Submission to the parliamentary inquiry into Family Business in Australia

By Francesco Barbera on behalf of
The Australian Centre for Family Business, Faculty of Business,
Bond University, Queensland

Executive Summary:

The Australian Centre for Family Business (ACFB), located in the Faculty of Business at Bond University, is a group of family business owners/managers, advisors, and academic researchers who have come together to establish a national centre to assist the many family-owned businesses in Australia.

One of the ACFBs stated objectives is to facilitate the dissemination of the results of ACFB research to the community; thus, in response to the parliamentary inquiry into family business in Australia, this submission will focus on 1) the issues pertaining to the definition of a family business, 2) the availability and reliability of information and statistics about family business in Australia, 3) a brief account of the contribution of family business to the Australian economy, 4) theoretical issues regarding the access to finance for small to medium sized family enterprises, 5) empirical evidence outlining debt and equity financing differentials between family and non-family firms, as well as 6) policy recommendations in relation to improving family businesses access to finance.

To summarise the material in this submission:

- The definition of the family firm can be a complex exercise and one which requires specific firm-level data. For example, the degree of family ownership in terms of the family's equity stake in the firm is clearly important, but qualitative information on the intention to involve the family in the firm, as well as the degree of interaction the family has with the rest of the firm is just as important.

- With newer data bases being difficult to access, the availability of family business data in the small business sector is more than 10 years out-dated and does not address the definitional issues mentioned above.

- Despite the age of the data used, family firms are shown to play a key role in the Australian economy; particularly in the Construction, Retail Trade, Manufacturing, and Accommodation, Cafes and Restaurants sectors.

- The composition of both debt and equity finance is significantly different for family firms. This submission relates these differences to the literature on the unique behaviours and preferences associated with family ownership. Specifically, due to extended relationships with their banks, increased potential for the quantum of collateral, and a stronger commitment to the firm, bank debt is greater for family firms; however, due to a failure to cultivate external networks with more diverse stakeholders outside of the family, coupled with a strong preference to protect the family's influence over the firm, loans from external sources are lower for family firms.

- As far as equity financing is concerned, due to the pooled personal resources that family members are willing to loan, contribute, or share for the benefit of the family business, equity from working owners is greater for family firms; however, as their first financing objective is not to lose control of the business, equity from external sources is lower for family firms because they avoid sharing equity with non family members.

- The demand-side issues mentioned above are potentially more important for family firm financing than any deficiency in supply. Thus, policy designed to overcome issues related to an SME financing gap would potentially be more effective by acknowledging the distinctive financing outcomes related to family ownership reported in this submission.

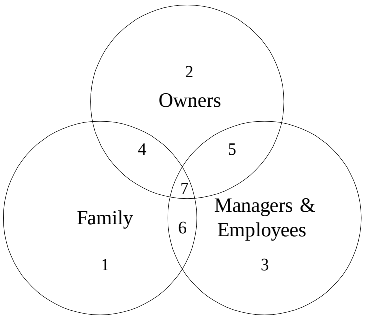
1. The Definition of a Family Business:

Despite family business being the focus of study for many years, the persisting challenge facing researchers is defining what exactly a family business is. In an attempt to clarify this issue, two different conceptual approaches have been established in the literature. Following the seminal work of Berle and Means (1932), the first approach focuses on a structural based classification. For example, family firms have been defined as those which are either owned, controlled and/or managed by a family unit. Such a definition allows for a wide range of "family firms" as the degree of family ownership, control and management can differ among individual firms, and studies have shown that varying degrees of family involvement does empirically matter (Villalonga and Amit 2006; Miller et al. 2007; Sciascia and Mazzola 2008).

In fact, some researchers have come to realize that the components of family involvement do not necessarily determine whether a firm is a *family* firm as the structural based approach does not account for the possibility of intra-organisational aspirations within the firm to either increase or decrease the degree of family-based relatedness (Litz 1995). Thus, when attempting to narrow the definition of a family firm, an intention based approach can be useful. Indeed, the intangible desire of the family unit to transfer ownership through succession within the family is considered to be a unique characteristic of family firms. Handler (1994) describes the issue of succession as the most important issue that all family firms face; Chua et al. (2003) find that succession is the *number one* concern of family firms; and Ward (1987) goes so far as to define all family firms specifically as those that will be "passed on for the family's next generation to manage and control".

Regardless of the definitional approach taken, and without any consideration about the degree of family influence, family firms may be considered unique from other firms in the sense that there is an interaction between ownership, management as well as a third entity, the family. Gersick et al. (1997) helped to classify these interactions by developing a "three-circle model" which describes the family business system as three independent but overlapping sub-subsystems. More recently, refined as: management, ownership, and family (Moores 2009). Depending on the alignment of the family sub-system with the other sub-systems of the firm, any individual can be placed in one of the seven sections formed by the overlapping circles, as identified in Figure 1.

Figure 1: *The three-circle model of family business*



1. Only family members
2. Only owners
3. Only employees/managers
4. Family owners
5. Employee/manager owners
6. Family employees/managers
7. Family owners and employees/managers

Based on Figure 1, it is the interaction of the family unit on the business entity and owners, and/or individual family members, which can bring about unique system conditions that impact strategic behaviour and performance outcomes (Habbershon et al. 2003). It is for these reasons that Anderson and Reeb (2003) contend that inside family business equity holders are a unique class of shareholders. More specifically, there is a strong identification by inside owners between the family and the business (Gallo and Vilaseca 1996), and family business owners, unlike other companies, have to satisfy the current and future needs of family members in addition to the needs of the business (Dreux 1990). Based on the discussion thus far, distinguishing family owned firms from their non-family counterparts can be a complex exercise and one which requires specific firm-level data.

2. The availability and reliability of information and statistics about family business in Australia:

To overcome the aforementioned definitional issues when investigating Australian family owned firms, comprehensive data is required on the structural components of family ownership (i.e. the quantitative composition of equity held by one or more controlling families in any given firm), the intention of owners regarding the degree of family-based relatedness (i.e. the qualitative desires and aspirations of both the incumbent and succeeding generations in any given firm), as well as the alignment of the family sub-system in relation to other aspects of the firm (i.e. the extent of the family's interaction with ownership and management regardless of structural ownership or intentions in any given firm). Despite the overwhelming incidence of family ownership in Australia, such comprehensive data are relatively scarce. With that said, The Australian Bureau of Statistics' "Business Longitudinal

Survey" (BLS)[1] and the more recent "Business Longitudinal Database" (BLD)[2] both contain some distinguishing questions as far as family ownership is concerned.

Specifically, the following questions, asked of all businesses which participated, are included in both surveys.

1. *Do you consider the business to be a family business? Yes/No*
2. *If yes, why do you consider this a family business? Family members are:*

i. Working directors or proprietors. Yes/No
ii. Employed in the business. Yes/No
iii. Not working, but contribute to decisions. Yes/No
iv. Business acquired from parents. Yes/No
v. Close working relationship between management and staff. Yes/No
vi. Other. Yes/No

Based on the questions listed above, a family firm can be defined as those who answered "yes" to question 1. Furthermore, considering one's business as a family firm could be due to one or more of the reasons listed under question 2. It seems that this list may capture both the structural definition of a family firm, i.e. options i to iii, as well as the essence of family firms, i.e. options iv and v. It is important to note however that the options listed under question 2 are not mutually exclusive of one another and thus identifying different "types" of family firms within these options does not offer any practical classifications[3]; thus, for the purpose of this inquiry our analysis in subsequent sections considers only the overarching question 1.

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[1] The BLS was designed to provide information on the growth and performance of privately held Australian small and medium-sized enterprises (SME), i.e. less than 200 employees. The BLS is the longitudinal component of several waves of the „Business Growth and Performance Survey". As such, the structure of the data includes not only a cross-sectional component, but also a longitudinal aspect for the years 1994-95 to 1997-98 inclusive. The BLS has the potential to inform many areas of research, including industrial relations, business, finance and economics (Hawke 2000).

[2] Similar to the BLS, the stated aim of the BLD is to facilitate micro level analysis for a panel (cross- sectional and longitudinal) of SMEs over time, and it includes both firm characteristics and financial data. The release of the BLD Confidentialised Unit Record File (CURF) provides information for the first two panels included in the BLD. Five years of data is included for both panels: Panel One includes data for the years 2004-05 to 2008-09 inclusive; and Panel Two includes data for the years 2005-06 to 2009-10 inclusive.

[3] Of all family firms responding to question 2, 34.91 percent selected *i* only; 27.45 percent selected both *i* and *ii*; 11.79 percent selected *i*, *ii* and *v*; 4.39 percent selected *i* and *v*; 3.18 percent selected *i*, *ii*, *iv* and *v*; and 3.18 percent selected *i*, *ii* and *iv*. Based on this, and out of 64 possible permutations, nearly 95 percent of all family firms at least selected *i*, which is understandable since we would expect small to medium sized family firms to have a more *operational* classification; however, not excluding these, approximately 37 percent also selected *iv* and *v*, which is associated with the *essence* based classification of a family firm.

Notwithstanding the fact that questions 1 and 2 are crucial to the family business scholar interested in the Australian SME landscape, in light of the previously mentioned definitional issues, both the BLS and BLD merely distinguish inter-firm ownership differentials. In other words, family firms are considered to be a homogeneous group. However, in order to better understand the national economic impact of family ownership, more effort must be directed towards collecting data which distinguishing the intra-firm differences across family owned firms. In other words, the current state of family business research necessitates a move towards viewing family firms as a heterogeneous group. Information specifically related to the structural, intentions, and family sub-system definitional approaches will help in this regard.

Another main issue for the family business scholar pertains to the actual use of the more recent BLD. As opposed to the BLS, the BLD is subject to rigid confidentiality restrictions. The stated reasons for such restrictions are to ensure the integrity of data, optimise its content, and maintain confidentiality of respondents. With that said, only remote access, via the Australian Bureau of Statistics' Remote Access Data Laboratory (RADL) is available, which severely limits the ability of the researcher to probe the data in a meaningful way. Our recommendation in this regard would be to release the BLD in the same manner the BLS was released. That is, maintain confidentiality by removing any reference to specific respondents, yet release the dataset in its entirety to sanctioned individuals.

3. The contribution of family business to the Australian economy:

Given the difficulties associate with accessing the newer BLD, by deriving a representative SME sample from the older BLS data, we wish to merely allude to the various economic contributions of Australian family business by reporting the proportions of family firm employment, total assets, and output by industry.

Table 1: *The economic contribution of family firms by industry in Australia*

	Industry (ANZSIC) code	# of firms	# of FF	% of FF	Total Employment[a]	% of FF Employment	Total Assets (000)	% of FF Assets	Total Output[b] (000)	% of FF Output
100	**Mining**	**27**	**7**	**25.93%**	**1202.46**	**6.18%**	**1179596**	**0.022**	**480419**	**4.72%**
	Manufacturing									
200	between 100 & 200 employees	90	28	31.11%	11120.78	27.14%	2172050	16.44%	1207550	21.38%
221	Food, Beverage and Tobacco Manufacturing	141	70	49.65%	3821.23	43.01%	596592	30.53%	368211	35.38%
222	Textile, Clothing, Footwear and Leather Manufacturing	106	62	58.49%	3316.12	48.70%	320765	31.10%	246444	42.46%
223	Wood and Paper Product Manufacturing	69	43	62.32%	1920.27	63.37%	207816	62.92%	185085	53.01%
224	Printing, Publishing and Recorded Media	101	60	59.41%	2204.62	45.65%	262692	40.52%	186604	40.64%
225	Petroleum, Coal, Chemical and Associated Product Manufacturing	168	73	43.45%	4630.29	35.07%	793867	18.34%	504888	22.97%
226	Non-Metallic Mineral Product Manufacturing	60	39	65.00%	1356	63.79%	166315	47.79%	116012	57.92%
227	Metal Product Manufacturing	184	103	55.98%	4998.75	54.23%	438533	40.56%	363630	49.95%
228	Machinery and Equipment Manufacturing	349	178	51.00%	7354.99	44.27%	632966	35.00%	531420	39.62%
229	Other Manufacturing	131	79	60.31%	2799.62	63.09%	144599	51.96%	162877	56.71%
	Construction									
300	between 100 & 200 employees	5	4	80.00%	676.98	83.16%	124884	98.67%	61508	89.48%
341	General Construction	65	43	66.15%	789.87	49.21%	88986	61.34%	95847	51.36%
342	Construction Trade Services	122	88	72.13%	1566.9	69.82%	82822	76.34%	147879	73.50%
	Wholesale Trade									
400	between 100 & 200 employees	29	10	34.48%	3411.28	33.34%	718899	16.43%	389169	24.10%
445	Basic Material Wholesaling	135	75	55.56%	3226	55.99%	782630	45.46%	345707	44.99%
446	Machinery and Motor Vehicle Wholesaling	230	106	46.09%	6391.66	37.84%	1423042	18.01%	658332	26.99%
447	Personal and Household Good Wholesaling	179	105	58.66%	4390.96	49.10%	717000	38.02%	457405	43.01%
	Retail Trade									
500	between 100 & 200 employees	15	9	60.00%	1385.35	61.16%	140675	48.80%	163610	73.62%
551	Food Retailing	78	56	71.79%	1196.76	65.19%	84167	67.43%	59002	63.95%
552	Personal and Household Good Retailing	122	71	58.20%	1671.3	49.92%	160185	46.11%	120581	45.61%
553	Motor Vehicle Retailing and Services	139	78	56.12%	3471.21	48.28%	356468	45.73%	245128	45.24%
	Accommodation, Cafes and Restaurants									
600	between 100 & 200 employees	4	2	50.00%	304.29	42.30%	5061	27.96%	16703	27.81%
657	Accommodation, Cafes and Restaurants	118	56	47.46%	1224.51	38.16%	113579	24.91%	85933	25.67%
700	**Transport and Storage**	**128**	**75**	**58.59%**	**2432.43**	**38.46%**	**641996**	**15.23%**	**331694**	**26.00%**

	Industry (ANZSIC) code	# of firms	# of FF	% of FF	Total Employment[a]	% of FF Employment	Total Assets (000)	% of FF Assets	Total Output[b] (000)	% of FF Output
	Finance and Insurance									
800	between 100 & 200 employees	2	0	0.00%	248.55	0.00%	54445	0.00%	49035	0.00%
875	Services to Finance and Insurance	70	35	50.00%	712.85	17.15%	180476	8.38%	81130	10.15%
	Property and Business Services									
900	between 100 & 200 employees	18	1	5.56%	2193.51	5.18%	1354346	59.69%	373796	2.52%
977	Property Services	106	49	46.23%	1328.13	35.74%	540490	6.98%	148620	26.62%
978	Business Services	327	99	30.28%	5904.33	19.17%	527391	27.71%	528223	11.81%
	Cultural and Recreational Services									
1000	between 100 & 200 employees	5	0	0.00%	536.06	0.00%	264852	0.00%	67956	0.00%
1091	Motion Picture, Radio and Television Services	37	8	21.62%	763.53	16.44%	212620	6.10%	111649	11.66%
1092	Libraries, Museums and the Arts	3	0	0.00%	91.41	0.00%	1371	0.00%	2578	0.00%
1093	Sport and Recreation	17	8	47.06%	222.99	32.67%	18391	47.30%	17855	50.35%
	Personal and Other Services									
1100	between 100 & 200 employees	1	1	100.00%	106.28	100.00%	10577	100.00%	10838	100.00%
1195	Personal Services	69	37	53.62%	794.8	61.82%	38670	58.26%	39742	62.67%
	All Industries	**3450**	**1758**	**50.96%**	**89767**	**40.85%**	**15559814**	**28.26%**	**8963060**	**31.33%**

[a] Full-time equivalent (FTE) workers employed in the firm is used as a measure of total employment. This figure is found via the sum of full-time workers and full-time equivalent part-time workers. Full-time equivalent part-time workers are found via the product of the number of part-time employees for each individual firm and a full-time equivalent ratio. The equivalent ratio is the Australian Bureau of Statistics' estimate of average hours worked by part-time non-managerial employees per week in time compared to full-time employees for all firms.

[b] An index number for value added (VA) is constructed and used as a proxy for total output. Such an index follows Kenneth Arrow's (1974) generally accepted "real value added" measure and is constructed by taking sales plus the change in inventories less purchases of intermediate inputs and other operating expenses. Although from a purely theoretical standpoint we would rather use actual output, in terms of number of units produced, the value added index allows us to analyse those firms which do not necessarily have a tangible output, such as the case of services rendered. Furthermore, the value added index has been found to accurately measure the dependent variable in the production function that explains value added in terms of the tangible and intangible primary factors, like labour and capital, and as such the function is independent of non-primary inputs (see Sato 1976).

From table 1 it can be seen that, of all firms sampled, just over half are family owned. Further, family firms employ more than 40 percent of all full-time equivalent employees, own nearly 30 percent of all assets, and contribute nearly 32 percent towards total output in all sectors. These values vary depending on the industry, with notable family business contributions being made in the Construction, Retail Trade, Manufacturing, and Accommodation, Cafes and Restaurants sectors.

4. Access to finance for family SMEs:

Given their economic importance, the issue of financing SMEs has played a central role in the economic, finance and managerial literature for decades (see for example MacMillan Committee 1931; Butters and Lintner 1945). During this period, many have argued that SMEs in particular have non-trivial difficulties in obtaining financing, either through debt or equity, leading to what is commonly referred to as an “SME financing gap”. Although there is no generally accepted definition of this gap, the term refers to the sizeable share of economically significant SMEs that cannot obtain financing from banks, capital markets or other suppliers of finance (Organisation For Economic Co-operation And Development 2006; 2007).

Under certain circumstances, financial explanations for an SME financing gap may be more closely associated with the characteristics of the owner-manager's demand for investment funds rather than any deficiency in supply. Supporting this view, Hutchinson (1995) asserts that, where the objective of an owner-manager is to maintain control of the firm, a sub-optimal capital structure decision is made in the form of reduced demand for both equity and debt. Such demand-side constraints arise from factors internal to the firm (Cressy 1996; Cressy and Olofsson 1997), which implies that the personal motives and intent of owners matters in terms of the magnitude and scope of financing accessible to the firm.

In this regard, family ownership is an interesting form of ownership since family business owners may have very different objectives relative to non-family firms, many of which being non-financial in nature (Ward 1988; Harris et al. 1994; Sharma et al. 1997; Nelly and Rodríguez 2008). Following this logic, the conduct of the family firm, specifically their financing preferences, can be linked to objectives such as preserving the firms identity, the ability to exercise family influence, and the perpetuation of the family dynasty, rather than short-term profit motives. This section is dedicated to exploring the literature on how family non-pecuniary objectives and the preservation of the sovereignty that is required to pursue them, might impact both the debt and equity financing outcomes of the firm. Basic descriptive statistics sourced from the BLS are also presented to reinforce the arguments.

4.1 Family debt financing

Since SMEs do not have access to public debt markets, they typically rely on financial intermediaries, particularly commercial banks, as a primary source of debt finance (Petersen and Rajan 1994). Credit rationing by banks therefore poses a large problem in terms of constraining the supply of SME finance, including family owned firms; however, based on the family business literature, the asymmetric information problems which trigger credit rationing may be mitigated by family ownership.

For example, Berger and Udell (1995) suggest that the relationship between lender and borrower is an important mechanism for solving the asymmetric information problems associated with financing small enterprises[4]. In this regard, it has been suggested that family firms favour long-term win-win relationships over transactions-links with providers of capital and other stakeholders (Miller and Le Breton-Miller 2005). Since bank financing often involves a long-term relationship, and since upholding the identity/reputation of the family firm, which often carries their name, is considered to be an objective of family owners, the long-term governance structure of family firms may be better suited to accommodate a closer relationship with their bank, leading to greater access to credit (Le Breton-Miller and Miller 2006; Chua et al. 2011).

Another potential alleviation of the credit rationing problem is the use of collateral in the credit contract (Jaffee and Russell 1976; Stiglitz and Weiss 1981). Hence, if personal commitments are prerequisites for bank financing, the wealth of small business owners will play a key role in successfully obtaining credit (Avery et al. 1998; Colombo and Grilli 2007). Again, family ownership may help in this regard since the extent of debt collateralisation is increased via the use of pooled personal family assets to secure bank loans (Steijvers et al. 2010), and such pooling is less likely to occur outside of family owned firms.

[4] So called "relationship lending" may mitigate the common asymmetric information problems facing lenders since screening and monitoring functions are facilitated when there is a closer relationship between lender and borrower. For an overview of the relationship lending literature, see Boot (2000).

Finally, due to their long-term orientation (Lumpkin and Brigham 2011), based on the objective of perpetuating the family dynasty, priorities such as the long-term survival and reputation of the firm receive a great deal of attention by family owners. Commitment to the firm is further enhanced by the fact that family owners have a majority of their wealth tied into the equity of the firm and therefore prefer more conservative investment strategies since they bear all the risk (Fama and Jensen 1983). It may be for this reason that the typical agency problems between lender and borrower are suggested to be mitigated by family ownership (Chrisman et al. 2004). Long-term objectives combined with a greater commitment signal to lenders that family firms intend to repay their loans, reducing agency risks and increasing the likelihood of credit application approval (Blumberg and Letterie 2008).

The discussion thus far leads us to believe that, as far as the supply of debt financing is concerned, family ownership can mitigate the causes of credit rationing by banks. If family firms in fact had better access to bank credit, all things being equal, we would expect family SMEs to utilise more debt financing from banks relative to their non-family counterparts.

Other, less orthodox, sources of debt financing may include loans from related or unrelated individuals and businesses (Harvey and Evans 1995). Successfully accessing such sources of debt finance can be related to what the other researchers have called organizational social capital, which refers to goodwill and resources a firm amasses because of its connections and relationships with others (Arregle et al. 2007). In the case of SMEs, relations between the firm and its stakeholders are likely to reflect personal relationships to a much higher degree than in larger firms where such relationships are more likely to be formalised.

In this regard, family SMEs may be disadvantaged since, as a result of their tendency to focus on building interpersonal networks with internal contacts within the family, they may fail to cultivate external networks with more diverse stakeholders outside of the family (Salvato and Melin 2008).

The notion that family firms have fewer external networks has lead researchers like Rosessl (2005) to hypothesise that family businesses tend to be less willing to enter into cooperative arrangements with outsiders, as many characteristics of family businesses have a hindering effect on such cooperation. In other words, external sources of debt financing are often not well known by family firms, and their networks are poorly structured, making access to them difficult.

Further, the Pecking Order Hypothesis developed by Myers and Majluf (1984) proposes that when firms have information that outside investors do not have, firms will prefer internal over external sources of finance. This approach can be explained by a desire to minimize the transaction costs of raising finance, which becomes especially important in the context of SME finance (Chittenden et al. 1996). Considering a pecking order, Romano et al. (2001) have found that small family businesses in particular tend to rely heavily on family loans, rather than loans from outsiders as a source of finance. Consistent with their non-economic objectives, these preferences protect the family's influence over the firm's operations.

However, from a financing perspective, lower social capital with outsiders would hinder the family firm's ability to access these sources and limit them, to some extent, to internal sources of debt finance. This coupled with a strong preference for internal loans from family implies that family firms will utilise more internal rather than external sources of debt finance.

4.2 Family equity financing

Since SMEs typically do not reach the required scale to issue shares on organised equity markets, they tend to rely heavily on internal sources of equity like private equity and retained earnings. For SMEs, financing preferences consistent with a pecking order theory have empirically been shown to hold (Cassar and Holmes 2003). That is, the most commonly utilised sources of SME private equity are raised from internal resources, such as the principle owner themselves (including retained earnings), followed by their family and friends (Berger and Udell 1998). Lower on the order of preferred equity sources is equity raised from external resources, such as venture capitalists, unrelated individuals and eventually organised equity markets (Myers and Majluf 1984). Similar to the case of debt financing, family ownership is also expected to influence the utilisation of these sources of equity financing in both a positive and negative way.

On a positive note, as per the family business literature, patient capital is a valuable asset for family firms (Sirmon and Hitt 2003). Patient capital refers to the equity holder's ability to focus on long term, rather than immediate, returns. Family owners are thus not as accountable for short-term results as nonfamily firms. For example, the presence of family owners, with their increased time horizon[5], may reduce the riskiness of an investment and hence the risk-equivalent cost of equity capital (Zellweger 2007). However, it is important to consider that a reduction of investment risk might also relate solely to internal, rather than external, equity providers. A tendency for internal equity providers to be more "patient" could in turn translate to a greater availability of equity from such sources.

Further, due to an intermingling of business and family finances in family owned businesses, there are potentially more sources of internal working owner equity for family firms than in non-family firms. Sirmon and Hitt (2003) refer to this advantage as survivability capital, which represents the pooled personal resources that family members are willing to loan, contribute, or share for the benefit of the family business (Dreux 1990; Haynes et al. 1999). Although it is understood that SMEs in general will rely heavily on such sources of equity, greater patient and survivability capital, along with the tendency to build a strong equity base over time through the retention of profits (Poutziouris 2001), would suggest that family firms may access internal equity, such as equity from working owners and retained earnings, more so than non-family SMEs.

In addition to the reasons already discussed, and since we are curious about the composition of equity finance, we may also find a higher proportion of working owner capital in family firms due to the notion that family owners‟ first financing objective is not to lose control of the business (Lopez-Gracia and Sanchez-Andujar 2007). Thus, if the family firm were to raise external equity, it would be from related sources such as other non-working family members and friends, rather than unrelated individuals or businesses. Thus, on the negative side, family firms have limited sources of external financial capital because they avoid sharing equity with nonfamily members (Sirmon and Hitt 2003).

Although family ownership may reduce the asymmetric information problems associated with internal equity holders, asymmetric information between current family owners and

[5] Zellweger (2007) argues that family firms display a longer time horizon than most of their nonfamily counterparts, since family firms display a longer CEO tenure, and strive for long-term independence and succession within the family.

prospective external investors may be enhanced due to the family firm's strong preference to maintain control (Schulze et al. 2003). Adherence to a pecking order of financing sources in itself would imply that family owners have information that outside investors do not, and in turn this would in turn raise the transaction costs of external equity financing. The notion that family firms are more opaque further enhances this information asymmetry problem (Bianco et al. 2012). Evidence of this has been presented in the literature. For example, using different approaches, Mahérault (2000;2004), Poutziouris (2001), and Lopez-Gracia and Sanchez-Andujar (2007) all have found that the financial development of family firms with regard to equity is governed by a "keep it in the family" tradition.

Together, these characteristics suggest that family SMEs tend to have a more limited external equity financing base, but a wider base of internally generated equity.

5. Empirical Evidence:

Using the same sample of firms presented in Table 1, and controlling for industry over a four year period, many of our expectations regarding family firm financing proportions are supported by the results presented in Figure 2.

Specifically, on average, we find that, as a proportion of total debt and relative to their non-family industry peers:

- Bank debt is greater for family firms
- Loans from internal sources are greater for family firms
- Loans from external sources are lower for family firms

With regards to equity financing, on average, we find that, as a proportion of total equity and relative to their non-family industry peers:

- Equity from working owners is greater for family firms
- Equity from internal sources (excluding working owners) is greater for family firms
- Equity from external sources is lower for family firms

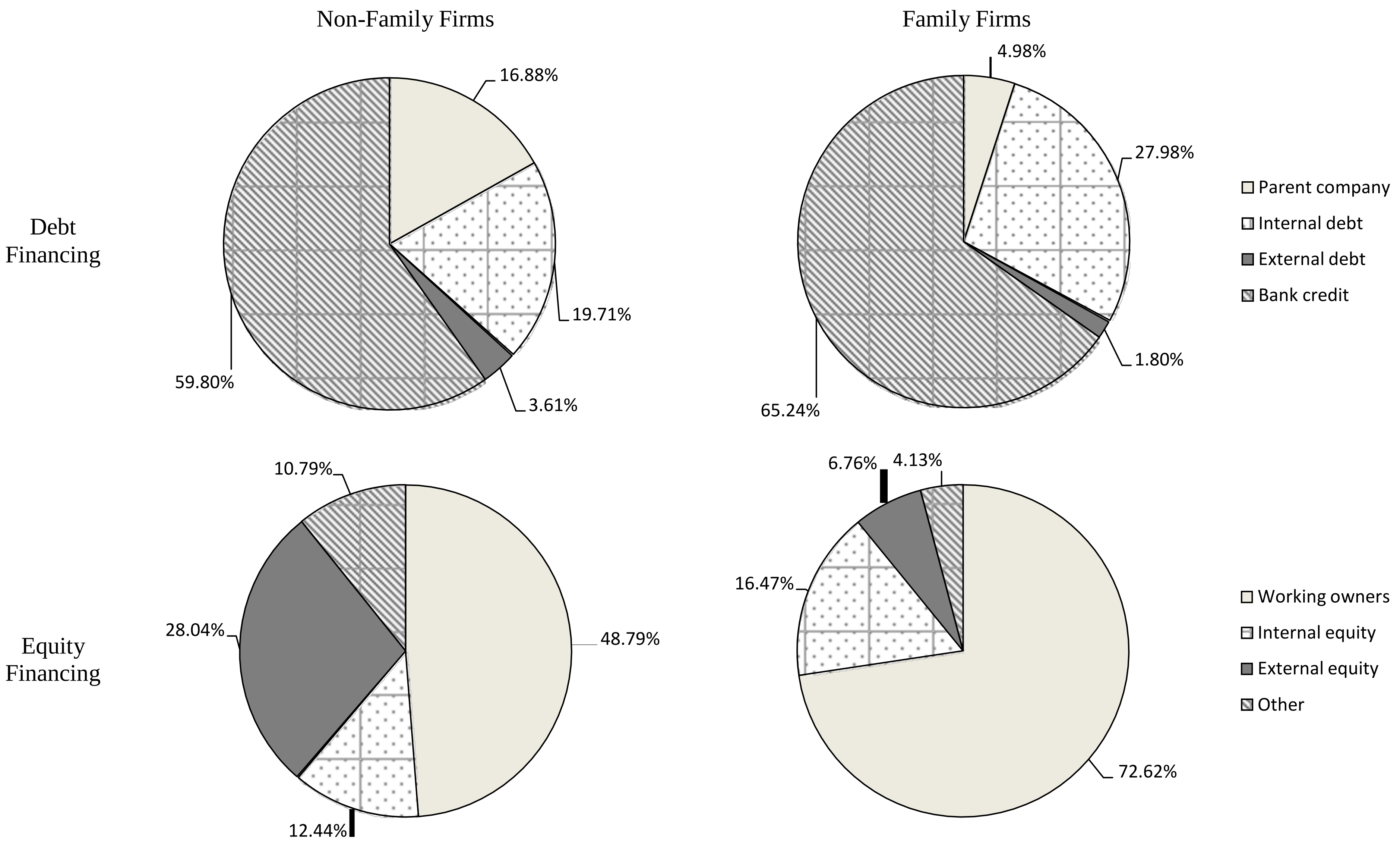
The above differences have all been found to be statistically significant with 95 percent confidence and reinforce the literature on the unique behaviours and characteristics of family SMEs in terms of the supply and demand for financing discussed in this submission.

6. Policy recommendations:

In relation to an SME financing gap, much policy emphasis has been place on supply-side issues i.e. resolving the notion that SMEs cannot obtain financing due to deprived access, but what this submission wishes to draw attention to are the unique demand-side issues specifically related to family owned firms i.e. family owners have a strong aversion to relinquishing control, which may result in sub-optimal levels of both debt and equity financing by choice. Given their prevalence in the Australian economy, such outcomes may inhibit economic growth. For example, a reluctance to issue both debt and equity finance may result in scale inefficiencies i.e. family business may have a tendency to be sup-optimally small.

With that said, policy designed to overcome issues related to an SME financing gap would potentially be more effective by acknowledging the distinctive financing outcomes related to family ownership reported in this submission. For example, economic and social growth may be promoted by providing education to family owners in terms of enhancing their ability to recognise viable external sources of finance, and the potential efficiency benefits associated

Figure 2: *The debt and equity financing compositions of family and non-family firms*[c]



[c] Proportions are based on industry averages over a four year time period.

with such partnerships. Further education should be provided to the suppliers of finance in terms of the priorities and resulting preferences of family owners as a means to successfully target and penetrate the family business market. Other economic benefits could be realised by policies which encourage and facilitate entrepreneurship and new venture creation within families given that family businesses rely heavily on the family unit itself as a primary source of finance.

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