

FINANCIAL PERFORMANCE OF FAMILY AND NON-FAMILY BUSINESSES

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Abstract

There has been much research on family and non-family businesses. During the 1990s special attention has been directed at problems of ownership. The paper is based on two research reports on Swedish family businesses. One of them concerns statistics for 1985 to 1994, involving data collected for legal entities. In measuring financial performance data were aggregated over all the firms in the category in question. In 1994, family firms accounted for 96,4% of the total number of firms, 54,5% of the total number of employees, 46,8% of the total sales, 25,9% of the total net income before taxes and 43,3% of the total corporate income taxes paid. Family firms were as good as non-family firms in the terms of profit margin, return on invested capital and average interest costs. Large differences between family and non-family firms were found in return on equity before taxes, equity-to-asset ratio, effective corporate income tax rate and use of government grants and support.

Introduction

During the 1990s there has been a growing interest in research on family businesses. Both problems of small firms and of entrepreneurship and problems of ownership have been dealt with. The following research problem is of interest: What differences are found between family and non-family businesses?

There is no theory relating specifically to family businesses or to managers of family firms. It would appear that problems of family businesses can be subsumed under problems both of small businesses and of entrepreneurship. Two opposing views on family businesses are found. According to Ang (1992), there is nothing special about a family business, although there are differences between small businesses that are privately held and their larger counterparts, implying the major differences to be due to size rather than to type of ownership. Leach (1994), in contrast, considers family businesses to differ from non-family businesses in many ways. "The overriding characteristic that distinguishes most family businesses is a unique atmosphere which creates a 'sense of belonging' and an enhanced common purpose among the whole work-force" (Leach 1994, pp. 5-6).

Five separate research projects in this area in work supported by The Swedish Foundation for Small Business Research have been conducted. These have been concerned, respectively, with the following:

- Financial performance of family and non-family businesses
- An overview of research on family businesses throughout the world
- The growth, stagnation or death of a group of medium-sized manufacturing firms
- Three cases of the path to growth and stability
- An ideological mustering of strength in medium-sized family firms.

As this listing of projects indicates a broad perspective was taken on family business questions. Research results from differing parts of the world, statistics available on Swedish firms, questionnaire studies of different firms and in-depth case studies were involved. There was a real need for this, since knowledge of family businesses is rather limited. The present paper concerns results of the first project (Gandemo 1998a) and the second one (Gandemo 1998b).

One question of interest is how a family firm should be defined. In a discussion at an ICSB workshop in Stockholm in 1996 David Storey declared "The number of family businesses depends on how you define them". The most common definitions include criteria applied to the owner family or families and to the involvement of family members in management or the board of the firm.

Two definitions will be examined here.

According to Smyrnios et al. (1997), a family business should fulfil at least one of the following four criteria:

- More than 50% of the ownership being held by a single family
- More than 50% of the ownership being held by more than one family
- A single family group effectively controlling the business
- The majority of senior management being drawn from the same family

In Westhead et al. (1997) a family business is defined as a company in which

- the chief executive, managing director and/or chairman perceived their business to be a family firm *and*
- the majority of ordinary shares in the company were owned by a single family group related by blood or marriage.

The latter definition, concerning both the persons in management and ownership by one single family, is more strict than the former definition was. Sometimes researchers add other criteria to their definitions, e.g. that a change of generations has taken place or can take place.

Research on family businesses

Research on family businesses has been of growing interest in many countries, particularly during the last 10-15 years. Many of the studies carried out have pointed to a lack of capital being a distinguishing trait of family businesses but there are other characteristics of note.

Donckels & Frölich (1991) found differences between family and non-family firms in both culture and the personalities of the managers. Luostarinen & Hellman (1994) compared the patterns of internationalization in family and non-family businesses, finding that in family businesses there is often a resistance to change, that family firms show slower internationalization than non-family firms, and that there are also differences between the two in goals, organizational climate and corporate culture.

Cromie et al. (1995) formulated and tested various hypotheses on differences between family and non-family businesses, collecting data by questionnaires. Family businesses were found to be more frequent within the manufacturing and business service areas and to have a greater number of employees than non-family firms.

Westhead et al. (1997) found the business of family firms to often be locally anchored, but they obtained no significant differences between such firms and non-family firms in terms of a number of economic performance measures, such as growth rate for sales and number of employees.

Smyrnios et al. (1997) conducted a comprehensive questionnaire survey of 5,000 family firms, studying such factors as lines of business, ownership, changes of generations, growth rate, financing, strategy and planning, and management.

There have also been discussions of family firms concerned with university training (Mugler 1995), change of generations (Bös & Kayser 1996, Smyrnios et al. 1997), survival (Schulze 1996) and situations faced in the next millennium (Donckels 1996).

Methods

Statistics Sweden, the official bureau of statistics in Sweden, presents a yearly report on financial accounts. Compiled data for the total business sector and for various parts of it are available. The legal or reporting units are employed in compiling such financial data. The various units considered are non-financial limited liability companies, partnerships, limited partnerships and co-operatives. Unregistered firms and inactive companies are not included.

Family firms are firms not owned by either the government, municipalities, consumers' cooperatives, producers' co-operatives, stock-quoted firms, foundations or foreign companies. There are also both family firms with subsidiaries and without. In the statistics, family firms are designated as closely-held firms. For such firms there are certain tax rules that do not apply to other types of ownership. In other contexts, it is more common to refer to these as family firms rather than as closely-held firms. Statistical tables were compiled for data concerning family-owned and nonfamily firms so as to be able to compare the financial performance of the two. For family firms, data were tabulated for the size categories 0-19, 20-49, 50-199 and 200 and more employees. Data were available for the years 1985 (1986 for size classification) to 1994. Due to a change in the statistical data base, it will not be possible in the future to study the financial performance of the two ownership categories.

Before carrying out the research I formulated a tentative hypothesis that, in comparing the financial ratios of firms, differences in type of ownership are not as important as differences in firm size. The underlying arguments are based on the results of earlier studies of Swedish firms.

Aggregate figures on numbers of firms and numbers of employees, together with detailed information concerning income statements, balance sheets and capital investments were available from Statistics Sweden. Figures on sales, income, wages, total assets, net capital investments, equity, untaxed reserves, new share issues, dividends, and state and municipal subsidies were collected for the firms as a whole, differentiated in terms of family firms and non-family firms.

Financial ratios were calculated for comparisons of the family and non-family categories. Gross profit margin, return on total assets (ROA), operating income as a share of the income in ROA, average interest costs (exchange profits/losses included), return on equity (ROE), equity-to-asset ratio, current ratio, effective corporate income tax rate and government and municipal subsidies as percentage of sales were included. Sales, wages and value added per employee were also calculated so as to obtain some kind of efficiency measure. Various of the performance measures are presented below. For further details see Gandemo (1998a).

Some basic statistical results

The numbers of family and non-family firms and the numbers of employees are presented in tables 1 and 2.

Table 1 Total numbers of firms 1985-1994 and percentages of family and non-family owned

Year	Number of family owned	Number of non-family owned	Total number of firms	Percentage family owned	Percentage non-family owned
1985	112 733	6 498	119 231	94,6	5,4
1986	117 431	6 986	124 417	94,4	5,6
1987	132 989	6 844	139 833	95,1	4,9
1988	144 791	6 114	150 905	95,9	4,1
1989	157 023	6 321	163 344	96,1	3,9
1990	164 378	5 945	170 323	96,5	3,5
1991	183 229	6 311	189 540	96,7	3,3
1992	193 367	6 601	199 968	96,7	3,3
1993	201 268	7 086	208 354	96,6	3,4
1994	205 176	7 599	212 775	96,4	3,6

Table 2 Total numbers of employees 1985-1994 and percentages of family and non-family firms

Year	Number in family owned	Number in non-family owned	Total number of employees	Percentage family owned	Percentage non-family owned
1985	861 659	946 181	1 807 840	47,7	52,3
1986	882 830	955 065	1 837 895	48,0	52,0
1987	893 717	953 317	1 847 034	48,4	51,6
1988	1 007 931	895 765	1 903 696	52,9	47,1
1989	1 089 698	861 356	1 951 054	55,9	44,1
1990	1 108 908	869 313	1 978 221	56,1	43,9

1991	1 106 220	831 739	1 937 959	57,1	42,9
1992	985 526	827 397	1 812 923	54,4	45,6
1993	915 859	801 885	1 717 744	53,3	46,7
1994	982 276	819 535	1 801 811	54,5	45,5

In 1994 family firms made up more than 96% of the total number of firms and accounted for more than 50% of the total number of employees. A steady economic growth took place in Sweden up to 1990, when there was a peak of employment. This period was followed by a severe financial crisis during 1991-1992 with many bankruptcies and rising unemployment. In some industries the crisis started already in 1990.

A number of observations can be made on the basis of the statistical results shown in the tables 3 and 4.

Year	No. of firms	No. of employees	Sales	PBIT	Income Taxes	Wages	Value Added
1985	94,6	47,7	40,6	30,8	37,7	45,3	43,8
1986	94,4	48,0	42,2	30,1	38,4	45,7	44,6
1987	95,1	48,4	43,9	32,2	42,1	45,7	43,8
1988	95,9	52,9	48,8	33,8	43,5	50,3	48,3
1989	96,1	55,9	50,6	38,7	49,0	52,9	51,4
1990	96,5	56,1	51,4	32,6	53,5	53,0	52,0
1991	96,7	57,1	52,3	43,6	60,8	53,0	53,1
1992	96,7	54,4	48,6	31,4	51,4	50,3	48,7
1993	96,6	53,3	45,8	31,1	50,3	48,4	45,7
1994	96,4	54,5	46,8	25,9	43,3	49,7	46,1

Family firms normally have a lower share of the total corporate sector figures concerning sales and profits before income taxes (PBIT). On the other hand family firms pay proportionately more taxes than non-family firms. A tendency appears concerning number of employees, wages and value added. Wages and value added do not follow the number of employees, indicating productivity in family firms to be less.

Table 4 Percentages of family firms based on figures from balance sheets, etc. for the total corporate sector

Year	Total assets	Net cap. investments	Equity	Untaxed reserves	New share issues	Dividends	State and municip. subsidies
1985	32,2	41,3	20,4	30,7	21,6	10,1	16,0
1986	30,3	46,4	17,7	30,3	12,7	6,8	12,4
1987	30,7	47,8	19,9	28,9	16,5	14,4	21,5
1988	35,0	50,9	24,6	31,6	36,3	17,8	16,5
1989	38,0	50,4	27,6	36,0	30,4	13,1	19,5
1990	36,7	49,0	26,5	32,8	33,6	15,8	45,9
1991	36,1	48,3	25,7	33,3	15,3	14,3	19,7
1992	30,5	45,7	23,6	29,5	27,1	16,2	18,9
1993	28,0	39,1	21,8	28,6	14,5	21,0	20,7
1994	27,5	40,6	20,7	27,4	19,0	14,4	15,4

Family firms account for approximately 27-38% of the total assets, but their share of total net capital investments is higher. In all other respects, as evident in table 4, family firms account for a rather small share of the figures for the total corporate sector. For state and municipal subsidies this is somewhat surprising. I had expected these to be larger for the group of family owned, often small and medium-sized, firms. A peak for subsidies used by family firms in 1990 is probably due to a special kind of subsidies that year to firms of less than 20 employees.

Ratios of financial performance

Return on total assets (ROA) is shown in figure 1 (omitted) and average interest costs in figure 2(omitted). These ratios show that family firms perform about the same as non-family firms.

The higher level of ROA for family firms can be explained by their total assets being lower than those of non-family firms. The larger differences obtained between family and non-family firms in terms of average interest costs were expected. Additional measurements show these larger differences to be due, however, to size rather than ownership. The increase in the level of average interest costs from 1988 to 1992/93 caused considerable problems for Swedish firms. In 1992/93, exchange losses accounted for 0,5-1,0 percentage units in family firms and 1,1-1,2 percentage units in non-family firms. A healthy normalization of average interest costs took place in 1994.

As shown in figure 3 (omitted), there are large differences between family and non-family firms in return on equity (ROE). The higher level of it for family firms is due partly to their somewhat higher ROA but is mainly due to their lower equity-to-asset ratio (see figure 4-omitted), or differently expressed to their higher debt/equity ratio.

The levels of ROE in 1992 were too low to be attractive for investors and lenders, being lower than the normal interest rate on bank deposits. Without the rise in ROA in 1993 and the falling average interest costs which occurred in 1994, the situation for the Swedish economy would be serious. The recovery of the economy in 1994 was very rapid. The combined effects of a rise in ROA and falling average interest costs restored the levels of ROE then to more normal figures of some 20-25% before taxes.

Equity-to-asset ratios are shown in figure 4 (omitted). The fact that the ratios have increased during almost the entire period can be observed. This is mainly due to relatively high ROE ratios, measured before income taxes, and to decreasing corporate income tax rates (see figure 5-omitted). The gap of some 7-10 percentage units between family and non-family owned firms can be explained by the access to the stock market which the majority of the non-family firms have. An equity-to-asset ratio of 25%, corresponding to a debt/equity ratio of 3, for family firms is quite acceptable, however.

Calculations of effective corporate income tax rates indicate a number of differences between the two firm-ownership types (figure 5-omitted).

In calculating effective corporate income tax rates, the sum of tax expenses and deferred taxes on yearly appropriations was placed in relation to operating income before appropriations and taxes. In 1990-1991, the corporate income tax rate was reduced from about 50% to about 30%. At the same time, however, transfers to untaxed reserves in the annual accounts in order to postpone or to reduce tax expenses were restricted.

There have been many peculiarities in the tax system, e.g. in group contributions to reduce taxes for firms within a group, different tax rates for operating income than for capital gains, deferred taxes in restructuring and mergers, and the use of losses carried forward. To some extent such measures explain both the declining tax-rate levels and the differences in effective tax rate between family and non-family firms. Normally, family firms cannot make use of many of the tax planning measures taken place within business groups.

Summary and conclusions

Earlier I referred to differences between the views of Ang (1992), who finds there to be nothing special about family businesses, and Leach (1994), who declares that family businesses differ in many ways from non-family businesses. From statistics on Swedish family and nonfamily firms I can conclude that there are both similarities and differences worthy to note (see table 5).

Table 5 Similarities and differences in financial performance between family and non-family firms

Similarities or small differences	Gradually increasing differences	Large differences
	<i>Discussed in the text</i>	
Return on total assets		Return on equity
Average interest costs		Equity-to-asset ratio
		Effective corporate income tax rates

	<i>Measured, or not discussed in the text</i>	
Gross profit margin	Sales per employee	Operating income as share of the income in ROA
Current ratio	Wages per employee	
	Value added per employee	Government and municipal subsidies as percentage of sales
	Net capital investments per employees	

Family firms are as good as non-family firms in carrying out normal business operations. Family firms (seen as a statistical population) do not seem to be negatively treated in the credit market, despite their higher debt/equity ratio. They have a higher return on equity, mainly due to their higher debt/equity ratio. Family firms do suffer in their treatment by the tax system, their calculated effective corporate income tax rates being higher than those for non-family firms.

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