The Research on Endogenous Financing of Small and Medium-Sized Family Enterprise

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Abstract: This paper does a textual research on the preference to endogenous financing and the culture of small and medium-sized family enterprise from the perspective of its particularity, and, holds that endogenous financing is the initiative choice of small and medium-sized family enterprise. The negative effects of this financing method are mainly the shortage of funds, the unreasonable internal governance and not realizing the profit maximization goal. Therefore, the financing innovation of family enterprises must center on the property rights system and enterprise culture etc.

Keywords: Small and Medium-Sized Family Enterprise, Financing Method, Capital Structure

Introduction

The financing problem of small and medium-sized family enterprise has been always the focus in the theory field. According to the different research angles, there are two clues in the problem of small and medium-sized family enterprise from home and abroad. According to the point of external enterprise, parts of scholars try to research on capital market, ownership discrimination and scale discrimination etc. and explore the financing difficult problem. Other parts of scholars are standing in the internal enterprise, using the mainstream theory to discuss the financing difficult problem of small and medium-sized family enterprises. All these studies have certain persuasion and theoretical significance, but, from the academic point of view, the literatures with real theoretical value are very limited. The universal defect of the financing research on family enterprises is that, the family enterprises have been taken as common enterprises, and the unique characteristics of family enterprises have not been analyzed yet. However, these unique characteristics can affect the financing arrangements of family enterprises, which also present behavioral characteristics as the preference to endogenous financing. This paper, therefore, conducts a systemic investigation in the financing method that is born in small and medium-sized family enterprise, in order to study the financing method through innovation and solve the financing difficult problem of family business. Must be made clear is that from the respect of enterprise scale, family enterprises are mostly small and medium-sized enterprises. It is the small and medium-sized enterprise what this paper calls family enterprise, while the larger and public enterprises are not within the scope discussed in this paper.

1 Endogenous Financing is the Initiative Choice of Family Enterprises

The family enterprise denoted in this paper is the enterprise which are founded and managed by a group of people united by ties of consanguinity, whose ownership is completely owned or controlled by the family, whose operation and management right is dominated by the family with overall responsibility for the daily operation and management. Since the family enterprise is a special kind of enterprise organization, it has many specialties, which will affect its financing arrangement. Usually enterprise financing can be divided into the endogenous financing and exogenous financing. Endogenous financing refers to financing in the enterprise, which with the characteristics of autonomy, finiteness, low cost and low risk, and, funds source includes the capitals accumulated from foundation and enterprise profit. Exogenous financing means financing out of enterprise, which with the characteristics of high efficiency, paid, low stability and high risk, including direct financing that issuing stocks and corporate bonds in the securities market and indirect financing that getting loans from financial institutions. The concerned investigation shows, in China, endogenous financing of family enterprises takes up 90.5%, bank loans only 4.0%, nonfinancial institution 2.6% and other channels 2.9%. Compared with non-family
-enterprises, family enterprises prefer endogenous financing and the order of financing is roughly capital accumulated in enterprise, raising money from relatives and friends, non-government borrowing, credit cooperatives loans and other ways.

The choice of the financing methods of different enterprises is the result of rational choice, for enterprises, in certain financing environment. While for family enterprises, the choice of financing methods must reflect the interests of family or “predestination community”. Therefore, only understand the special influence factors of family enterprises financing, can we better study the financing methods of family enterprises.

1.1 Family enterprises are in the nature of strong preference to endogenous financing

When the owners of family enterprises consider the financing arrangements, their goal is actually not the enterprise value maximized supposed in the mainstream theory. In family enterprises, due to the overlap of ownership and operation right, personal behavior factors make a decisive influence on the behavior of enterprises financing. The revenues of family enterprise are from two aspects: one part is the gains that are easily measured as money; the other part is earnings that are non-monetary and hard to measured, such as the entrepreneur’s achievement of resurgent family property and bring glory on their ancestors, the satisfaction of command and control, the honor attached to the entrepreneur title and a series of “affinity potential” that is corporeal and intangible social network capital etc. Moreover, family interests are often given high priority. In the financing process, family enterprises are the leaders of enterprise financing arrangements. The enterprise financing target is not just considering the enterprise value maximization, but realizing the interest of the whole family and enterprise. Because of the multi-goals enterprises pursued, family enterprise shows the preference to endogenous financing. Due to the risk of external financing, family enterprise will be very cautious. Compared with exogenous financing, endogenous financing does not have the risk of information disclosure and the operation of family enterprise basically relay on their funds. Even if they need external financing, they often prefer debt financing because the owners with strong desire to control enterprises are reluctant to use equity financing, what’s worse they contradict this method.

1.2 Endogenous financing is the natural choice under the influence of family enterprise culture

Family enterprises have their unique family idea or family cultural values and the long history of family culture and internal trust mechanism produces the natural choice of family enterprise endogenous financing. Under the path dependence of the profound “domestic culture”, Chinese family relation pattern is transplanted in the financing behavior of family enterprise. From the very beginning of its establishment and development, the financial resources are scarce. In this case, the culture resource “human sentiment first” in family ethics just makes up for it. Entrepreneurs mobilize the funds scattered in individual families by light of the advantage of “family power” and the blood and genetic relationship network, so as to make sure that its accumulate wealth functions can be fully into play, which is able to decrease the financing cost, on the other hand, reduce the financing uncertainty and financial risks. The family enterprises funded on the basis of special affection in which exist mutual trust, loyalty and supportive relationship. So the mutual trust and loyalty in this kind family enterprise will make their financing more convenient and low cost. In order to reduce transaction costs and control family enterprises, the family trust mechanism has become the supportive component which family enterprises choose endogenous financing to improve the financing efficiency.

2 Defects of Family Enterprise Endogenous Financing

With the expansion of the enterprise scale, it needs large financing funds, so the result is that high portion of endogenous financing and narrow channel in exogenous financing, what’s more the shortage of capital will become the “bottleneck” of family enterprises in their development. Meanwhile, the negative influence that the oneness of capital structure impacts corporate governance is gradually enlarged.
2.1 The shortage of capital is the obstacle hindered the development of family enterprises
The oneness of capital structure makes family enterprises low funds in external, and the internal funds could not meet the need of its development. This not only leads the opportunity cost of investment delay added, but also, with the outspread of its life cycle and the extension of intergenerational inheritance chain, the relationship between family members is just like water ripple—go farther and farther, become thinner and thinner, so as to the affinity and cohesion is faded gradually and the borrowing costs formed through the family relationships is increased.

2.2 The unreasonable internal governance structure in family enterprises
Superficially, the financing structure is a certain state that various funds sources formed in enterprises. Actually, however, it is a certain benefits structure that co-produced under the interdependence and interaction of their property rights. This benefits structure composes its corporate governance structure. The endogenous financing of family enterprise must form internal governance mechanisms dominated by family, which is blood relationship as a link and the distribution of power and the system between family members as a core. The enterprise, with individual decision and family decision most of time and even with controlling doctrine pattern, is dominated by one strong leader, which makes the democratic and scientific decision-making level low and unable to form a sound corporate governance framework.

2.3 Family enterprises can not realize the profit maximization goal
In china, the single way of capital structure in family enterprises intervenes in its operation. In family enterprises, its internal management is set up by the family relationships, which substitute family affinity for regulations, and, the management rules with economic benefits as a link are often ineffective. Its management is based on human relationship and family affinity; therefore, the important positions are usually occupied by core family members. So the business operations strategy and decision-making policy have embodied the balance and coordination of benefits between families and enterprises; the goal of enterprises is not targeted to profit maximization, but obey the needs of balance between family and enterprise.

3 Innovation of Family Enterprise Financing Method

3.1 Carrying out the property rights system innovation in family enterprises
The single property structure restricts the financing channels of family enterprises; thereby, it has hindered the expansion of enterprise scale. If family enterprises intend to become bigger and stronger, they will be bound to reform the closure of property system and absorb the non-family enterprises’ capitals, in order to realize the change from proprietorship to investment sources diversification. Property right system innovation must clear property rights, according to the principle of contribution, efficiency and fairness, and straighten out the property right relations between family members and define the property right. On the basis of the clarity of internal property, we try to realize the ownership diversification, whose forms are limited liability company, stock limited company or the joint-stock system, and achieve capital socialization by the form of shareholding, joint ventures and mergers etc. Moreover, some qualified and large-scale family enterprises could introduce social public investment to realize ownership diversification through going public. With the establishment of corporate governance structure, which has been separated into decision-making, management and operation, to improve the efficiency and stability of enterprises?

3.2 Establish the Brand-New Enterprise Culture
Enterprise culture refers to the behavioral pattern, value and code of ethnics that could get all enterprise members together in its long-term development process, which can increase the cohesion, centripetal force and endurance of organization and ensure the rationality of enterprise behavior, so as to improve the organization grow and develop healthily. At present, the family enterprises in China, the family culture is dominated and it essentially is the culture based on family affinity and lacked innovation consciousness, which is unfavorable to the absorption of external resources. If family enterprise intends
to merge the social financial capital together, it must realize the change from "family culture" to "enterprise culture", of which the emphasis is discarding the irrational concepts of blood and genetic relationship in the traditional ethics and establishing the sense of businesses and affairs connections adapted modern corporate system. Only get rid of the value judgment criterions discriminated between family and non-family members, and insist the principle that “appoint people on their merits”, can they realize the humane capital marketization.

3.3 Perfecting capital market and broadening financing channels
Firstly, we should construct the multi-level capital market as the main body of direct financing system, reduce the threshold of family enterprises going public and encourage them to finance in the main board market; we should take advantage of secondary market to open up financing channels for scientific and technological family enterprises and explore financing channels of overseas markets through foreign securities markets; meanwhile, we should reduce the threshold of family enterprises going public in the A market and promote the establishment of the secondary market actively, issue corporate bonds in order to promote the direct financing of enterprise. Next, to improve the bank-centered indirect financing system, we should reform the bank loan approval procedure and the access to information, as well as the operation mechanism and policy of loan suited for family enterprises, moreover, we actively encourage and guide the local small and medium-sized financial institutions to support the development of family enterprises. Finally, since multi-channel financing is an important measure to solve the difficult financing problem of family enterprise, we can choose to follow the example of state-owned enterprises in their combination between industry and finance, so that financial institution can participate in enterprise management, take blood transfusion for family enterprises, and guide and develop actively non-government financing.

Conclusion
Through the briefing of the relevant documentary, duo to the specialty of small and medium-sized family enterprises, we could not explain well their financing difficult problem if mainstream financing theory is applied mechanically. In addition to the objective condition, such as information asymmetry and the imperfect capital market etc, restricts its financing options, its own particularity is also the main reason for financing difficulty. This paper believes it is the strong endogenous financing preference and family enterprise culture that is the primary reason family enterprises prefer to endogenous financing. Now that there are much negative effects in the oneness of capital structure based on endogenous financing, the innovation of family enterprises' financing method will must be centered on the property system and corporate culture etc.

References