EVALUATING FAMILY FIRMS FINANCES IN DEVELOPING COUNTRIES
by Rafiu Akinpelu Olaore

Family firms dominate economic sectors of most developing countries, in particular, Nigeria. The financing of family firms has been a collective effort of most family members. The business has been a major source of living so, its growth and finances are paramount in their minds. In Nigeria, the vast majority of publicly traded firms are family-owned. The study gives insights into a strategy for accumulating cash and possibly protecting assets from creditors, generation of start-up capital and financial management of the business. It includes challenges in sourcing for a fund, the growth of the firm, and contribution to economic development. It further evaluates the family firm survivability in financial distress and effect of paternalism on its operation. The findings suggest that Government and financial institutions should focus more on financing family businesses to spread entrepreneurial firms to sustain economic growth and national development.

Introduction

Among distinct types of Small and Medium Enterprises is family firm and is fast becoming the dominant form of business enterprise in both developed and developing countries (Bridge, O'Neill, and Cromie 2003; Ryan 1995; Phillips 2011) and are distinguished for their role in driving entrepreneurship and economic development. Family firms have been recognized as an important governance structure of business organizations in both developed and developing economies, with a substantial impact on the development of national economies (Demsetz and Lehn 1985; Phillips 2011).

The type of financing family firms need and receive at various stages of their growth are very significant, including the nature of the private equity and debt contracts associated with this financing, and the connections and replaceability among these alternative sources of finance (Berger and Udell 1998).

SMEs have increasingly become the focus in Nigeria banking industry, with banks introducing products and services targeted at attracting patronage from them. It is beside the two hundred and twenty billion naira only N220 billion ($1.1billion) established by the Central Bank of Nigeria (CBN) for Micro Small and Medium Enterprises (MSMEs) in 2014. In line with this trend, Banks unveiled the SME Club and different empowerment programmes which offers preferential business support, products and services to MSMEs across the country, and to enhance their financial, marketing and management skills (Komolafe 2015). Financial intermediaries perform a critical role in the private markets as funding information producers by assessing the small business quality and address information problems through the activities of screening, contracting, and monitoring (Berger and Udell 1998).

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The purpose of this article is to provide an overview of the family firms' finances and examine its contribution to the national development. Entrepreneurial finance differs from traditional corporate finance only in the sense that the magnitude of these two problems is larger, thereby requiring contractual solutions that differ from those typically encountered in larger, more established corporations (Denis 2004). The paper highlights the literature through evaluation of alternative funding sources, observations and recommendations for further studies.

Literature review

The challenge that exists in business is not only about the establishment of a new venture, but firm sustenance, avoidance of business failure, expansion and enhancement of its contribution to national economic development (Phillips 2011). Family firm's shareholders inactive in the business, with little understanding of management and the time cycles involved in new strategies or new investments, can hamper the company's effective operation (Poza and Daugherty 2013). Cromie, Stephenson, and Monteith (1995) emphasised that families are very keen to control the issue of shares and are not keen on selling shares to raise finance for growth.

Many of the family firms have a short average lifespan, and many firms do not survive more than five years. This lack of survival is often attributed to poor business management such as location or inadequate financing. Personal and family reasons also account for business closures and financial problems were indicated as a major non-personal reason for business closure (Duncan 2003; Phillips 2011). The majority of family firms have a suboptimal capital structure that relies heavily on internally generated capital, which not only inflates these firms' average cost of capital and hence suppresses their value but also limits the rate of firm growth to the growth of internally generated assets (Welsh, Dianne, and Zellweger 2010; Schulze and Dino 2004).

According to Khan and Butt (2002) "while entrepreneurs cited inadequate financial support from lending institutions as a major impediment to starting entrepreneurial ventures, bankers cited inability to evaluate the personal characteristics of entrepreneurs as a barrier in supporting them." In his view, Denis (2004) found that the existence of multiple sources of financing raises the question of whether the source of funding matters for the entrepreneurial firm.

Khan and Butt (2002) stated that family advice, family business exposure, previous start-up experience, and entrepreneurial experience are credibly required for firm's financial stability and growth. Postponing further expansion due to lack of funding has been identified as one of the most challenging trends among SMEs. While it is positive that SMEs are getting better at eliminating costs and improving cash management, delayed investments create havoc with their growth plans (Khan and Butt 2002), so, in the end, this will have a negative impact on national economies. Lack of easy access to finance, enables the loss of new jobs and investments in national economic growth. Vijverberg (1992) expressed that the family firms income measures may be fairly imprecise because there is no yardstick by which to evaluate those measures separately, but a comparison among them and with measures of enterprise size forms the foundation of the evaluation. The family may not be able or may not choose, to provide sufficient management or financial resources for growth, and families are not keen on using outside advisers as they dominate boards and senior management positions (Cromie, Stephenson, and Monteith (1995). Moreover, even publicly owned companies can continue as

"family businesses," if management or financial control is maintained by the family (Lussier and Sonfield 2004).

What is a family business?

One of the problems of identifying and describing family businesses is the variety of definitions (Bridge, O'Neill, and Cromie 2003). Phillips (2011) stressed that a family-owned business is an enterprise in which a family has significant ownership and control, which may or may not be in a majority but holds significant influence. The family includes (spouse, offspring and adopted children) immediate relatives (grandparents, parents, siblings) and extended family members (aunts, uncles, cousins, nephews and adopted children).

The 2008 report of the Institute for Family business, UK states that a firm qualifies as a family business if it meets the following criteria;

-the majority of votes are held by the person who established or acquired the firm, or their spouse, parents, child or child's direct heirs, and

-at least one representative of the family is involved in the management or administration of the firm.

-in the case of a listed company, the person who established or acquired the firm, or their family, possesses twenty-five percent of the right to vote through their share capital, and that there is at least one family member on the board of the company.

-for micro (typically sole traders) businesses, subjective criteria are also needed. In particular, in the BIS Annual Business Survey firms are asked to self-identify as either family or non-family businesses (Institute for Family business, UK 2011).

SME Finance

Small and Medium Enterprises (SMEs) are critical to the development of any economy as they possess great potentials for employment generation, improvement of local technology, output diversification, development of indigenous entrepreneurship and forward integration with large-scale industries. In Nigeria, there has been gross underperformance of the SMEs sub-sector, and this has undermined its contribution to economic growth and development. The key issues affecting the SMEs in the country can be grouped into four namely: unfriendly business environment, poor funding, low managerial skills and lack of access to modern technology (FSS 2020 SME Sector Report, 2007).

Among these, shortage of finance occupies a very central position. Globally, commercial banks that remain the biggest source of funds to SMEs have in most cases, shied away because of the perceived risks and uncertainties. In Nigeria, the fragile economic environment and absence of requisite infrastructure have rendered SME practice costly and inefficient, thereby worsening their credit competitiveness (Central Bank of Nigeria, 2015).

Demand for external finance

Theoretically, internal finance is more inexpensive and involves less risk than external finance to fund investment projects and working capital and (or) cash flow needs. The decline in the availability of internal finance to family businesses increases their demand for external finance (IFB, UK).

Purpose for acquiring finance

The family firm acquires finance to develop the business and primarily for its sustenance and expansion. In most cases, firm access external finance for seed capital or either to acquire working capital for growth and to fund current operations or in order to fund capital investment (Institute for Family business, UK. 2011). Family firms financing through Micro credit Institutions in the developing countries is an effective way to spread entrepreneurship and innovation among the family members and facilitate the expected requisite skills and employment opportunities.

The types of external finance for family business

Bank loans and overdrafts are the common forms of external financing for the family business. The types of finance available to firms are thought to vary with size. Smaller firms are typically thought to be dependent on bank finance, while their larger counterparts have greater access to the financial markets, although banks remain their primary source of external funding (Institute for Family business, UK. 2011). Family firms need to be consulted and supported by Commercial banks in a specific way, assuring that their independence goal and their willingness to finance investment projects with equity is respected. Only once a secure reference point with low leverage is achieved; family firm owners will be demanding for debt financing from banks (Mishra and McConaughy, 1999; Welsh, Dianne and Zellweger, 2010). In addition to borrowing from the bank, Poza and Daugherty (2013) suggested that the family should consider the deferment of shareholders dividend distributions and reinvestment of all company's cash flows to fund growth.

Sources of Family Firms Financing

Trade credit: Procurement of goods and services, equipment and supplies on credit from suppliers is an added advantage to family business development. This method saves cost, and the larger portion of small business financing comes from trade credit sources.

Borrow from lending Institutions: In a situation where equity capital from family members is not sufficient for the expansion of the firm, then, borrowing money from banks, or other financial institutions or individuals are essential.

Equity financing: The major sources of equity financing for most family firms are fund from family members (personal savings), friends, and venture capitalist. Extending the ownership of the business to the member of the family, by taking part as shareholder generates capital for the business.

Retention of profits: Reinvestment of profits into the business enhances the opportunity for firm growth. Instead of sharing the whole profits among the family firm participants, it will be vitally necessary to plough back the larger part of the profit into the business for sustainability and growth.

Leasing: Leasing of equipment, land, and other business fixed assets reduce the cost and provide access to modern technology.

Access to finance

Access to external finance has to be a major problem for most family businesses. Among the constraints are the ability to take financial risk, family stakeholders decisions, and, terms and conditions that businesses had to fulfil to obtain loans (such as the provision of collateral security). Financial Intermediaries screen the firms by conducting due diligence, including the collection of information about the business, the market in which it operates, any collateral that may be pledged, and the entrepreneur managerial capability or start-up team (Berger and Udell 1998).

Recommendation

With the clear entrepreneurial responsibilities of family firms, the government and financial intermediaries' attention should be on family firms' ability to generate revenues for national development. Another potential area for family business growth is government action towards the firm accessibility to basic supports, such as market intelligence, Research and development, conducive environment and government grants. According to the International Finance institutions, (2012), the Apex bank can make a significant contribution to improving access to finance by providing capital and technical assistance to local intermediary banks. It further recognises the role of stimulating small business lending by effective and cost-efficient cooperation with local partner banks, applying strict lending standards and using expertise from similar situations in other markets. Improving SMEs access to finance and reducing constraints to small business growth are key goals for the economic development developing countries.

The effectiveness of the board of director's functions, owner's plans, shareholders meeting and family meetings are few ways to make family firms growing financially (Poza and Daugherty 2013). Millions of small and growing businesses in emerging markets need capital to grow. With the necessary financing, these firms could create millions of jobs and drive sustainable economic growth in the developing world. Global finance community is required to develop new incentives, new investment models, and new financing mechanisms to drive this growth."

Conclusion

Family businesses are very complex, and simultaneously vital to the wellness of an economy and to the life satisfaction of millions of people (Gersick, Davis, Hampton, and Lansberg 1997). It is clear that SMEs and family firms have a vital role to play in the global economy, and it will be difficult to exercise their functions in the absence of adequate capital. Khan and Butt, (2002) opined that the role of family advice and exposure to family businesses can be particularly useful, especially in low trust environments where the radius of trust does not extend beyond the immediate family. The literature explained various financial challenges to family firms and the paper suggested few ways of generating finances among the family members to spread entrepreneurship and innovation, and most importantly job opportunities that will promote economic development.

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