Chapter 14
Leverage and Family Firms:
A Multi-Theoretical Approach

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ABSTRACT

This chapter analyses the relationship between ownership structure and leverage, providing an integrated theoretical approach that combines traditional financial theories, agency theory, and recently developed theories relating to non-financial preferences. The results show that, after controlling for endogeneity, being a family firm has a positive effect on the propensity to incur debt. These findings add to the existing body of literature and underline the need for a multi-theoretical approach when explaining the capital structure of family firms. The authors apply panel data methodology to control for individual heterogeneity of family firms. The chapter uses a sample of Spanish firms operating in the tourism industry.

INTRODUCTION

Despite intense research efforts to analyse the capital structure of family firms, the empirical results have not been entirely conclusive (Schmid, 2013). Although the literature has striven to uncover the inherent causes of the use of debt or equity capital in family firm financing, it reports contradictory effects. While some authors have pointed to a negative effect (Margaritis and Psillaki, 2010; Ampenberger, Schmid, Achleitner and Kaserer, 2013), others have found positive (González et al., 2013; Croci et al., 2011) or non-significant relationships (Bjuggren, Duggal, and Giang, 2012).

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This diversity of empirical results may arise from the fact that classical theories of finance cannot deal with the heterogeneity in family firms. Family firm research is underpinned by agency theory (Jensen & Meckling, 1976) and stewardship theory (Davis et al., 1997), with the supposition that there is closer alignment between owners and managers in family firms, and lower agency costs. The main implication of this hypothesis is that family firms have less need to use debt and dividends as part of their corporate governance systems.

On the other hand, pecking-order theory (Myers, 1984; Myers & Majluf, 1984), as well as new theories based on motivations and preferences—including the theory of preferences (Hutchinson, 1995; Romano, Tanewski & Symyrnios, 2001), the SEW perspective (Wiseman & Gómez-Mejía, 1998; Gómez-Mejía et al., 2007), and the theory of planned behaviour (Koropp et al., 2014; Ajzen, 1985)—point in the opposite direction. Specifically, they hold that in family firms, the desire to maintain control, along with the socioemotional wealth and the social capital invested in the firm, make family firms more oriented towards higher leverage levels.

In order to shed light on the debate about the capital structure of family firms, and in line with the growing academic interest in this subject (Le Breton-Miller & Miller, 2014), this study combines the abovementioned theories to construct an explanatory theoretical framework for the relationships between ownership, financial considerations, non-financial preferences and leverage. In a second stage, the theoretical framework is empirically tested in order to gain a better understanding of the relationship between family firms and leverage. This model is tested using data from 1019 Spanish tourist firms.

This study contributes to the literature on the relationship between ownership structure and financing decisions regarding the use of leverage. Specifically, it shows that, after controlling for endogeneity, being a family firm has a positive effect on the propensity to incur debt. This finding is to be expected given family firms' intense desire to maintain social control and socioemotional wealth.

The system GMM estimator is used to deal with the potential endogeneity problem in the analysis. Additionally, a panel data approach is used to avoid biased coefficients due to unobservable heterogeneity; this is a particularly relevant issue in in family firm research because of specific unobservable characteristics that may affect the models (Chi, 2005).

BACKGROUND

There is no universal theory that can explain the diversity of factors affecting firms' financial structure (Myers, 2001). According to Michiels and Molly (2017: 371), the predominant theoretical framework in the current study of financial decisions in family firms is agency theory, followed by traditional theories of capital structure, such as pecking-order theory and trade-off theory.

Pecking-order theory (Myers, 1984; Myers & Majluf, 1984) highlights the costs and problems stemming from information asymmetries as the key factor determining imperfections in the capital structure. Information asymmetries between managers and investors create uncertainty in all financing negotiations. This results in increased costs (for example, arising from the demand for more information) or a higher rate of return required by the financier. In this context, managers prefer to draw on internal financing to prevent information asymmetries and their associated costs, applying maximum managerial discretion in the use of these funds. Thus, they only resort to the capital market when the firm has insufficient financial resources of its own. However, if it becomes necessary to secure external financing, managers also tend to prioritize the different possibilities. In this case, they first opt for debt, which, although af-