quite close to what is forecast by Trade-Off Theory. The lesser information asymmetry associated with greater age, the lesser likelihood of bankruptcy associated with greater size, as well as the lesser concentration of ownership and management consequence of greater age and size, may be especially important in the financing decisions of family-owned firms. In addition, we find that GDP, interest rate and periods of crisis have a greater effect on the debt of young, low-sized family-owned firms than on that of family-owned firms of the remainder research samples.

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Introduction

In the context of firms' financing decisions, following the important studies by Modigliani and Miller (1958, 1963), ascertaining what the main determinants of these financial decisions were became the focus of various studies. Thus, two theories are particularly important in explaining firms' financial decisions: i) Trade-Off Theory (Kim, 1978; Kraus and Litzenberger, 1973; Scott, 1977), and ii) Pecking Order Theory (Myers, 1984; Myers and Majluf, 1984). According to Trade-Off Theory, firms seek to reach an optimal level of debt, which implies balancing the benefits and costs of debt. According to Pecking Order Theory, variations in debt do not seek to reach an optimal level of debt but are the consequence of external financing needs, because when internal funds are insufficient, firms prefer to turn to debt rather than external equity.

The main objective of family-owned firms is to keep ownership in family hands, which leads to the reluctance to acquire external financing, with these firms having a clear preference for internal financing (Blanco-Mazagatos et al., 2010).

Hannan and Freeman (1984) state that firms' age and size may be particularly relevant for strategic options of firms. Furthermore, Hannan (1998) claims that organizations' initial situation — namely the quality and quantity of the resources — affects their future strategies and survival. As financial resources are fundamental to firms' activity, age and size may be crucial factors in explaining firms' financing decisions; we can expect the financing decisions of young, small firms to be quite different from those of older, larger ones.

When internal financing is insufficient, difficulties in accessing external financing are one of the main limitations to growth in European firms (Jõeveer, 2012). On the one hand, the dependence on internal financing diminishes with increased firm size, since greater size generally implies less likelihood of bankruptcy, greater transparency of information provided about firm size, and greater capacity to provide collaterals (Berger and Udell, 1998; Diamond, 1991), allowing large firms access to debt on more advantageous terms. On the other hand, higher firm age involves great reputation and less uncertainty about the future, also contributing to older firms gaining easier access to debt (Chittenden et al., 1996; Diamond, 1989; Hall et al., 2004).

Family-owned firms are especially relevant in the economies of developed countries, as they stimulate employment and economic growth (Eklund et al., 2013; Poutziouris, 2001; Uhlaner et al., 2012). Given the importance of these firms in the economies of developed countries, the study of how they finance their activities is also very relevant, since obstacles in accessing finance may affect their growth and survival options. Greater age and greater size are important characteristics of the firms for then obtain financing on favorable terms, so influencing their funding decisions (Ang, 1991; Berger and Udell, 1998; La Rocca et al., 2011; Pettit and Singer, 1985; Scherr and Hulburt, 2001). Therefore implications of age and size in firms financing decisions is a subject worthy of study, in that context, studying the applicability of Pecking Order and Trade-Off Theories to family-owned firms of different age and size may be particularly relevant.

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Based on the above, the aim of this study is to test whether the age and size of family-owned firms have implications for their financing decisions. More specifically, we check whether the age and size of family-owned firms influence the applicability of Pecking Order and Trade-Off Theories to their financing decisions.

To reach the objectives of this study, we consider four samples of Portuguese family-owned firms: i) 185 young, low-sized family-owned firms; ii) 167 young, high-sized family-owned firms; iii) 301 old, low-sized family-owned firms; and iv) 353 old, high-sized family-owned firms. To estimate results, we use OLS regressions to find the relationship between financial deficit and variations in debt, estimating standard deviation according to cluster option. To estimate the adjustment of actual debt towards target debt ratio, and the relationships between determinants and debt, we use the GMM system (1998) dynamic estimator, estimating standard deviations according to robust option.

This study makes a relevant contribution to the literature on the financing decisions of firms in general, and those of family-owned firms in particular. On one hand, we find that the financing decisions of young, low-sized family-owned firms are closer to the assumptions of Pecking Order Theory than those of family-owned firms belonging to the other research samples. On the other hand, we find that the financing decisions of old, high-sized family-owned firms are closer to the assumptions of Trade-Off Theory than those of family-owned firms of the remaining research samples. In other words, above all, young, low-sized family-owned firms resort to internal funds to finance their activities, with little consideration given to recourse to debt to reach an optimal level that corresponds to the maximization of debt benefits and minimization of the probability of bankruptcy. Old, high-sized family-owned firms, in their financing decisions, more effectively consider the possibility of reaching an optimal level of debt corresponding to maximum debt benefits and minimum likelihood of bankruptcy, with the preference for internal funds to finance activities being less relevant.

After this introduction, the current study is structured as follows: i) Section 2 presents the theoretical framework and research hypotheses; ii) Section 3 presents the methodology: i.e., the database, variables used and estimation methods; iii) Section 4 presents the results; iv) Section 5 discusses the results; and v) Section 6 presents the conclusions and implications of the study.

Theoretical framework and research hypotheses

Theoretical framework

The relationship between financing decisions and ownership is one of the least well understood in the financial literature, the result of mixed empirical evidence regarding the influence of ownership in firms' financing decisions. In this context, Lyagoubi (2006) and López-Gracia and Sánchez-Andújar (2007) conclude that family ownership implies increased access to debt. On the contrary, Holderness and Sheehan (1988) and Jensen et al. (1992) identify a negative relationship between family ownership and debt. Finally, Holderness et al. (1999) and Anderson and Reeb (2003) conclude that ownership has no effect on firms' financing decisions.

Various authors, such as Cater and Schwab (2008), Kellermanns et al. (2008), King and Santor (2008), and Villalonga and Amit (2010), conclude that the financing decisions of family-owned firms are clearly influenced by these firms' specific characteristics, highlighting among them risk aversion, the desire to keep family ownership, and reluctance to open up the firm's capital to investors. Moreover, family-owned firms adopt a conservative attitude towards growth, preferring not to grow beyond a given size, so that additional financial needs do not force the loss of ownership and management (Bianco et al., 2013; Davis and Pett, 2000).

According to Blanco-Mazagatos et al. (2010), family-owned firms follow the Pecking Order Theory in their financing options. These firms prefer to use internal funding, with debt a secondary option, and external equity only as a last resort. Firstly, the owners/managers of family-owned firms prefer internal financing to debt, given that they are cautious of using debt, in order to minimize the interference in firm's ownership and management by agents outside of the family (Blanco-Mazagatos et al., 2007; Gallo et al., 2004; Lyagoubi, 2006). Secondly, the owners/managers of family-owned firms prefer debt to external equity, seeking to keep firm's ownership control within the family (Anderson et al., 2003; Blanco-Mazagatos et al., 2010; Coleman and Carsky, 1999; Gonzáles et al., 2010; King and Santor, 2008; López-Gracia and Sánchez-Andújar, 2007). According to Barton and Gordon (1987), Barton and Matthews (1989), and McMahon and Stanger (1995), family-owned firms have the main goal of passing ownership from one generation to the next, rather than of reaching an optimal level of debt.

From the above, we can expect that family-owned firms follow the assumptions of Pecking Order Theory in their financing decisions. However, Ampenberger et al. (2013) conclude that family-owned firms can establish optimal debt ratios; this is in concordance with the assumptions of Trade-Off Theory regarding firms' financing decisions. More specifically, Ampenberger et al. (2013) conclude that family-owned firms can establish lower levels for target debt ratio, due to family members' perception of bankruptcy costs associated with debt. This conclusion is corroborated in the study by Gonzáles et al. (2010). These authors also conclude that firms prefer the resource of debt to the external equity, in order to get funding to do in meet its growing needs. This situation can contribute to those firms seeking to establish a greater target debt ratios. In this context, Pindado et al. (2012) conclude that family-owned firms make relatively high adjustments of actual debt towards target debt ratio. According to these authors, this result is the consequence of less information asymmetry in the relationships between firms and creditors given that the latter ones identify firm's owners and managers more easily.

Khan (2003) concludes that family-owned firms go through three stages of financing behavior. First, growth is financed internally. Later, when external financing is needed, the family firm turns to debt. Finally, in a second phase of recourse to

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