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The Views of Family Companies on Venture Capital: Empirical Evidence from the UK Small to Medium-Size Enterprising Economy

Panikkos Zata Poutziouris

This explorative research paper draws evidence from a database of small to medium-size unquoted private companies (n = 240) in the UK and reports on the family business and venture capital relationship from the demand side. Following the review of literature relating to financial affairs of private companies, the main research inquiries are outlined and a set of generic hypotheses is elicited based on the pecking order theory—that is, private companies, including family-controlled ventures, have a propensity to finance their operations in a hierarchical fashion, first using internally available funds, followed by debt and, finally, external equity (Petitt & Singer, 1985). Univariate statistical analyses confirm that family companies adhere strongly to the pecking order principles of financial development. The paper explores factors governing the rationale of owner-managing directors of private and family companies for considering venture capital dealings as well as main areas of concern about the deal structures. The paper then concludes with a discussion of the policy implications from the perspective of the owner-manager, financier, and enterprise policy maker. To encourage equity development of smaller privately held companies, particularly family firms, there is room for policy initiatives that respect the financial philosophy of private companies.

Introduction

Family firms, generally defined as businesses either owned or managed-operated by the family (or its units), are the most prevalent form of business organization. For most developed economies, the family business sector is estimated to account for over two thirds of all enterprises and about half of the GDP economic activity (Gersick, Davis, Hampton, & Lansberg, 1996). Commentators view family firms as the backbone of the private economy, as they make a substantial contribution to national socioeconomic and entrepreneurial development (Connolly & Jay, 1996; Poutziouris & Chittenden, 1996; Neubauer & Lank, 1998; Leach & Bogod, 1999; Romano, Tanewski, & Smyrnios, 2000).

On the positive side, family firms are credited for nurturing entrepreneurial talent, a sense of loyalty, long-term strategic commitment, pride in the family tradition, and corporate independence. On the negative side, family firms can suffer from a lack of professionalism, nepotism, rigidity in adapting to new challenges, and family feuding. Conflicting family and business politics can undermine strategically planned ownership, leadership, and management succession, which can derail the development of the family firm. To safeguard family ownership, control, and financial independence from outsiders, owner-managers of family firms often overlook growth opportunities (or even eschew growth), owing to heavy dependence on internally generated funds

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and limited access to external, long-term risk capital options.

Stakeholders, with an interest in the survival, long-term growth, and sustainable corporate prosperity of the prolific small to medium-size family enterprise, have been concerned about the financial affairs of owner-managed smaller companies (DG23, EU-Commission, 1997, 1998a, 1998b, 1999). Strong financial health and a wide capital base are paramount not only for survival across the swinging macroeconomic business cycle, but also for financing strategic business transitions, including succession and entrepreneurial renewal.

According to the European Observatory Network for SME Research (1996), about 30% of all European enterprises (or about 5 million business units of all legal forms) now face business transfer. Moreover, estimates suggest that 30% of such business transfers will not materialize because failure to plan can be tantamount to planning to fail. In the case of family businesses, management and ownership succession is usually related to strategic business plans or to factors exogenous to the business, including sudden family feuding, death, or changes in transfer taxes. Consequently, sourcing supplementary outside capital (such as private equity/venture capital) to finance liquidity and other capital requirements that might result from generational, management, or ownership transitions is increasingly central to their survival and sustainable development.

In light of the new economy, it is possible that family firms will fail in the face of increasing competition. Also, emerging internal pressures to finance entrepreneurial and technological renewal could result in family firms selling out, facing hostile takeovers, struggling to defend market share, or even becoming insolvent (deVisscher, Aronoff, & Ward, 1995).

The Finance Gap. The finance gap, hampering the strategic financial development of family and nonfamily privately held SMEs, has been under the microscope of business economists and enterprise policy makers for decades (Bolton, 1971; Wilson, 1979; Aston Business School, 1991; ESRC—Business Research Centre, 1992, 1996; Bank of England, 2001). This finance gap is a multidimensional barrier involving:

- The problematic flow of development debt financing (costly, insufficient, heavily short termist)
- The persistence of an equity gap (owing to asymmetrical objectives of owner-managers and investors), which exacerbates the debt gap
- The short-termist (and anti-outsider) approach to strategic financial management and development planning of closely held SMEs, especially family firms, which are often skeptical about the deployment of externally generated, long-term funding. This attitude is symptomatic of the undercapitalization of private SMEs as a result of the overreliance on short-term financial options (Poutziouris, Chittenden, & Michaelas, 1998).

The response of the government to closing the equity side of the finance gap—via channelling more equity capital essential for the realization of the growth potential of entrepreneurial SMEs—has been the orchestration of a number of schemes, including the following:

- The promotion of the business angel network (individual, small venture capitalists)
- The Business Expansion Scheme, now the Enterprise Investment Scheme, which is a tax-efficient vehicle to encourage equity investment in unquoted companies and certain smaller public limited companies
- The establishment (since 1995) of the Alternative Investment Market (AIM), a secondary market (regulated by the London Stock Exchange, but with less demanding rules than the official listing) designed primarily for smaller growth-inspired companies
- The promotion of tax-efficient share options and all employee share ownership schemes to broaden equity share ownership

Stakeholders with an interest in the survival and long-term growth of SMEs call for more

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drastic action to ameliorate the equity gap that arrests the development of tomorrow's growth stars (Basham & Pickering, 1999; HM Treasury, 1998; EU—Commission, 1999; Bank of England, 2001). Better access to equity, either through development of suitable SME-oriented capital markets or through helping SMEs to overcome the inherent (financial and behavioral) barriers that restrain them from considering external equity options, will allow growth-ambitious SMEs not only to invest in development strategies, but also to facilitate business transfers, especially strategic generational succession in family firms.

The Supply of Private Equity Funding in the UK

According to the British Venture Capital Association (BVCA, 1999), there was about £41 billion worth of investment under management in the private equity sector. The private equity providers, such as banks, business angels, venture capital companies, and special investment schemes, cater to different segments of the market and channel their investments through a variety of small and mega deals, categorized as follows:

- *Start-up*: Financing ventures at the very early stages of their development, needing funds for research and development and initial marketing
- *Other early stage*: Financing ventures (operating in the no-profit generating phase of the gestation period) that have developed their prototypes and now need to invest in the production function and sales network
- *Expansion*: Development finance provided for the growth and expansion of an established company. Funds may be invested in the extension of production capacity, technological upgrading, product development, and diversification as well as working capital and/or marketing; rescue and turnaround capital is also included in this category of deals and accounts for about half of financing
- *Refinancing debt*: To repay debt when the client company seeks to restructure its capital base and to improve the gearing ratio
- *Secondary purchase*: To purchase existing shares in a company from another venture capital firm or institutional shareholders (share-ownership restructuring)
- *Bridge financing*: Short-term capital funding, generally extended to companies planning to float within a year
- *Management buy-outs (MBOs)*: To enable current active management and investors to acquire an existing product line, units, or all of the business
- *Family management buy*-out (*FAMBO)*: To enable the transfer of a family business to the next generation of family and nonfamily management
- *Management buy-in (MBI)*: To enable an external manager or group of managers to buy into a company
- *Buy-in management buy-out (BIMBO)*: To enable a company's management to acquire the business they manage with the support of incoming management

Most of the SME-venture capital funds are channelled to restructuring ownership (MBO/MBI deals) rather than enabling entrepreneurs to start up and grow their businesses (Joseph, 1999). In general, large investors are not enthusiastic to finance start-up and early start-up investment in growing companies, as such companies are too risky and often too small for their investment scope. Thus, private equity investment in the SME sector is often in the form of development capital for established companies with growth potential. Typically, a small company (with sales of about £10m) will seek development capital because it has exhausted its internally generated funds (mainly retained profits) and its capacity to take on more debt. The additional risk equity capital improves the equity base and, thus, increases the borrowing capacity of the business. Development capital investors tend to take a minority stake in the business in

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exchange for the equity investment. This stakeholding (ranging from 30% to 40%) is in proportion to the value that they place on the business valuation—an issue that is often the main area of disagreement between owner-managers and their financiers.

Venture capitalists are in business to invest in undervalued, suboptimally managed companies with growth potential and to use new, existing, or transformed management to enhance or turn around business performance, thereby maximizing shareholder value on flotation or trade sale. According to BVCA (1999), about half of venture capital divestment are through trade sales, with flotation on SME capital markets accounting for another 10% of exits.

From the demand perspective, venture capital deals are not that popular in the private SME economy at large. According to researchers (ESRC Business Research Centre, 1996; Poutziouris et al., 1998), venture capital financing represents as little as 3% of external finance for SMEs. However, venture capital has played a central role in the financing of ambitious growth companies that have transformed into the growth stars of the new economy. Owner-managers of venture capital-backed growth stars are generally comfortable with the diluted ownership control (30% to 40% reduction of stake) and the sharing of management control, as venture capitalists or their representatives normally take a seat on the board of backed companies.

The Strategic Orientation of Family Firms—In Search of Growth Stars

Evidence from the SME economy suggests that a minority of family business owner-managers are growth orientated. Most owner-managed ventures are lifestyle activities and the motives of their owner-managing directors (OMDs) are not always financially orientated (Westhead, Cowing, Storey, 1997). The strategic orientation of the lifestyle ventures is tuned to the "Small Is Beautiful" socioeconomic ethos. The predominant small family business owner-manager prefers the status quo (Reid, Dunn, Cromie, & Adams, 1999) and cherishes an autonomistic culture (Birley, 1996).

In a recent empirical analysis of the responses of family business OMDs about their business and personal goals concerning the future of their business, Poutziouris (2000) categorizes the UK SME family business economy into the following four generic groups:

- *Traditionalists:* This group represents OMDs of traditional and lifestyle family firms that have a propensity to retain family control across generations. They appear interested in carrying on as normal (maintaining the status quo) and in enjoying independence and control, possibly until market conditions or family developments make them reconsider their business agenda. This type of firm represents the majority (i.e., 61%) of family companies.
- *Open-growth stars*: This group represents OMDs who are interested in increasing the size/scale of the business, organically or via acquisitions and joint ventures. They do not abide dogmatically to introverted family business traditions and are willing to recruit outsiders and to raise external capital to finance their expansion and diversification, which may subsequently lead to flotation. This group comprises 21.4% of family companies.
- *Strugglers:* This group of OMDs have no clear strategic orientation, as they are subject to financial pressures and have to limit their drawing/payout to make the books balance. They do not have diversification/expansion plans, as they are struggling and, so, survival precedes plans to retain the business in the family. This group makes up approximately 15% of firms.
- *Exiters:* This group considers exit options either through trade sale or even flotation. This group represents a small minority of less than 4% of family companies.

According to Romano, Tanewski, and

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Smyrnios (2000), the openness of family companies to externally generated sources of capital are interrelated to personal, familial, and business objectives and aspirations, as well as certain market-imposed capital requirements (i.e., as in the case of fast-growing, capital-intensive, high-technology ventures and so on). Evidence suggests that the higher the extroversion of family company OMDs—positively associated with growth aspirations—the more adventurous they are with external capital. Introverted and closely held family ventures, which adhere strongly to family business control, are less likely to pursue business growth agendas and, consequently, tend to be more reliant on internally generated funds and a conservative approach to financing. External financing of privately held smaller companies is heavily biased toward short-term fund solutions. There appears to be an aversion to institutional finance and, in particular, external equity. This antipathy to external, long-term finance (both debt and risk equity capital) is particularly strong in family companies. This is symptomatic of the behavioral side of the strategic financial development agenda of privately held companies (Michaelas, 1998).

The behavioral side of business venturing, which is stronger in the case of family firms, naturally plays a crucial role in shaping their financial structure-conduct and performance. In contrast to the large business organizations that normally have a separation of ownership from management control, family companies operate as an extension of the ethos of their owner-managers (Birley, Ng, & Godfrey, 1999).

The Financial Development of Family Companies

In a recent comparative analysis of the balance sheet structure of family and nonfamily companies, Poutziouris, Michaelas, Chittenden, and Sitorious (2000)—after controlling for the impact of demographic variables such as age, sector, and size—find evidence to suggest that family-controlled companies tend to invest more in tangible rather than intangible assets; have fewer long-term liabilities (i.e., fewer long-term loans, etc.); and through the retention of profits, build a stronger equity base (i.e., shareholders' funds).

Interestingly, given the adherence of family firms to the retention of profits, certain traditional family companies, that is, in production and distribution activities, have stronger corporate equity (shareholders' total assets) than their private counterparts do. This high level of equity suggests that certain groups of family companies—especially growth-oriented ventures with a more open culture—appear to be more bankable and could benefit from the advantages of venture capital (infusion of financial and human capital) when they embark on growth agendas, provided the deal addresses certain restrictive aspects that are incompatible with their ethos, e.g., dilution of control, exit options, and so on.

In line with the above discussion, the central research inquiry addressed in this paper concerns the extent to which concentration (in the case of introverted family companies) or dilution of ownership has an impact on the financial strategies (as epitomized by venture capital dealings) of private and family companies. The present project builds on previous comparative analysis of the financial structure-managerial, behavior-business performance of family and nonfamily private SMEs (see Poutziouris, Chittenden, & Michaelas, 1998; Poutziouris, Chittenden, & Michaelas, 1999; Poutziouris, Michaelas, Chitenden, & Sitorious, 2000) and provides further empirical evidence on the *Quo Vadis*: Financial Development of Family Companies as governed by the pecking order principles.

Hypotheses Development

According to the pecking order hypothesis (Myers, 1984), privately held, smaller companies finance their capital needs in a hierarchical fashion, first using internally available funds, followed by debt and then, finally, external equity. This preference reflects the relative costs of various sources of finance, owing to the existence

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of information asymmetries. It could be argued that the pecking order hypothesis is particularly relevant to family firms, as they are widely characterized by an aversion to outside capital infusions (Dunn & Hughes, 1995; Gallo & Vilaseca 1996; Poutziouris et al., 1998; Romano et al., 2000; Poutziouris, 2000), and they experience relatively more restrictive transactional and behavioral costs in raising external equity (Pettit & Singer, 1985). Furthermore, a stock market flotation would widen the share ownership of the firm, leading to loss of control by the original owner-managers or even a hostile takeover. As such, the rational response of owner-managers of smaller private companies is to avoid the use of external equity finance and to rely more heavily on retained profits and short-term bank loan finance.

In a recent empirical investigation, Poutziouris, Chittenden, and Michaelas (1998) established that the financial development of private companies is influenced by the state of the economy, conditions in the capital markets, internal business characteristics, and the owner-directors' attitudes toward financial independence, business risk, and family business control. Owing to these considerations, it appears that private companies do not necessarily optimize their capital structures when deploying external sources of finance. OMDs adhere to the pecking order philosophy: a sequential preference for internally generated funds (mainly through the retention of profits), followed by short-term overdraft finance and then medium-term bank loans. External equity finance is rare and is often considered as a last resort.

However, evidence from practice reveals that certain growth-inspired family companies employ outside equity capital to finance strategic transitions, such as market-oriented business growth, generational and management succession, widening the capital base in the context of an MBO/MBI, and other exit options (Poutziouris, 1999). Therefore, it is imperative to establish the attitude of family OMDs toward externally generated equity capital as they confront the "growth versus control" dilemma. More specifically, this research paper aims to test empirically the following generic hypotheses governing the financing of family businesses vis-à-vis the experience of their mainstream private counterparts:

- *H1: Family firms tend to use more internally generated funds for their development* (Ward, 1987, p. 3; Corbetta, 1995; Poutziouris et al., 1998).
- *H2: Family firms have a stronger antipathy toward external private equity—venture capital deals* (Dreux, 1990; Dunn & Hughes, 1995; Westhead & Cowling, 1997b; Gallo & Vilaseca, 1996; Upton & Petty, 2000).

The purpose of this explorative investigation is to consider the prevalence of behavioral and business factors that influence the flow of private equity risk capital (in the form of development finance, replacement capital, etc.) to private companies (family and nonfamily) from a demand perspective. More specifically, the paper seeks to test the aforementioned hypotheses and to address the following two questions:

- Do owner-managers of private companies (family and nonfamily controlled) and family companies have different rationales for seeking venture capital?
- What is the perception/experience of owner-managers of private companies about the problems/areas of dealing with venture capitalists?

Data and Methodology

The database under analysis is the result of the 1999 survey into the Financial Development of Smaller Private and Public Ltd. Companies comprising 254 private companies and 89 smaller public limited companies quoted on the different London equity markets, e.g., AIM, OFEX, and LSE. This paper reflects on the views of 240 owner-managers of private companies, of which 62.5% classified their ventures as family firms. The fact that the classification of sample companies as family firms is based on the perception of OMDs is not a panacea to the caveats relating to the definition of the family business

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(Westhead & Cowling, 1998).

The distribution of sample family companies by the generation in control revealed that founders still controlled 60.6%; 25.4% were in the hands of the second generation of family owner-managers; and 14% were generational firms that reached the third generation (and beyond) of family owner-managers. This survival rate across generations is broadly in agreement with research from the following: Stoy Hayward/LBS (1990); Dunn (1995); Cromie, Stephenson, and Monteith, (1995), Poutziouris and Chittenden (1996), and Reid, Dunn, Cromie, and Adams (1999).

Table 1 shows a breakdown of demographic characteristics of participant family and nonfamily firms in terms of age, size, and sectoral distribution. The demographic profile of the database of private companies can be summarized as follows:

- Age distribution: The majority of family companies (60.4%) are more than 20 years old, with a median age of 28 years.
- Size distribution: About 45% of family companies have sales turnover in excess of £5M, whereas 22.1% employ more than 100 employees. Median sales turnover is £4 million and median number of employees is 45.
- Sectoral activities: It appears that family companies are predominant in manufacturing, construction, and distribution, but less so in services.
- Interestingly, 18.8% of family companies classified their business activities as high technology, compared with 32.7% for the nonfamily business sector.
- Transfer of ownership: Only 12.6% of family companies have been through ownership change (e.g., MBO/MBIs, acquisition, family sale/acquisition), which is approximately one quarter of the level for nonfamily companies.
- Family shareholding: Generally, family firms are regarded as more traditional ventures whose OMDs' propensity to keep it in the family results in a profound antithesis to outside equity partners. A distribution of sample family companies by family found the majority of family firms (65.3%) to be "totalitarian regimes," with 100% of shareholding in the hands of the family (and its units); only 3.5% of sample family firms said that the traditional owning family had less than 50% of shareholding.

In summary, the present database appears to be representative of the small to medium-size enterprise family business economy in the UK. Family companies are characterized by a concentration of shareholding in family hands and a static ownership regime, as a small minority of sample companies reported an ownership transfer in recent years.

Empirical Results

Table 2 shows a comparative account of the funding structure of family versus nonfamily companies and highlights the importance of retained profits as the overriding source of capital. Moreover, it reveals that the external financing of private companies is heavily biased toward short-term funding solutions.

It is evident that there is an aversion to institutional finance and, in particular, external equity. This antithesis to external long-term finance (both debt and risk equity capital) is particularly strong in family companies.

Table 3 summarizes responses of OMDs of family and nonfamily companies about sources of development capital used and reveals the following statistically significant ($p < .05$) differences: family firms tend to draw more social capital from the family network, but are less enthusiastic about venture capital.

In summary, an analysis of financial structure of family companies vis-à-vis that of mainstream private companies demonstrates that the majority of family business owner-managers have a relatively short-termist attitude to financing that may lead to capital deficiencies, especially during a downturn in the economy. Arguably, sustainable development and growth of family companies

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Table 1. Profile of Database of Private Companies

Number of Responding Companies	*Family Firms (n = 150, 62.5%)*		*Nonfamily Firms (n = 90, 37.5%)*	
Age Distribution				
(Median: Years Trading)		(28) years		(18.5) years
<10 years		15.6%		27.1%
11-20 years		24.0%		23.9%
20+ years		60.4%		49.0%
Size Distribution	***1996***	***1999***	***1996***	***1999***
(Mean: Sales Turnover)	(£3.4M)	(£4.0M)	(£3.2M)	(£4.0M)
<£1M	15.7%	10.9%	21.2%	10.4%
£1M-5M	48.2%	45.5%	50.0%	49.3%
£5M+	36.1%	44.6%	29.8%	30.3%
Size Distribution (Employment)	***1996***	***1999***	***1996***	***1999***
(Median: Number of Employees)	(40)	(45)	(46)	(50)
<10	11.5%	9.6%	10.6%	6.1%
10-50	47.2%	43.3%	45.5%	45.4%
50-100	20.1%	25.0%	24.2%	21.2%
100+ employees	21.2%	22.1%	19.7%	27.3%
Sectoral Distribution				
Agricultural, forestry, fishing		2.7%		
Manufacturing		27.0%		23.2%
Construction		19.8%		7.2%
Transport/distribution		7.2%		1.4%
Trade (retail and wholesale)		9.9%		10.1%
Services		20.7%		36.2%
Other activities		12.6%		21.7%
Transfer of Ownership in Recent Years				
Yes		12.6%		49.3%
No		87.4%		51.7%
Technology Intensity				
High tech		18.8%		32.7%
Medium tech		44.3%		47.7%
Low tech		36.9		19.3%

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Table 2. Funding Structure of Private SMEs

Source of Finance	*Family Companies* *% of All Funding*	*% of External Funding*	*Nonfamily Companies* *% of All Funding*	*% of External Funding*
Retained profits	51.5	—	42.8	—
Bank overdraft	17.9	52.4	15.5	37.5
Owners' equity	14.4	—	15.7	—
External loans	6.2	18.2	8.5	20.4
HP/finance leasing	4.7	13.8	10.9	26.3
Factoring	2.6	7.6	3.8	9.2
External equity	0.8	2.3	1.3	3.1
Other	1.9	5.6	1.5	3.5

Source: Poutziouris, P., Chittenden F., & Michaelas N. (1998, June). *The financial affairs of private companies.* Liverpool: Tilney Fund Management.

Table 3. Sources of Development Finance for Private SMEs

Source of Finance	*Family Companies*	*Nonfamily Companies*	*T Statistic*
Retained profits	92.8%	90.1%	-.61
Bank overdraft/loans	72.1%	81.7%	1.53
HP financing/leasing	42.3%	43.7%	.17
Owners' equity	22.5%	31.0%	1.24
Capital from directors	20.7%	28.2%	1.13
Capital from family	*15.3%*	*2.8%*	*-3.15**
Factoring	9.9%	7.0%	0.29
Business angels/private investors	2.7%	7.0%	1.27
Other sources	2.7%	2.8%	.05
Venture capital	*0.9 %*	*25.4%*	*4.63**

*$p < .05$

necessitates the steady flow of long-term capital, particularly when there is a need to finance certain business transitions—for example, accelerated growth, internationalization, and transfer of ownership to the successive generation.

In addition to capital requirements central to the financing of business development, the family business may have to offer liquidity to certain family investors—that is, retirement funds for founders, payouts to passive minority stakeholders who wish to exit, and so on. In such cases of increased capital needs, the traditional sources of finance could prove to be inadequate and inconsistent, thus necessitating the use of external venture capital.

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Rationale for Venture Capital

It has been documented that the majority of all private companies, including family companies where ownership is sustained in family hands for longer, have a profound antithesis to venture capital. Notwithstanding, investigations (Poutziouris, 2000) demonstrate that a group of family companies are open to long-term external capital to ensure sustainable investment in new technologies and marketing strategies that can help them to develop their competitiveness in the new economy.

Table 4 shows a series of reasons why private companies consider utilizing external venture capital. Respondents rated rationales for dealing with venture capital on the 1 to 5 Likert scale, where 1 = not important and 5 = very important. According to OMDs of both subgroups of the private SME economy, the primary important reason for raising external equity finance is to finance growth. Notably, the rationale of family and nonfamily companies for considering venture capital does not vary significantly. It seems that family business owner-managers, and to a lesser extent, OMDs of nonfamily private companies, have an idiosyncratic business culture—staying there as independent.

The main differences in terms of the motivation of family and nonfamily companies to seek venture capital are based on their propensity to pursue certain business strategies. In summary, family companies, when compared to their nonfamily counterparts, are less likely to use venture capital for the following purposes:

- To invest in research and development that will enhance the growth potential of the business ($p < .05$)
- To finance growth strategies via acquisitions ($p < .1$)
- To finance the shaping up of the balance sheet to become more bankable and appealing to potential investors ($p < .1$) in the context of a potential flotation

It is evident that private company owner-managers remain wary of parting with venture capital. Anecdotal evidence suggests that this anti-venture-capital stand prevails even though owner-managers of private companies have

Table 4. Rationale for Venture Capital Dealings

	Family Companies (n = 150) Rated Important	*Nonfamily Companies (n = 90) Rated Important*	*Family Companies (n = 150) Mean*	*Nonfamily Companies (n = 90) Mean*	*T Statistic*
To finance growth	45.6%	56.2%	3.50	3.56	-.4
To finance acquisition program	29.2%	40.0%	2.88	3.24	-1.72**
To pass on company and retire	25.5%	20.2%	2.64	2.59	0.21
To develop new products/markets	24.8%	36.7%	2.88	2.97	-.47
To expand/move into new premises	24.2%	22.8%	2.62	2.45	.80
To repay borrowings	19.0%	21.1%	2.67	2.53	.66
To groom the balance sheet	16.1%	26.7%	2.23	2.61	-1.75**
To realize capital	15.4%	20.0%	2.23	2.53	-1.51
To diversify wealth	11.0%	13.3%	2.10	2.16	-0.34
To buy out existing shareholders	10.1%	9.1%	1.96	1.84	.51
To finance research & development	6.0%	27.3%	2.61	2.38	-3.17*

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

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partially relinquished shareholding control. The level of share ownership required by venture capitalists is normally less than 50%, with a typical stake between 30% to 40%, whereas a single seat on the board of directors is also common. However, if the business does not meet certain performance parameters, venture capitalists revert to tactical clauses as part of the deal structure, which give them more power to turn around business fortunes and/or shake up the owner-management regime.

Antithesis to Venture Capital

The most problematic issues perceived by OMDs of private companies in terms of venture capital relationships relate to dilution/loss of control and loss of management freedom of action (see Table 5). Other important considerations are pressure from third parties to meet profit/dividend targets and the costs associated with external equity finance.

In contrast to the views of OMDs of mainstream nonfamily companies, owner-managers of family businesses appear to be more concerned about problems (perceived rather than experienced) that venture capital deals often involve. More specifically, the comparative analysis of views of the two subgroups established the following statistically significant differences: family business directors are more concerned about the displacement of family managers with outsiders, and they feel less knowledgeable with the mechanics and rules of the venture capital deals.

Realistically speaking, the great majority of private SMEs either do not have the capacity or the motivation to progress to that stage of business development where they will have to consider the private equity capital option. However, it is my thesis, supported by anecdotal evidence and research noted above, that due to the prevalence among smaller company directors of the general antipathy (and myopia) about venture capital dealings, the majority of privately and closely held owner-managed ventures (often not in pursuit of growth strategies in the emerging

Table 5 . Perceived Problems, Issues in Venture Capital Deals

	Family Companies (n = 150) Rated Important	*Nonfamily Companies (n = 90) Rated Important*	*Family Companies (n = 150) Mean*	*Nonfamily Companies (n = 90) Mean*	*T Statistic*
Dilution/loss of control	71.6%	59.2%	4.07	3.78	1.5
	63.0%	59.2%			
	60.0%	48.9%			
	40.5%	32.4%			
	43.2%	26.8%			
	49.5%	46.5%			
Loss of management freedom			3.88	3.76	0.59
Third-party pressure to meet targets			3.74	3.41	1.62
Pressure to change the management			*3.29*	*2.88*	*2.2**
Lack of knowledge about VC			*3.29*	*2.74*	*2.59**
Financing costs			3.43	3.36	0.34

* p < .05

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new economy) experience an information gap about the mechanics of venture capital provisions.

Conclusions and Policy Implications

Findings of this explorative study indicate that the financial development of family companies is governed by the "keep it in the family" tradition. In contrast, mainstream nonfamily companies are more likely to be growth inspired and, subsequently, adopt a more market-oriented approach to funding. Empirical evidence supports the following two generic hypotheses:

- Overall, family companies are systematically more dependent on internally generated funds (i.e., retained profits) for their survival and development.
- Family companies are not enthusiastic about widening the equity base—with venture capital—at the cost of relinquishing family business control.

Thus, family companies seem to be more skeptical about fast-growth plans, as such plans often entail relinquishing control and more dependence on external investors (long-term debt or private equity providers).

Evidence seems to suggest that closely held family firms adhere relatively strongly to the pecking order philosophy. As a result, family firms tend to have a wider base of internally generated equity—that is, share capital plus retained profits. Despite their symbolic level of issued capital, family firms tend to build a strong equity base over time through the retention of profits (Poutziouris et al., 2000). This sustainable marriage of ownership and management control, coupled with an idiosyncratic and prudent funding approach, enables family-owned firms to embark independently on business strategies and transitions—that is, succession across generations with a minimum of influence from outsiders.

Some family companies have survived many recessions and outlived many conglomerate-owned business competitors because they enjoy a pool of internally generated equity capital and strong support from the family and loyal associates (who exhibit an idiosyncratic knowledge about future strategic plans). Therefore, we can hypothesize that certain growth-inspired and established family companies could represent a less risky investment for a family business-friendly, private equity provider.

Multidimensional Policy Issues. The empirical results of this investigation have a series of ramifications for company OMDs, their suppliers of financial products, advisory and general support service providers, and enterprise policy makers.

Family business OMDs. The present findings suggest that owner-managers of family companies are in business for a variety of reasons other than just the maximization of profits. Better understanding and balancing of market-tuned growth plans with the owner-inspired family business control culture is paramount for the design and implementation of effective strategic business and financial planning. In the context of enhanced capital requirements to finance fast-growth activities and other concurrent business transitions (e.g., succession), external equity could prove to be indispensable to sustainable growth of the business and family harmony. When mapping out their long-term strategic business and family plans, it is important for family owner-managers to consider the *Quo Vadis* in terms of evolving financial development, ownership, and corporate governance regimes.

Financiers. Family companies are characterized by intertwined family and business dynamics. Financiers should familiarize themselves with the critical issues (market based and familial) confronting the survival and growth of the family company. Understanding the sociocultural, financial, economic, and legal aspects related to the joint development of the family and the business would help to segment the family business economy better and, thus, ensure the development of family business-friendly equity investment options. Family companies are not very enthusiastic about venture capital deals. Moreover, according to anecdotal evidence, the empathy gap between venture capitalists (VCs) and OMDs of family companies

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is due not only to asymmetries relating to strategic growth objectives, but also to exit routes—at the moment the preferred exit route of the VC is though trade sale or flotation (Gasson, 1999).

Another dimension of the empathy gap is related to family companies being antithetic to venture capital options simply because they feel less knowledgeable and comfortable about deal structures. Thus, VCs have to develop more case studies featuring success stories of family businesses that have benefited from venture capital support (in terms of finance, management expertise, and access to a network of corporate associates).

There is a need to revisit the topic of venture capital and family business relationships from the supply side. It would be useful to establish how VCs develop and market their services to family firms (in particular, those going through succession). In other words, how do they deal with certain behavioral and cultural issues? What are the main problems characterizing the deal structure?

Tax policy makers. There is evidence to suggest that private companies have an aversion to external equity investments. Principal sources of capital are internally generated funds, mainly through the retention of profits (sweat capital). The operationalization of the pecking order calls for more tax-based schemes seeking to offer an allowance for corporate equity—ACE. This will ensure that reinvestment of profits receives the same tax treatment as interest paid to lenders (Poutziouris, Chittenden, & Michaelas, 2001) and also gives incentive to the issue of new share capital.

Moreover, although transfer taxes, with tax planning, can be rolled over where the business continues to trade (capital gains tax) or postponed (inheritance tax), they mount a double taxation on business success and adversely affect investment in the long-term growth and prosperity of all private companies (Astrachan & Tutterow, 1996). Transfer taxes should be rationalized to promote family business entrepreneurship as well as facilitate early business transfers across generations.

The present findings reveal that external equity participation is not an important source of finance in private and family companies owing to the empathy gap between family objectives and institutional conditions. However, family owner-managers tend to cherish long-lasting bonds with associates and relatives, which could make them natural equity partners. At the moment, the rules of the Enterprise Investment Scheme tend to discriminate against certain familial equity investors prepared to back the survival and growth of family companies with familial capital. The fiscal regime ought to recognize the importance of familial and social capital in terms of widening the financial (and human) capital base of closely held family firms (Fukuyama, 1997).

Epilogue. The following statement expressed by an anonymous entrepreneur involved in the survey is thought provoking:

> Venture capital has been a horror dream on a 24-hour basis…but it did work for the financing of the sustainable growth of our family business. However, in the SME economy, returns rarely materialize as quickly as anticipated and you should jump into bed with a VC who is prepared to take a longer view.

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