Capital structures in family and non-family firms: The effect on firm performance

by Manuel Vester

Manuel Vester graduated in June 2017 from the Master Strategic Management. Manuel was intrigued by the performance differences between family and non-family firms and tried to answer why these performance differences exist.

The existing literature has found that family firms on average tend to perform better than non-family firms. This study tried to explain how these performance differences arise. A possible explanation could be the different capital structures of family firms and non-family firms. The academic literature postulates that family firms are more risk averse and consequently use less debt. In addition, debt dilutes the influence of the family. Therefore, family firms tend to avoid financing their activities with debt. The leverage ratio of a firm has been related to the performance. If companies find themselves in an unstable environment, a higher leverage ratio has an adverse effect on firm performance.
In order to test the hypothesized relationships, Manuel collected long-term data from large, public family and non-family firms. The sample of family firms was retrieved from the Global Family Business Index and was matched with a sample of non-family firms based on the Forbes 2000. In this study, capital structure was measured by the long-term debt-to-assets ratio, while for firm performance, return on assets was used. Based on the literature, it could be assumed that the firms in this sample were all situated in an unstable environment as a major economic crisis happened during the data collection period which ran from 2007 until 2011.

Based on the sample, no differences between family and non-firms in terms of their capital structure or firm performance. In correspondence with the existing literature, a significant negative relationship between leverage and firm performance was found, entailing that more debt leads to a weaker firm performance. At last, it was studied whether a firm's capital structure mediates the relationship between family involvement and firm performance. This mediation could not be supported, especially because there was no significant relation between family involvement and capital structure. A significant relationship between these two variables is requirements for mediation to be present.
The main implication of this study comes from the negative relationship between leverage and firm performance. For managers, this implies that it is wise to avoid financing the firm's activities with debt as much as possible, as this eventually will lead to lower firm performance. On the academic side, this study contributes to the discussion about the positive or negative influence of leverage on firm performance. This study shows that even though short-term gains might be a result of higher debt, leverage will negatively affect firm performance when measured over a longer period of time. Differences between family and non-family firms in terms of capital structure or firm performance could not be supported. Explanations for these findings might be, for example, the characteristics of the sample. In large firms, family influence might be more diluted. This opens avenues for future research.

If you are interested in the master thesis you can contact the Tilburg Institute of Family Firms via tifb@tilburguniversity.edu and request the pdf file.