



Impact of Family Control and Influence on Financing Decisions of Family Firms: A Case of Pakistani Family Firms in the Prospective of Socioemotional Wealth

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ARTICLE INFO	ABSTRACT
<p>Article History: Received: January 27, 2023 Revised: March 25, 2023 Accepted: March 26, 2023 Available Online: March 27, 2023</p> <p>Keywords: Financing Decisions Socioemotional Wealth Family Firms</p> <p>Funding: This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.</p>	<p>This study focuses on the financing choices of family firms under the umbrella of Socioemotional wealth. It investigates how a family firm makes its financing policy based on persuasion of a non-financial goal which is the need to maintain family control over the business. In the context of non-financial Pakistani listed firms in the Pakistan Stock Exchange, with data range starts from 2009 to 2020. Our results show that family firms with a high need to maintain their family control over the business have high debt levels. Similarly having family representation on the board shows a positive relationship with debt financing. We also conclude that having a family CEO is also linked with the use of extensive debt. Our findings are consistent with the view that Socioemotional wealth is an important determinant of making important financial decisions.</p> <p>© 2023 The Authors, Published by iRASD. This is an Open Access article distributed under the terms of the Creative Commons Attribution Non-Commercial License</p>

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1. Introduction

The topic of optimal capital structure for family businesses has been widely studied in recent years, but there are still some unresolved questions (Motylska-Kuzma, 2017). Historically, research has focused on traditional theories of capital structure, such as the trade-off, pecking order, and agency theories, to compare family-owned and non-family-owned firms (Jensen & Meckling, 1976). These theories, which are based on business and economic perspectives, are appropriate for non-family businesses, but they do not provide clear results when applied to family firms with a combination of economic and non-economic goals (López-Gracia & Sánchez-Andújar, 2007).

In family businesses, the most important strategic choices are often based on non-economic factors. This is why a theory that mainly focuses on a non-economic perspective, rather than solely financial goals, is necessary (Vincent Molly, Lorraine M Uhlener, Alfredo De Massis, & Eddy Laveren, 2019b). These non-financial goals are referred to as socioemotional wealth (SEW) of the family business. SEW is defined as the "non-economic factors of a firm that must be focused on in order to preserve the familiness of a firm" (Berrone, Cruz, & Gomez-Mejia, 2012). The preservation of familiness is a unique characteristic that separates family firms from non-family counterparts. This familiness can include factors such as family identity, family involvement, control of the business, and preservation of the family dynasty (Gomez-Mejia, Cruz, Berrone, & De Castro, 2011). Therefore, assuming SEW is the main element based on which most strategic decisions are made, it is important to understand it more in depth in theory and literature (Martin, Campbell, & Gomez-Mejia, 2016b).

SEW plays a crucial role in shaping important decision making and guiding them towards non-economic goals rather than solely business goals (Berrone et al., 2012). As the preservation of familiness is a priority for owners of family businesses, they tend to prioritize family-focused goals over strategic financial goals (Blanco-Mazagatos, de Quevedo-Puente, & Castrillo, 2007).

However, it is important to note that SEW is a key factor in shaping policies for strategic financial decisions in family businesses, but the process of strategic decision making can vary within different family firms (Chua, Chrisman, & De Massis, 2015). In many studies, the primary focus has been on economic factors in family firms, neglecting the importance of familiness and the efforts to preserve it. To address this gap, some studies have attempted to focus on family-personal goals and their impact on financing decisions in family-owned businesses (FOBs) (Gottardo, Moisello, Gottardo, & Moisello, 2019; Molly et al., 2019b). However, limitations still exist in these prior studies due to methodological flaws and invalid measures of certain variables. As a result, there is a need for further research in this area to overcome these limitations.

The current research aims to investigate the effect of family control and influence on financing decisions in the context of Pakistani family firms. Financing decisions are crucial in the life of a family business, as it is their primary source of finance (Thiele & Wendt, 2017). The study hypothesizes that the desire to preserve family business control and influence may result in high debt levels. Additionally, the research aims to explore the impact of family board representation on the use of debt and the effect of having a CEO from the family on the use of more debt.

By examining these factors, the study aims to address the need for further research on the key differences in attitudes and decision-making criteria between family and non-family firms. All of the variables being studied are related to the goal of maintaining family business control over the business and are expected to impact the financing patterns of a family firm. The study will use a sample of Pakistani family businesses and analyze the data empirically.

In context of Pakistani economy, Family firms are playing a vital role in sustainability and economic growth of the country (Tahir & Sabir, 2015). They also identified that many of the companies which are publicly listed on the PSX are managed by various family groups. According to Shahid et al. (2018), there are currently 441 companies from the non-financial sector listed in PSX. Among them 80 percent are family firms based on different proportions of ownership.

Research on family business contributes to the field in several ways. First, we have tried to address the financial policy of a family corporation that completely depends on their non-financial goal that is desire to protect family business control. Furthermore. This research is based upon the SEW theoretical framework, and it addresses the need to focus on other theories rather than traditional capital structure theories. Secondly this paper focuses on heterogeneity issues of family firms, as every firm is different from each other in terms of family business control.

This paper has 5 sections. Section 2 is dedicated to the literature review, hypothesis development and research framework. Section 3 includes sample, variable names and methodology for conducting analysis. Section 4 shows the empirical findings and their interpretation, lastly, in section 5 discussion and conclusion is present about this research.

2. Review of Literature and Hypothesis Development

2.1. Conventional Financial Theories

In prior literature of family businesses, pecking-order theory is supported more oftenly (Jensen & Meckling, 1976). Because of the information asymmetry, family businesses are very likely to consume internal funds as their first funding source, then comes debt and then equity. Use of retained earnings and debt financing serves against the issue of ownership dilution which can be risky for family businesses (Gottardo & Moisello, 2019). These researches put a very little emphasis on dimensions of SEW, not knowing the fact that preservation of socioemotional wealth is a motivation behind extensive use of funds from internal sources and debt (Vincent Molly, Lorraine M. Uhlaner, Alfredo De Massis, & Eddy Laveren, 2019a). The use of equity comes at the last resort, just to retain the family business control. This matches with the SEW framework proposed by (L. R. Gómez-Mejía, K. T. Haynes, M. Núñez-Nickel, K. J. L. Jacobson, & J. Moyano-Fuentes, 2007).

Another important theory of capital structure is trade off Model which describes that an optimal capital structure somewhere lies between the trade-off between cost and benefits of having debt financing (Margaritis & Psillaki, 2010). This trade-off differentiate this theory with the formal having no targeted capital structure ratio. Mostly family businesses adopt these

traditional theories of capital structure ignoring the non-financial aspects of family firms (Michiels & Molly, 2017). However the thought process behind the decision making about borrowings is still inconclusive. (Ampenberger, Schmid, Achleitner, & Kaserer, 2013b) suggest that family companies have less borrowings in comparison with non-family firms while Lozano-Reina, Sánchez-Marín, and Baixauli-Soler (2022) concludes that family businesses are using excessive debt to fund their investment needs. Still literature merely accepts the contribution of non-financial goals in making financial decisions.

Few researchers raise the issue of focusing on newly proposed frameworks like SEW theory to address the family business financial decision making process (Molly et al., 2019b). There it is really necessary to focus on the frameworks that lead to the non-economic perspectives of the family businesses decision making (Romano, Tanewski, & Smyrniotis, 2001)

2.2. Preservation of Family Control and Use of debt

Financing choices in family corporations are not only formulated in pursuance of financial goals, but also by family non-economic considerations like family culture, need for maintaining family control and influence on the business (Koropp, Kellermanns, Grichnik, & Stanley, 2014). Therefore, prior studies have concluded that the financing choices of family owned businesses are very different in comparison with non-family business (Ampenberger, Schmid, Achleitner, & Kaserer, 2013a). In view of just family businesses, they are observed to be heterogeneous as well because need to preserve their control is different among different families. so this makes SEW theory quite an interesting determinant to validate the reason of having different financing choices in their development of financial policy (Chua et al., 2015).

In the light of SEW Umbrella, the main point of focus for family business owners is to preserve SEW according to their mindset and preferences (Martin, Campbell, & Gomez-Mejia, 2016a). non-economic goals become the top priority and financial goals become less important relatively. The passion to protect the family control and influence may lead to impact on important strategic decisions such as: diversification, going global, accounting choices, financial decisions like financing and investment decisions and decisions to innovate the business (Worek, De Massis, Wright, & Veider, 2018).

In Between all the important strategic decisions mentioned, Molly et al. (2019b) was the first to inquire the impact of non-business goals on the financing choices of family corporations. The sample was based upon family SMEs in Belgium; they concluded that the need to maintain family business control has an indirect impact on financing decisions with the help of family board representation. If we go deep into SEW theory, there are two different point of views from different researchers.

First view is, family businesses with a higher wish to protect socioemotional wealth will make strategy to maintain strict ownership concentration, therefore opting for debt financing. The main motive is to maintain its control over family business (Hadjimanolis & Poutziouris, 2011). Concluding this argument, a positive and significant relationship is expected among Family control and Debt Financing (Gottardo et al., 2019).

The other point of view is in comparison to generating funds through retained earnings and debt as the other source, the need and desire to retain family business control is observed to have a negative effect on debt levels. Family Firms likely to avoid financial risk and intrusion from the financial institutions by maintaining low debt levels and to use internal funds as financing source (Schmid, 2013). In this regard, high debt levels lead a firm to financial distress which may possibly bankrupt a family business. Thus losing all the control and influence over the business they establish. By keeping both points of views in mind, desire to retain family business control is a very important determinant in making financial decisions. As the need to avoid ownership dilution and a motive to retain the controlling rights a firm prefer to generate funds from debt rather than issuing external equity (Molly et al., 2019b) whereas business growth of a firm also may prefer a firm to use high debt levels (González, Guzmán, Pombo, & Trujillo, 2013).

We are expecting a positive impact of Preserving family control on debt financing to negate potential negative effects. This positive impact is endorsed by the argument that the

motive to maintain the controlling ownership rights of a family firm and to protect the SEW will allow family firms to rely more on debt as compared to external equity source (Molly et al., 2019b). We proposed the following Hypothesis:

Hypothesis 1: Family Control retention in family business positively affects level of debts.

2.3. Family CEO vs Non-family CEO

The position of CEO in a business is an esteemed position having all the management under its control. Decisions made by CEOs are the primary reason for the success of a company (Waldkirch, 2020). Control of family over the business increases if it is managed by a person who also belongs to same family (Berrone et al., 2012). In case of having family member as a CEO will definitely try to focus more on family goals and make policies that can help in maintaining family control and influence.

According to SEW theory, A family CEO has a strong preference for the preservation of family control (Kraiczy, Hack, & Kellermanns, 2015), leading the firm to take low risks and often sacrifice financial goals in order to serve non-financial goals. Whereas a CEO from outside the family will take risk just for the sake of getting profits and focuses only on financial growth of the company (Sciascia, Mazzola, & Kellermanns, 2014). A family CEO will seek to maintain control of the family as his top priority as compared to his non-family counterpart (Sánchez-Marín, Meroño-Cerdán, & Carrasco-Hernández, 2019).

The motive to preserve family control over the business leads a family CEO to avoid high equity financing levels as it can lead real owners to lose their voting power because of ownership dilution (Mishra & McConaughy, 1999). The approach of the family CEO is to address the financial goals without taking any decision which may endanger family control over the business (Huybrechts, Voordeckers, & Lybaert, 2013).

In this regard, Corbetta and Dawson (2011) concludes that a family firm with a non-family CEO may result in high preference of equity financing as it is a cheaper source as compared to debt-financing and it can be disastrous sometimes as the family may lose control and external intrusion becomes unavoidable (Kraus, Mensching, Calabrò, Cheng, & Filser, 2016). So, if a CEO of a firm belongs to a family, we propose that the effect will be positive in using more debt for a family business.

Hypothesis 2. A CEO from the controlling family positively influences the debt-level of a family firm.

2.4. Family Board Representation

In family businesses the Board basically comprises only family members or a majority of family members (Gallo, Tàpies, & Cappuyns, 2004). Under such a scenario it is worth mentioning that a family's ability to preserve its control over the business increases as the family is having a strong representation on board (Chrisman, Chua, De Massis, Frattini, & Wright, 2015). Such a board can easily impact the key strategic decisions like whether to issue shares or rely on external debt if a firm needs cash in order to expand its operations (Faghfour, Kraiczy, Hack, & Kellermanns, 2015).

Family business owners intentionally select family members to be a part of the board so that they can implement their own strategy just to retain the family control and influence (Jaskiewicz & Klein, 2007). Therefore the risk that the board may disapprove key decisions made to protect the family SEW is reduced (Anderson & Reeb, 2004). Comparatively, if a board consists of more members from outside, it will be more likely that they will prefer short-term profits and may forgo the family centered goals including the retention of control (Nordqvist, Sharma, & Chirico, 2014).

Based on the above arguments from studies in the past, we expect owners of family companies are likely to maintain their power and influence over the company, which is why they will increase the number of family members as board of directors. Because of their high representation they will be in position to pursue goals set to preserve SEW. Which means a family board can intervene in strategic decision making that includes financial decisions as well. Therefore from the above arguments we hypothesize.

Hypothesis 3. Having members in the family will positively influence the use of debt-financing.



Figure 1: Research Model Framework

3. Methodology

3.1. Sample and data

To examine the impact of SEW on financing decisions of family business, the data is taken from annual reports of the listed companies at Pakistan Stock Exchange. Financial data is collected manually from the financial section of annual reports. Data of Past 12 Years that is 2009-2020 is taken in this regard.

The main sample is based upon all non-financial firms listed in PSX. We exclude the financial sector because of the different nature of services they offer. Firms with the missing data are also removed. In the last family firms are identified using various protocols.

3.1.1. Family firm identification protocol

A firm is categorized as a family firm if it belongs to a specific group. That specific group must also hold more than 25 Percent shares in that company. GEEF, which is also called a group of owner managed enterprises, proposes a 45% cut off point. The Board of Family Business Network also adopts this cut off point. For this reason we also took a 45 percent cut off point for family firms, which means any family holding more than 45 percent of shares will be termed as family firm (Miller, Le Breton-Miller, Lester, & Cannella Jr, 2007). In Pakistani family firms the ownership threshold for family groups is almost 30 to 50 percent (Javid & Iqbal, 2010).

For family firm identification, we took the shareholding patterns from all annual reports of non-financial companies. We identify family groups with more than 45 percent share or voting rights. We use the surname approach to identify the family directors who are also shareholders (Samara & Berbegal-Mirabent, 2018). For those companies where the information was somehow vague, we make phone calls to their head offices in order to confirm their origin as a family or non-family group. We found 41 companies with 45 percent family ownership with complete 12 years of data.

3.2. Variables

3.2.1. Dependent variable

This research focuses on the effect of family control and influence on its financing choices. Hence in financing decisions the main element is leverage. Therefore we took total debt taken as our dependent variable as suggested by Molloy et al., 2010. The motive behind taking total debt taken by company as a dependent variable is to consider both long-term and short-term debt. Short-term finance is a cheaper source of funds and it may help a firm to rely on without taking much risk of financial distress. Whereas long term debt can save a firm from having immediate intrusion from outside in case of equity financing. We proxy Tdebt as the ratio of total debt to total assets (Molly et al., 2019b).

3.2.2. Independent Variable

There are three independent variables used in this study. Our first independent variable is Fcontrol We took family ownership as a measure of degree of family involvement in preserving socioemotional emotional wealth. The variable of family ownership is proxied as the ratio of shares owned by a family and total no. of shares (Acedo-Ramirez, Ayala-Calvo, & Navarrete-Martinez, 2017).

2nd Independent variable of the current study is Family representation in the board. We proxify this variable as the division of total family executive directors by total no of board members (Molly, Laveren, & Deloof, 2010). Family board representation means the family is now able to propose and adopt policies which are necessary for the preservation of socioemotional wealth.

The 3rd independent variable in this study is CEO From the family. we take this variable as a dummy variable and proxify it as 1 or 0. If ceo belongs to the family then the value will be 1 or else it would be 0 (Lozano-Reina et al., 2022)

3.2.3. Control Variables

Focusing on the studies from the past on potential determinants of financing decisions, Our control variables are liquidity, firm size and firm cash flows (Lardon, Deloof, & Jorissen, 2017). Liquidity is quantified by the division of property plant and equipment over total assets. We took a natural log of total assets to proxify firm size. Cash Flow is measured as the ratio of cash equivalents over total assets. We expect a negative relationship between all control variables and debt level. Table 1 shows the details of all the variables we include in this research.

3.3. Methods

In this research we investigate the effect of SEW protection with the dimension of family control on the family business debt levels using different statistical techniques. We perform two different univariate analyses: Firstly we check descriptive statistics of variables present in the current study, 2ndly we perform correlation analysis to check if there is any issue. Furthermore we calculated VIF to see if any multicollinearity problem exists in our variables.

After applying the univariate tests, we test the very first hypothesis of our research using Ordinary least square regression, which is the impact of family control on financing choices of a company. We apply White test to see if there is an issue of homoscedasticity or heteroscedasticity (alternate hypothesis. We use a jarque bera test to see if the data is normally distributed. Our main model of this research paper is as follow:

$$Debt_i = \beta_0 + \beta_1 \cdot FCONTROL_i + \sum \beta_i \cdot FBOARD_i + \beta_1 \cdot FCEO_i + \sum \beta_i \cdot CVari + \epsilon_i \quad 1$$

Where Debt_i is dependent variable total debt a firm takes, Fcontrol, Fboard and FCEO are the independent variables representing family control, family board representation and family ceo respectively. Cvari represents our control variables which are size of the firm, cashflows of the firm and liquidity.

Table 1: Operational definitions of variables included in the study

Variable Name	Symbol	Variable	Operational Definition
Total Debt	TDEBT	Dependent	Quantified as the division of total debt to total assets
Family Control	FCONTROL	Independent	Quantified as the ratio of family shares to total shares
Family Board Rep	FBOARD	Independent	Ratio of family directors to total no of directors
Family CEO	FCEO	Independent	Dummy that is if CEO is a family member, then 1 otherwise 0
Firm Size	FSIZE	Control	Natural Log of total Assets
Liquidity	LIQUIDITY	Control	Property Plant and Equipment divided by Total Assets
Cash flow	CASH	Control	Ratio of Operational Cash flow to total assets

4. Empirical Findings

4.1. Descriptive Statistics

Table 2 depicts statistical characteristics of all the variables presented in this research. Characteristics like Arithmetic mean, Median and standard deviation of 492 observations. If you just look at the mean value of total debt is 0.37. Which explains that a family firm uses 37 percent debt on average. 63 percent of family firms have family members as CEOs.

Table:2 Descriptive Statistics

Variable	Obs	Mean	Std. Dev	Min	Max
TDEBT	492	.371	.17	.021	.862
FCONTROL	492	.544	.191	.203	.929
FBOARD	492	.427	.204	.04	.86
FCEO	492	.638	.481	0	1
LIQUIDITY	492	.522	.21	.074	.943
CASH	492	.066	.118	-.4	.486
FSIZE	492	15.354	1.402	11.979	18.727

4.2. Correlation coefficient

Table 3 provides correlation coefficients between all financial variables used within this study. We have calculated VIF values and they are less than 10 poses no risk of multicollinearity (Myers, 1990).

Table 3: Correlation coefficients

Variables	(1)	(2)	(3)	(4)	(5)	(6)
TDEBT	1.000					
FCONTROL	0.005	1.000				
FBOARD	0.429	0.071	1.000			
FCEO	-0.045	0.017	0.079	1.000		
FSIZE	-0.335	0.002	-0.307	-0.077	1.000	
CASH	-0.289	-0.053	-0.022	0.111	0.072	1.000
LIQUIDITY	-0.363	-0.037	-0.933	-0.053	0.207	0.012

4.3. Regression Analysis

In this study we use panel data to analyze the relationship between our dependent and independent variables. For this reason we used Fixed and Random effect models on our model. we use hausman specification test for proper estimation. The p value of the Hausman specification test is less than 0.05. So we use random effects in our panel estimation.

Table 4: Regression Analysis

TDEBT	Coef.	St. Err.	t-value	p-value	[95% Conf	Interval]	Sig
FCONTROL	.107	.045	2.36	.018	.018	.196	**
FBOARD	.61	.112	5.45	0	.391	.83	***
FCEO	.034	.013	2.72	.007	.01	.059	***
LIQUIDITY	.373	.105	3.55	0	.167	.58	***
CASH	-.268	.039	-6.83	0	-.345	-.191	***
FSIZE	-.03	.008	-3.77	0	-.045	-.014	***
Constant	.312	.171	1.83	.068	-.023	.646	*
Mean dependent var		0.371	SD dependent var			0.170	
Overall r-squared		0.237	Number of obs			492	
Chi-square		126.638	Prob > chi2			0.000	
R-squared within		0.204	R-squared between			0.257	

*** $p < .01$, ** $p < .05$, * $p < .1$

All of the independent variables of the study showing positive coefficients against dependent variables. All of them are significant at 0.01 and 0.05. Although the prior studies

provide mixed findings with regards to the impact of family control on firm debt financing. Our research points to the positive impact of family business control on using debt. This result is consistent with the argument that family firms use more debt as compared to equity just because they don't want any dilution in their ownership structure (Acedo-Ramirez et al., 2017; Poutziouris, 2011).

Family board representation shows a positive and significant relationship against debt financing which means family members, when becoming part of the board try to impact the key financial decisions such as debt financing. Using external equity may cause monitoring from other owners as well, so consistent with this logic, family firms tend to use debt financing by making a direct impact with representation on the board (Baek, Cho, & Fazio, 2016). The third independent variable that family ceo shows a positive and significant relationship with debt financing. The reason is family ceo is motivated to fulfill the desires of a family he belongs to. The need to preserve family control over the business is more aggressive in his role. The result is consistent with the studies of Gottardo et al. (2019); Pindado and Requejo (2015); Schmid (2013).

The control variable family size shows a negative and significant relationship with debt level, because of the reason big firms use their own funds to fulfill their needs. Use of internal generated funds are risk free to use especially if a family firm avoids debt and equity financing. The other control variable used in a firm which is Cashflow shows a negative and significant relationship with debt financing. The argument behind this result is that if the firm already has enough cash, why would it go into debt.

The firm may use cash in possession to fulfill the need for funds, that is why firms with large cash holdings use low amounts of debt. Liquidity shows a positive and significant relationship with debt financing. It is interesting to see family firms with high capacity to pay their debt often prefer debt financing. The reason behind this is they are sure that they will not engage their business in financial distress. So a high liquidity ratio means the firm will use more debt just because they have the capacity to repay this debt with ease.

5. Conclusions and Discussion

Family businesses make important financial decisions under the intention of focusing more on non financial goals rather than financial goals (L. R. Gómez-Mejía, K. T. Haynes, M. Núñez-Nickel, K. J. Jacobson, & J. Moyano-Fuentes, 2007). Preservation of SEW in family firms has become an important element in the decision making process (Berrone et al., 2012). Therefore SEW is becoming a point of focus as well when structuring the financing model of a family business (Motylska-Kuzma, 2017).

The new findings presented in this research, in a context of Pakistani family firms is matched with the argument which SEW offers. Our results indicate that the more a family tries to maintain its control over the business, the more it will avoid equity financing as it involves a risk of ownership dilution. So the company focuses more on debt - financing. Therefore a positive and significant relation has been observed in this study.

In Pakistani family firms, the boards are often referred to as rubber stamp boards because the family members are part of the board and they mostly adopt the policies which are beneficial to their own family. Under the light of SEW, the most important point for a family is to retain their control over the business. That is why having family members on board may ease the policy making regarding the preservation of family control. In the present study family boards show a positive and significant relationship with the debt level. The more family members on a board there is more appetite towards preservation of family non-economic goals (Molly et al., 2019b).

In Pakistani family members mostly ceo are selected by board members. Having family members as a board of directors is likely to appoint family members as a CEO. In this way they bring more power to the cause of preserving their family control and influence over the business. Family CEO shows positive and significant relationship with debt level. All the three independent variables are showing the same course of action of SEW framework (Luis R Gómez-Mejía et al., 2007). Therefore we conclude that Pakistani family firms are having a strong need of preserving

their SEW. As the business owners do not want to lose the control of their business, that's why they are offering their shares in a way that their ownership concentration is not disturbed.

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