The Trade-Off Between Financial Resources and Agency Costs in the Family Business: An Exploratory Study

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This exploratory study is intended to analyze how a combination of the resources-based view and agency theory can provide a better understanding of the internal dynamic of the family business and its evolution. Our evidence seems to suggest that the desire to keep family control produces specific sources of value and conditions the firm's financial capacity to acquire resources. These peculiarities change between first and following generations. During the first generation, we find that less severe agency costs balance the negative effect of scarce financial structure on the family firm's value. After descendants join the firm, the increasing agency costs are compensated by the enlargement of the firm's financial structure.

In recent years, research on family business has been undertaken with a broad perspective and on a more rigorous conceptual basis (Bird, Welsch, Astrachan, & Pistrui, 2002). Among the various theories applied, the resource-based view and agency theory have emerged as the leading theoretical perspectives on family businesses (Chrisman, Chua, & Sharma, 2005). We believe that considerable understanding can be gained by integrating both approaches to elucidate the internal dynamics of family businesses.

The main argument of this exploratory study is that the specific characteristics of family businesses generate a trade-off between the extent of resources structure and the quality of contractual structure that differs between first and subsequent generations. That is, the will to keep family control constrains the financial resources of the firm and its capacity to obtain resources in general. Concurrently, as the firm develops over time, the mix of economic and affective links changes the magnitude of agency problems. During the first generation, the resource structure handicap is compensated by an advantage in agency costs. With succession, the rise in agency costs forces enlargement of the financial structure in an effort to retain the family business's capacity to create value.

We test our hypothesis on a sample of private family businesses located in the biggest Spanish Autonomous Community. Although our empirical analysis is limited to a narrow geographical area, this is a very interesting empirical context for testing the effects of family influences because the sample we have chosen has the same level of ownership concentration in family and nonfamily businesses. This circumstance allows us to distinguish between the general influence of concentrated ownership and the particular influence of family involvement. Furthermore, the division of the sample into two different age subsamples allows us to analyze trade-off differences between first and following generations.

This article is structured as follows. We begin with an integrative view of the resource-based view and agency theory that allows us to raise the question of the tradeoff between resource

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structure and agency cost over time in the family business. This has led us to study two different issues of family business. On one hand, restricted financial resources make it difficult for the family business to develop its resource structure, and delving into the reason for this financial restriction has moved us to analyze the pecking order for the case of family business. On the other hand, the relations within family businesses evolve over time. We then outline the methodology used to test the model and present our results. Discussion and conclusions follow.

The Trade-off Between Financial Resources and Agency Costs

A family business can be seen as a nexus of contracts (Hill & Jones, 1992; Jensen & Meckling, 1976) between co-specialized resource owners (Rajan & Zingales, 2000) who are linked through a special contractual structure that combines economic relations and family ones. The family manages the firm and thus can control the firm to guide decision making toward its main concern: to maintain control of the firm over the course of generations, for the sake of the nonpecuniary benefits that the family obtains from this control (e.g., lifestyle within the community, job creation for family members) (see Demsetz & Lehn, 1985; James, 1999).

From this family business view, the firm's capacity to create value depends not only on the quantity and quality of its resources, but also on the quality of the ties that link the resources within the firm. This fact creates a trade-off. The aim of guaranteeing family control of the firm (Casson, 1999; Chrisman, Chua, & Litz, 2003) reduces its array of potential financial resources and thus limits its entire resource structure (Galve & Salas, 2005; Habbershon & Williams, 1999; Sirmon & Hitt, 2003). Lack of financial resources is one of the chief causes affecting the development, growth opportunities, and long-term survival of private family businesses (Romano, Tanewski, & Smyrnios, 2000). However, it is true that value creation depends not only on the resources held but also on the way resources are managed by the firm (Hoskisson, Hitt, & Ireland, 2004). The particular

ties that link family resources are characterized by altruism. The nature of this altruism and the types of agency problems engendered by it are contingent on the ownership stage of the family business (Lubatkin, Schulze, Ling, & Dino, 2005, p. 323). In the first generation, the duality of economic and family ties acts as a regulator and incentive for a cooperative attitude on the part of resource holders that reduces agency costs in their relationships. With succession, however, family businesses suffer from adverse selection costs, since managers are selected altruistically (Smith & Amoako-Adu, 1999; Pérez-González, 2006; Schulze, Lubatkin, & Dino, 2003a; Villalonga & Amit, 2006). Even more, ownership dispersion and the lessened intensity of family ties will engender agency costs (Schulze, Lubatkin, & Dino, 2003b), so the family business will need to increase its financial resources to maintain the firm's value.

Financial Structure in Family Businesses

According to the resource-based view, the firm's sustainable competitive advantage is grounded in the availability of strategic resources that enjoy imperfect mobility (Barney, 1991; Peteraf, 1993). Family businesses have been described as rich in intangible resources because the duality of economic and family relationships and the will to continuity create an atmosphere favorable to generating some strategic resources (e.g., social capital, tacit knowledge) (Cabrera-Suárez, De Saá-Pérez, & García-Almeida, 2001; Habbershon & Williams, 1999; Miller & Le Breton-Miller, 2006; Sirmon & Hitt, 2003). However, the drive to keep family control leads family businesses to face problems in obtaining an adequate store of financial resources. Since these financial resources condition the firm's ability to achieve competitive advantage (Vicente-Lorente, 2001), our study is focused on the family business's financial structure.

A firm can finance its resource structure through equity, debt, and/or internal financing. In a family business, the family's main concern is to pass the company across generations, so family managers will base financial decisions more on how these decisions may affect family control than on a

comprehensive assessment of complex financial issues (e.g., optimal leverage) (Barton & Gordon, 1987; Barton & Matthews, 1989; McMahon & Stanger, 1995). These organizations are reluctant to open up capital to nonfamily members (Sirmon & Hitt, 2003) because this would imply sharing family control; they prefer family and firm internal equity financing (Romano et al., 2000). Thus, family business owners usually reinvest their funds (Poutziouris, 2001; Ward, 1987).

Whether and why family firms use debt financing is controversial. Various studies have found that family businesses tend to use less debt (Agrawal & Nagarajan, 1990; Gallo, Tàpies, & Cappuyns, 2004; McConaughy, Matthews, & Fialko, 2001). They argue that family businesses prefer less risky financial options for two main reasons. First, an increase in debt would make more likely a loss of family control. Second, business failure implies not only the loss of personal wealth, but also the loss of family human capital. However, other studies have revealed that family businesses are as likely to use debt as nonfamily businesses (Anderson, Mansi, & Reeb, 2003; Anderson & Reeb, 2003a; Chaganti & Damanpour, 1991; Coleman & Carsky, 1999). Here, the argument is that family members' reluctance to open up the firm's capital will positively affect their beliefs about the utility of debt financing (Matthews, Vasudevan, Barton, & Apana, 1994). Therefore, after internal funds have run out, family businesses may find the needed capital investment through debt (Hamilton & Fox, 1998). Even more, as the number of generations increases, family members are less "overinvested" in the firm and are more willing to use debt and bear the attendant risk to their individual wealth. Thus, the use of debt will be favored by ownership dispersion across generations (Schulze et al., 2003b).

In brief, family managers would prefer to finance the firm's needs from internally generated funds, but if retained earnings are inadequate, then debt financing will be used. These alternative ways of financing fit into a financial pecking order (Myers, 1984; Myers & Majluf, 1984). The pecking order model (Donalson, 1961; Myers, 1984) uses information asymmetry and other financial costs to explain why firms prefer internal to external finance and, when outside funds are necessary, prefer debt to equity. Issuing equity is a last resort. These arguments are valid for the family business case, but in these organizations the main cause of this funding sequence is the desire to keep control (Romano et al., 2000). Davidsson (1989) found that owner-managers will even deter growth when growth is expected to result in a loss of control. Thus, keeping family control limits the firm's financial resources, restricts its resource structure, and inhibits its growth (Carney, 2005; McMahon & Stanger, 1995). This disadvantage will harm firm value unless it is outweighed by the agency cost advantage in exploiting the firm's resources (Randoy & Goel, 2003; Sirmon & Hitt, 2003).

Low Agency Costs in the First-Generation Family Business

Agency costs in the first generation are relatively low. In this stage, ownership is normally concentrated in the nuclear family, and the management and power of the organization fall chiefly on the founder. This coincidence between ownership and management decisions mitigates agency problems (Dalton & Daily, 1992; Jensen & Meckling, 1976), and the family's large ownership stake provides a strong economic incentive to maximize firm value (Anderson & Reeb, 2003b; Villalonga & Amit, 2006).

However, these are not the only mechanisms that reduce agency costs inside the family business (McConaughy et al., 2001). In this stage, the family is usually nuclear, with closed relationships that minimize information asymmetries between family members and lead them to maintain concentric objectives. Accordingly, the cooperative attitudes adopted by the family members will be influenced not only by the content of the contract but also by the trust and altruism generated by their strong familial relationships (James, 1999; Pollak, 1985). Altruism promotes a governance system that is particularly efficient in the controlling-owner generation (Lubatkin et al., 2005; Schulze, Lubatkin, & Dino, 2002). The collaborative effort among family members, focused on enhancing the firm's capacity to create value

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across successive generations (Jenssen, Mishra, & Randoy, 2001; Van den Berghe & Carchon, 2002), will be greater than that which they could put into a firm in which they maintained only economic relationships.

Increasing Agency Costs Across Generations

Once successors join the firm, the agency costs derived from the relations among different resource owners will increase. Altruism exposes family businesses to agency problems associated with lack of ability because family successors are more likely to occupy senior management positions irrespective of merit (Schulze et al., 2003a). Because hiring and promotion are not subject to either external market mechanisms or internal evaluation processes, family businesses are deprived of the best managerial talent possible (Burkart, Panunzi, & Shleifer, 2003). Thus, family interests in management appointments may harm corporate objectives, such as maximizing value creation (Pérez-González, 2006; Smith & Amoako-Adu, 1999; Villalonga & Amit, 2006). Additionally, the dispersion of ownership and the diversity of roles that family members may perform in the firm over the course of generations will increase conflicts of interest and information asymmetries between owners and managers. Fractional ownership reduces the managers' motivation to exert effort in promoting cooperation, while it increases their incentive to act opportunistically because they bear only a part of the cost of such action but enjoy all the benefits (Fama & Jensen, 1983; Schulze et al., 2003a). In addition, as the branches of the family continue to fan out, the affective bonds with the original family will be less intense, and family interests will be centered on the new family unit that each member is forming. In this context, altruism will have less power to drive cooperative attitudes (Lubatkin et al., 2005). Members will give priority to current rents, which may be enjoyed by their new nuclear family, to the detriment of long-term rents that will go to the extended family. The family members' objectives will disperse, and the information asymmetries will increase. Therefore, agency conflicts among the different resource holders will rise and there will be greater possibilities for managerial opportunism.

Of course, every family evolves in a different way. However, altruism, norms of equality, implicit familial relationships, and feelings of loyalty will always have less influence on resource owners over time (Karra, Tracey, & Phillips, 2006; Lubatkin et al., 2005). It is true that private family businesses characterized by good governance practices will be less affected by the gradual increase in agency costs (Mustakallio, Autio, & Zahra, 2002; Schulze, Lubatkin, Dino, & Buchholtz, 2001), but as new generations come into the firm, it will be harder for the family business to balance the disadvantage of operating on a small scale with the agency costs advantage of efficient management of resources. In these circumstances, during following generations private family businesses will try to augment their capital investment to foster the accumulation of resource stocks and to compete on the same scale as nonfamily businesses.

As we discussed above, when the need for financing exceeds the internally generated funds, family managers will strongly prefer debt to new nonfamily equity (Hamilton & Fox, 1998). Over the course of generations, the progressive weakness of family ties raises the problem of opportunism. Specifically, family managers who run the business can take advantage of family members who have career interests outside the business and, even more, of nonfamily stakeholders (Schulze et al., 2003b). They may enjoy excessive salaries and perks, they may shirk, or they make risk-avoidant decisions in their own interest or in the interests of family members to the detriment of nonfamily stakeholders (Hanlon, Kishida, & Poza, 2004). In this context, debt is an efficient governance mechanism that helps ease the increasing agency costs in subsequent generations. Debt tends to prevent family managers from wasting free cash flows on perquisites and bad investments (Easterbrook, 1984; Jensen, 1986).

Methodology

Research Focus

Our main research focus is on how private family businesses face the trade-off between the cost of keeping control (operating at a disadvantage in financial resources) and the savings on agency costs (efficient relationships among resource owners) across generations. Specifically, we address two questions. Do family and nonfamily businesses have the same financial capacity to acquire resources? Do family businesses have the same sources of value as nonfamily businesses?

Data and Variables

The information source we used was the SABI (Iberian Balance Sheets Analysis System) database for the year 2000. However, to calculate certain variables we extended the information used backward to 1999. This database collects annual balance sheet records from official registers for Spanish firms. The sample was made up of a set of nonfinancial Spanish firms belonging to the biggest Spanish Autonomous Community, Castilla y León. Although our empirical analysis is limited to a narrow geographical area, this sample allows us to advance our understanding of the actual influence of the family on the firm. Traditionally, Anglo-American studies of family businesses have compared a dispersed ownership structure, where no shareholder has a significant stake, with a concentrated ownership structure, where a family effectively controls the firm. These countries have a common-law legal system. However, most of the continental European countries, which have civil-law systems, offer lower investor protection and, as a result, have higher ownership concentration (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998) in the hands of a large shareholder (e.g., a family or single individual, a financial institution, a nonfinancial company, or a government) (Pedersen & Thomsen, 2003). Our sample is a very interesting case to study because it is made up of firms where ownership structure is as concentrated in nonfamily businesses as it is in family ones. This circumstance allows us to distinguish between the general influence of concentrated ownership and the particular influence of family involvement.

We included in our study only firms that have more than 10 workers. Thus we eliminated micro firms, as classified by the European Commission (96/280/CE). This condition was used to exclude "lifestyle firms," those firms that are created as a way of family survival, but whose owners do not intend to pass them on to future generations of the family. After we dropped 109 cases because some of their variables were outliers (that is, had values three or more standard deviations from the mean), or because some information about the variables included in the analyses was missing, the final sample consisted of 654 firms, of which 477 were family businesses and 177 were nonfamily businesses.

Dependent variable: family business. In line with Westhead and Cowling (1998), we classified firms as family businesses when more than 50% of the equity was owned by one family, the majority of members of the board of directors were members of the owning family, and one member of the family was the manager of the firm.

Independent variables. The pecking order theory posits that imbalances between internal funds and investment needs (i.e., financial deficit) are met primarily with debt, while equity is viewed as a last resort for financing. To proxy FINANCIAL STRUCTURE we used two variables suggested by the pecking order approach (Shyam-Sunder & Myers, 1999). First, we used financial deficit to measure the amount that firms needed to raise externally. Specifically, we defined the financial deficit variable as the sum of investments, dividends, change in working capital, and long-term debt outstanding, net of cash flow. Second, we calculated the ratio of long-term debt to the book value of assets to measure how much of the external financing came from debt. To proxy value creation we employed two common indices of private firms' performance: return on assets (ROA) and return on equity (ROE). ROA was

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defined as earnings before interest, tax, depreciation, and amortization (EBITDA), divided by total assets. ROE was defined as net profit divided by equity. Industry may influence our variables for financial structure and value creation. Therefore, before applying the logistic regression we standardized variables by industry to control for a possible industry bias. We segmented the 673 Spanish firms into six industry groups—agriculture; forestry and fisheries; construction; manufacturing; wholesale and retail trade; and services industries—according to the primary activity of the company, signified by its single-digit SIC code.

Control variables. We added five control variables to reduce variance that would be extraneous to the research questions or that might confound interpretation. We measured FIRM AGE as years from the foundation date. To define FIRM SIZE, the most common measures are related to sales, number of employees, and assets (Scott, 1981). We included three of these in our size measure, following the criteria established by the European Commission (96/280/CE). That is, we classified a firm as small when it had fewer than 50 employees, sales of less than €7 million, and total assets of €10 million or less. A medium-sized firm had fewer than 250 employees, sales of less than €40 million, and total assets of €27 million or less. Any firm that exceeded any of these three limits fell into the group of large companies. We controlled INDUSTRY effects by including the average ratio of fixed assets to total assets for the industry in which firm operated. We also included BOARD SIZE (number of directors) and BLOCKHOLDING (the percentage of shares controlled by the main shareholder).

Methods

The empirical analysis was organized in two sections. First, we carried out tests for the equality of means. Second, we completed the empirical research with a binomial logit regression. Logistic regression is an appropriate estimation technique when the dependent variable is binary, as in family

(1) versus nonfamily (0) firms (Demaris, 1992; Hair, Anderson, Tatham, & Black, 1995). We ran separate logistic regressions for the two value-creation independent variables (ROA and ROE) to contrast the robustness in results. A correlation analysis revealed that the independent variables were not highly correlated.

Results

Initially, we performed the analyses for the total sample. Table 2 presents the differences in means between all the family and nonfamily businesses included in our sample. Table 3 presents the results of the logit analysis for the full sample. Results were consistent between the univariate and multivariate analyses. With regard to the blockholding variable, the different results showed similar concentrations of ownership in family and nonfamily businesses. Regarding control variables, the mean tests indicated that there were significant differences in firm size, industry ratio of fixed to total assets, and board size between the family and nonfamily business groups (Table 2). In addition, the logistic regression showed significant and negative relations between the same control variables and the family-dependent variable (Table 3). The fact that family businesses had smaller board size (Cabrera-Suárez & Santana-Martín, 2004) may reflect that the family's main concern is to retain control of the organization. This constraint causes a smaller array of financial resources in private family businesses. The smaller firm size and the tendency to operate in industries requiring a lower volume of fixed assets show us the problems that the family firm experiences in developing its resource structure because of its lack of financial resources.

With regard to financial structure, the statistical difference in means (Table 2) and the coefficients of the logistic regression (Table 3) show that the financial deficit variable is statistically nonsignificant. However, even though family and nonfamily firms have the same need for external funds, the univariate analysis revealed that family businesses have higher levels of debt than nonfamily busi-

Table 1 Correlation Matrix

Variables	Mean	SD	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1. Family business	0.730	0.445	1								
2. Firm age	15.986	11.224	−0.165(***)	1							
3. Firm size	1.200	0.483	−0.283(***)	0.225(***)	1						
4. Industry	0.357	0.083	−0.230(***)	0.095(**)	0.083(**)	1					
5. Blockholding	68.094	26.012	0.018	−0.037	0.190(***)	0.018	1				
6. Board size (log)	1.002	0.773	−0.476(***)	0.317(***)	0.277(***)	0.265(***)	−0.147(***)	1			
7. Deficit	0.025	0.056	0.022	−0.045	−0.020	0.006	−0.048	0.004	1		
8. Debt/total assets	0.645	0.214	0.086(**)	−0.231(***)	0.063	−0.006	0.051	−0.271(***)	0.174(***)	1	
9. ROA	0.079	0.078	−0.003	−0.100(**)	0.007	0.008	0.001	0.018	−0.020	−0.267(***)	1
10. ROE	0.108	0.249	0.003	−0.041	0.019	0.003	0.058	−0.068(*)	0.027	−0.012	0.581(***)

$* p < 0.1.$
$** p < 0.05.$
$*** p < 0.01.$

nesses (Table 2). This finding is congruent with studies that have found that family businesses are as likely as nonfamily ones to use debt (Anderson et al., 2003; Anderson & Reeb, 2003a; Chaganti & Damanpour, 1991; Coleman & Carsky, 1999). Moreover, it supports the argument of Matthews et al. (1994) and Hamilton and Fox (1998) that the aversion to opening up the firm's capital will make family businesses prefer debt to equity for covering external financing. Thus, it seems that family businesses are more likely to make financing decisions following the pecking order hierarchy (Poutziouris, 2001; Romano et al., 2000). Moreover, previous research has suggested that family businesses experience a lower cost of debt than nonfamily businesses (Anderson et al., 2003). Our evidence suggests that family businesses use this competitive advantage over nonfamily businesses. Although in the multivariate analysis the ratio debt/total assets has a nonsignificant relation with the family business dependent variable (Table 3), there were interesting results in the partial analysis where we divided the sample into two different age subsamples.

As far as firm value is concerned, the univariate tests did not reveal significant differences, either on ROA or on ROE measures (Table 2). In the multivariate test, ROA and ROE variables exhibited a nonsignificant impact on the family dependent variables (Table 3). It can be concluded, then, that the disadvantage of operating under limited financial resources may be compensated by the low agency costs that the family business enjoys from better relationships among the resource holders (Carney, 2005).

The results we report thus far do not distinguish among generations. However, we have argued that the trade-off between the lack of financial resources and the lower agency costs will change through generations (Morck, Shleifer, & Vishny, 1988; Villalonga & Amit, 2006). Thus, we divided the sample into two different age subsamples, for firms less than 25 years old (first-generation businesses) and firms more than 25 years old (second- and subsequent-generation businesses). Although arbitrary, the 25-year cutoff is around the time that second-generation siblings start to join the

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Table 2 Comparison of Family Businesses and Nonfamily Businesses

FB $N = 477$

NFB $N = 177$

Variable	Means		T test	Mann-Whitney
	FB	NFB	T-statistics	Z-statistics
Controls				
Firm age	14.860	19.020	4.267***	−1.642*
Firm size	1.12	1.43	7.538***	−7.140***
Industry	0.345	0.386	6.027***	−6.041***
Blockholding	68.378	67.239	−0.458	−1.004
Board size (log)	0.778	1.606	13.839***	−11.863***
Financial structure				
Deficit	0.026	0.023	−0.662	−0.258
Debt/total assets	0.662	0.600	−3.272***	−3.323***
Value creation				
ROA	0.078	0.081	0.463	−1.069
ROE	0.112	0.099	−0.593	−1.216

* $p < 0.1$
** $p < 0.05$
*** $p < 0.01$

Table 3 Logistic Regression with Family Versus Nonfamily Businesses

Family business = 1; Nonfamily business = 0

Variable	With ROA variable	With ROE variable
	B(S.E)	B(S.E)
Controls		
Firm age	0.003 (0.009)	0.003 (0.009)
Firm size	−0.771 (0.215)***	−0.767 (0.215)***
Industry	−4.211 (1.366)**	−4.168 (1.369)**
Blockholding	0.003 (0.004)	0.002 (0.004)
Board size (log)	−1.582 (0.184)***	−1.589 (0.185)***
Financial structure		
Deficit	0.110 (0.164)	0.112 (0.164)
Debt/total assets	−0.032 (0.116)	−0.032 (0.111)
Value creation		
ROA	−0.012 (0.104)	
ROE		−0.057 (0.116)
Constant	5.230 (0.629)***	5.217 (0.628)***
Chi2 model	189.732***	189.968***
Log likelihood	574.005	573.768
Pseudo R^2	0.248	0.248
Cox and Snell R^2	0.252	0.252
Nagelkerke R^2	0.366	0.366
Hosmer and Lemeshow test	6.322	6.240
Cases correctly classified	80.7%	80.3%

* $p < 0.1$
** $p < 0.05$
*** $p < 0.01$

Table 4 Comparison of "Younger" Family and Nonfamily Businesses (< 25 Years Old)

FB *N* = 436
NFB *N* = 133

Variable	Means		T test	Mann-Whitney
	FB	NFB	T-statistics	Z-statistics
Controls				
Firm age	12.957	11.707	−2.195**	−2.161**
Firm size	1.09	1.35	6.571***	−6.243***
Industry	0.242	0.387	5.474**	−5.432***
Blockholding	68.23	66.94	−0.502	−1.610
Board size (log)	0.736	1.492	11.524***	−10.030***
Financial structure				
Deficit	0.027	0.023	−0.688	−0.360
Debt/total assets	0.663	0.637	−1.267	−1.482
Value creation				
ROA	0.079	0.084	0.646	−0.811
ROE	0.109	0.099	−0.417	−0.506

* $p < 0.1$.
** $p < 0.05$.
*** $p < 0.01$.

business (Gersick, Davis, McCollom, & Lansberg, 1997) and therefore allows us to test the effect of agency costs caused by altruism (i.e., by allocating managerial positions not according to the abilities of the candidates, but exclusively on the basis of family altruism) and increasing family conflicts (see Schulze et al., 2003a). We repeated the analyses for both subsamples, trying to observe differences in the family businesses' internal dynamics between generations.

The results of the difference of means and the logistic regression for the younger group are respectively shown in Table 4 and Table 5. The smaller board size in the first-generation family businesses reflects the family's desire to keep control. Also, family businesses tended to reach smaller size and have more presence in less "capital-intensive" industries than did nonfamily businesses. This may be a sign of the limited financial structure of first-generation family businesses. Family and nonfamily businesses have comparable levels of financial deficit. The reluctance to open equity to third parties makes first-generation family businesses as likely as non-

family firms to use debt. Nevertheless, there were not significant differences between the average of ROA and ROE variables (Table 4). In the logistic regression, the relation between this variable and the family-dependent variable was nonsignificant (Table 5). Consequently, the limited financial structure did not notably limit profitability. One possible explanation, as we have argued, is that the low agency costs generate value equivalent to the gains that nonfamily businesses achieve from their broader financial resources structure.

However, results were very different when we performed the analyses on the subsample of firms more than 25 years old. The results of means differences and logit analyses for this group are shown in Table 6 and Table 7, respectively. The results were consistent and showed that there were not statistically significant differences in firm size and industry variables between family and nonfamily businesses. That is, in second and subsequent generations, family businesses seemed to have resource structures as broad as those of nonfamily businesses. However, the results showed significant differences in financing.

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Table 5 Logistic Regression with "Younger" Family Versus Nonfamily Businesses (<25 Years Old)

Family business = 1; Nonfamily business = 0		
Variable	With ROA variable B(S.E)	With ROE variable B(S.E)
Controls		
Firm age	0.064 (0.021)**	0.065 (0.021)**
Firm size	−0.971 (0.272)***	−0.975 (0.272)***
Industry	−4.459 (1.496)**	−4.435 (1.500)**
Blockholding	0.005 (0.005)	0.005 (0.005)
Board size (log)	−1.651 (0.206)***	−1.666 (0.208)***
Financial structure		
Deficit	0.226 (0.184)	0.235 (0.185)
Debt/total assets	−0.166 (0.138)	−0.169 (0.132)
Value creation		
ROA	−0.032 (0.113)	
ROE		−0.109 (0.121)
Constant	4.861 (0.762)***	4.871 (0.760)***
Chi2 model	157.311***	158.076***
Log likelihood	461.488	460.723
Pseudo R^2	0.254	0.255
Cox and Snell R^2	0.242	0.243
Nagelkerke R^2	0.364	0.366
Hosmer and Lemeshow test	9.767	6.744
Cases correctly classified	83.3%	83.3%

* $p < 0.1$
** $p < 0.05$
*** $p < 0.01$

Both univariate (Table 6) and multivariate analysis (Table 7) showed that second- and subsequent-generation family businesses had similar needs for external financing. However, in the univariate analysis there were significant differences between descendant family businesses and nonfamily ones in the debt/total assets variable (Table 6). The relation of this ratio with the family-dependent variable was positive and significant (Table 7). Thus, the analyses show that in second and subsequent generations, the opposition to opening equity to nonfamily members makes it difficult to capitalize the firm and forces family firms that choose external financing to rely more on debt financing. These findings seem to suggest that family businesses adhere relatively strongly to the pecking order hierarchy (Poutziouris, 2001; Romano et al., 2000). Furthermore,

there is another interesting reason to increase debt in the second or subsequent generation. The proliferation of roles over the course of generations favors divergence of interests and information asymmetries. Consequently, family members who are not managers of the firm will put pressure on to increase the leverage because debt is a governance mechanism that reduces managerial opportunism (Schulze et al., 2003b). Our results are consistent with research suggesting that the use of debt in private family business is associated with the firm's size and age (Coleman & Carsky, 1999).

Finally, descendant-controlled firms remained as profitable as nonfamily businesses (Tables 6 and 7). It seems that the higher agency costs in following generations force family businesses to increase their financial resources for optimizing

Table 6 Comparison of "Older" Family and Nonfamily Businesses (> 25 Years Old)

FB $N = 41$
NFB $N = 44$

Variable	Means		T test	Mann-Whitney
	FB	NFB	T-statistics	Z-statistics
Controls				
Firm age	35.101	41.126	2.114**	−2.168**
Firm size	1.44	1.68	1.508	−1.433
Industry	0.365	0.389	1.514	−1.498
Blockholding	69.920	68.501	−0.246	−0.407
Board size (log)	1.244	1.951	5.026***	−4.127***
Financial structure				
Deficit	0.013	0.021	0.806	−0.066
Debt/total assets	0.642	0.490	−3.304***	−3.430***
Value creation				
ROA	0.062	0.071	0.609	−0.185
ROE	0.136	0.099	−0.993	−1.275

* $p < 0.1$
** $p < 0.05$
*** $p < 0.01$

firm size in an effort to sustain their economic returns.

Discussion

From our point of view, the distinctiveness of family business comes from the particular contractual structure that mixes economic and family ties and from the family management's desire to retain firm control across generations. Apparently, these characteristics generate a trade-off between resource structure and contractual structure as sources of value creation, a trade-off that changes across generations. Family businesses have more restrictions on financing sources than do nonfamily businesses because of their will to keep family control. During the first generation, this competitive disadvantage is compensated by the establishment of efficient relationships between the resource owners that lower agency costs. Across generations, the progressive disappearance of the agency costs advantage will force the firm to increase its capital investment in order to compete in the same resource structure conditions as nonfamily businesses.

Our findings add support to the argument (Barton & Gordon, 1987; Barton & Matthews, 1989) that managerial preferences affect the firm's financial decisions. In family businesses, these preferences boil down to the decision maker's desire to maintain control (Matthews et al., 1994; Romano et al., 2000). Globally, our results related to financial structure show us that family businesses follow this particular logic in their financial decisions. The reluctance to open the equity to nonfamily owners moves the firm to finance new investments by increasing debt levels. This pecking order story obstructs the firm's capitalization because, unless the family has a vast fortune, family members' contributions are likely to be smaller than those of other potential shareholders, such as financial institutions, nonfinancial companies, government, or the total contribution from minority shareholders.

Clearly, in family business research it is very important to take into account which generation runs the firm. It seems that family businesses have specific sources of value while the founder is active in the company. However, over the course of generations the agency costs become more intense

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Table 7 Logistic Regression with "Older" Family Versus Nonfamily Businesses (> 25 Years Old)

Family business = 1; Nonfamily business = 0

Variable	With ROA variable B(S.E)	With ROE variable B(S.E)
Controls		
Firm age	–0.027 (0.024)	–0.025 (0.024)
Firm size	–0.321 (0.416)	–0.286 (0.419)
Industry	–2.174 (4.068)	–1.444 (4.291)
Blockholding	–0.002 (0.012)	–0.002 (0.011)
Board size (log)	–1.526 (0.515)**	–1.592 (0.535)**
Financial structure		
Deficit	–0.335 (0.418)	–0.389 (0.421)
Debt/total assets	0.570 (0.273)**	0.665 (0.281)**
Value creation		
ROA	–0.213 (0.357)	
ROE		–0.339 (0.442)
Constant	4.444 (1.851)**	4.131 (1.906)**
Chi2 model	31.905***	32.146***
Log likelihood	85.824	85.583
Pseudo R^2	0.271	0.273
Cox and Snell R^2	0.313	0.315
Nagelkerke R^2	0.417	0.420
Hosmer and Lemeshow test	5.852	8.695
Cases correctly classified	72.9%	72.9%

* $p < 0.1$
** $p < 0.05$
*** $p < 0.01$

because of altruism problems and the dispersion of both ownership and familial ties. Therefore, second- and subsequent-generation family firms have to complete their resource structure to compete in the market.

This work generates one main recommendation for practitioners. With succession, the agency problem in the family business is going to evolve because information asymmetries and conflicts of interest will rise. Therefore, family businesses must design mechanisms to safeguard the conditions under which each resource is exploited, and its potential contribution to the creation of value. In addition to the mechanisms necessary in all organizations, the duality of economic and affective relationships calls for other complementary ones (e.g., the family assembly or the family council) to regulate family and economic relations and to avoid instability that endangers the continuity of the family business.

Of course, there are a number of limitations to this study. First, our division of the sample into only two subsamples by age, and our use of cross-sectional analysis, limit our ability to check the family business's evolution across generations in greater depth. Second, our sample comes from only one geographical part of Spain, and although this provides an interesting case in that ownership concentration in this area is equal for family and nonfamily firms, it does constrain the generalizability of our results. Lastly, our use of secondary information sources limits us to the study of financial resources. However, financial resources are the main restriction on resource structure in general, so they are a good indicator of the firm's capacity to acquire a nearly optimal resource

structure. The results have been so interesting that we intend to deepen this line of research and complete it by analyzing primary sources of information that will allow us to empirically analyze the family business's structure of human and intangible resources.

Conclusions

This exploratory study has intended to explain how a combination of the resources-based view and agency theory can provide a better understanding of the internal dynamic of the family business and its evolution. Our evidence seems to suggest that the desire to keep family control produces specific sources of value and conditions the firm's financial capacity to acquire resources. These peculiarities change between first and following generations. During the first generation, we find that less severe agency costs balance the negative effect of scarce financial structure on the family firm's value. After descendants join the firm, the increasing agency costs are compensated by the enlargement of the firm's financial structure.

Moreover, the present findings indicate that when outside funds are necessary, the aversion to losing control will lead family businesses to avoid new equity issues and to be more dependent on debt than are nonfamily firms. That is, family managers will firmly follow a pecking order in their funding preferences.

Therefore, it would be useful for future studies to interweave the resources-based view and agency theory in order to increase our knowledge of family firms. Also, more developed models should be make to test the pecking order theory in the family firms. These are challenges for both theoretical and empirical research.

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