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FINANCIAL ASPECTS OF CZECH FAMILY BUSINESSES

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Abstract: The production and activity of family businesses are significant in the economy of countries. In order to function and be passed on to the next generation, companies should be financially sound. The aim of the contribution was to determine the indebtedness of Czech family firms. 245 Czech family firms participated in the qualitative study. The total indebtedness of Czech family firms is within the range of the recommended value between 30% - 60%. The level of indebtedness is moderate, mostly hovering at the recommended value below 1. It has long been known that family businesses prefer equity capital for financing It can be expected that, they will continue to struggle with the choice of appropriate management of the financing structure from either equity capital or debt capital.

Keywords: Czech Republic, Debt Capital, Equity Capital, Family Firms, Indebtedness

Family businesses (FBs) are specific in many ways. By examining their financial specifics, it is possible to find unique knowledge. The specifics include parallel financing of the family and the family business, incl. succession financing; financial management including the issue of indebtedness and, last but not least, sources of capital in the sense of increasing external capital. This is mainly influenced by the family's desire to maintain the ownership of the family business and the management of the business within the family, to ensure the family's financial independence, risk avoidance and intermingling of family and business matters [1, p. 17]. In the literature, FBs are presented as a combination of three systems that overlap and interact. It is a family system that is emotionally oriented and primarily focused on non-economic goals. The second is a business system that is results-oriented and focuses on economic goals. The third system is focused on asset management and ownership [2, p. 168] consider that family-oriented goals indirectly affect the overall rate of use of debt capital, and equity capital through the representation of generations involved in the management or ownership of the business. FBs show a lower level of indebtedness in relation to debt capital due to the founders' aversion to the risk of losing family control over the business. The tendency to use less short-term debt capital leads to a more conservative financial policy [3, p. 349]. External factors (e.g. economic and political environment, competitive environment, market relations, etc.) also play an irreplaceable role in influencing business risk perceived by business owners [4, p. 420]. Most SME FBs struggle with the preference of using debt capital and equity capital for investment in development, innovation and expansion. The extent of the need for financial capital, including external capital, depends mainly on the life cycle of the FBs, the number of family members employed in the FBs, and on specific plans for its development [5, p. 211].

FBs are characterized by the duality and ambivalence of the dimensions of family, business and property management, even in the case of financial issues. Financial decision-making in FBs is influenced by aspects that include long-term goals of passing the business on to a family member rather than solely profitability. The current state of family and business financial needs and the preference for handling family finances at the expense of business needs is often influenced by the need to put finances into the family or business, and individual family needs. These are providing housing, providing jobs for family members, ensuring operational stability, maintaining the excellent reputation of FBs and the family, and maintaining the size of the business at a level that the immediate family can manage [6, p. 47].

The area of financial decision-making is still under-researched. Most studies on financial decisions focused on the capital structure do not give clear answers to the question of what factors are relevant for the use of debt or equity capital, and what is the real financial logic of FBs [7, p. 360]. So far, it has not been clearly decided whether and under what conditions and for what purpose FBs prefer more debt financing to the use of their equity capital [8, p. 80]. Both forms respect the family level and the property level and are relevant from an economic point of view [9, p. 1201].

The goal of the contribution was to determine the indebtedness of Czech family firms. It has long been known that family businesses prefer equity capital for financing. However, the results of research on this topic are different.

Methodology: Research samples were obtained in the following ways:

1. By the method of primary qualitative research: discussion round tables, personal interviews, and on-site investigations. During the years 2014-2021, qualitative research was conducted with representatives of Czech FBs. The companies' legal forms limited liability companies and joint stock companies were selected. The reason was that data from the financial statements was needed for the research. Relevant financial data was obtained through a public database of economic entities. If accounting data were not publicly available, the author approached representatives of FBs to receive the data. If the author did not receive this data, the FBs were not included in the research. Less than 5 % of FBs were eliminated in this way.
2. Internal materials of FBs – annual reports, websites etc.
3. Processing of data from secondary external sources.

The research sample (n = 245) consists of Czech family businesses. According to the Ministry of Industry and Trade of the Czech Republic, the definition of what a FBs are as follows (abbreviated version): "1) A family business is the corporation, 2) craft family business 3) for the purposes of FBs working together are considered members of the same family spouses or partners [10].

In the first step, the sample was tested for the completeness of the tested variables using the SPSS program. The examined sample passed the data completeness test at 100 %. FBs established until 2021 were examined, see Table No. 1.

Table No. 1: Year of the establishment of FBs

Year/ Frequency	To 1989	1990-1994	1995-2000	2001-2005	2006-2010	2011-2021	Summary
Absolute f.	4	83	45	49	30	34	245
Relative f.	1,6	33,9	18,4	20,0	12,2	13,9	100,0

Source: own processing

Distribution of family businesses according to statistical legal form, see Table No. 2.

Table No. 2: Legal forms of FBs

Legal form/ Frequency	Limited liability companies	Joint stock	Summary
Absolute f.	218	27	245
Relative f.	89	11	100,0

Source: own processing

FBs are important employers, create new jobs, offer job opportunities in the region of their business, see Table No. 3.

Table No. 3: Number of employees

Employees/ Frequency	1-9	10-19	20-49	50-99	100-199	200-249	250-499	500-999	Above 1000	Summary
Absolute f.	48	34	83	37	22	5	10	4	2	245
Relative f.	19,6	13,9	33,9	15,1	9,0	2,0	4,1	1,6	0,8	100,0

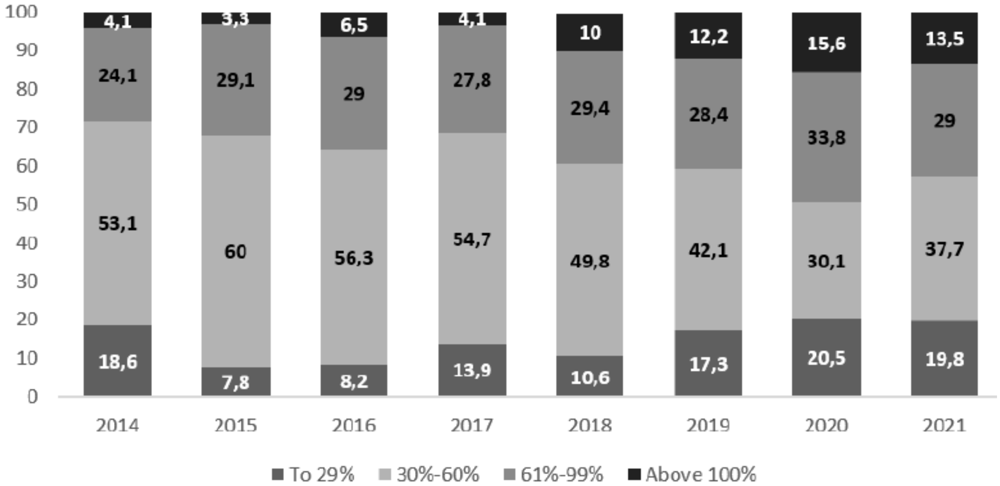
Source: own processing

Research results and discussion: In this section, an analysis of indebtedness is carried out using indicators of total indebtedness and the level of indebtedness. Indebtedness indicators express the relationship between equity capital and debt capital, i.e. the extent to which the company is financed by debt capital. Indebtedness does not have to be a negative characteristic of the company. A certain level of indebtedness is usually useful for the business because debt capital is cheaper than equity capital. This is due to the fact that interest from debt capital reduces the tax burden of the company because interest as part of costs reduces profit (tax shield effect) [11, p. 85]. The increase in indebtedness with the help of debt capital contributes to increasing profitability (financial leverage effect). As indebtedness increases, the risk that the company will end up in an unfavourable financial situation and have problems paying interest increases. When analyzing indebtedness, in addition to the representation of equity capital and debt capital in the company's financial structure, attention should be paid to the structure of resources, from the point of view of their maturity. Short-term foreign liabilities mean a greater risk for the company due to early maturity. Long-term is less risky, but the reduced risk is paid for by the higher price of long-term financing sources. Long-term external liabilities include, for example, long-term bank loans, reserves and long-term liabilities arising from the leasing form of financing. Leasing liabilities are not part of the balance sheet according to Czech accounting standards, they are usually listed in the attachement to the financial statements [12, p. 86-87]. Assets acquired through leasing are not part of the balance sheet but are recorded as expenses in the profit and loss statement. A company that appears to be relatively debt-free according to the ratio of equity capital and debt capital, may in fact be highly indebted, precisely due to the large number of assets acquired in the form of leasing.

Total indebtedness is a basic indicator of indebtedness. The level of total indebtedness can be called an indicator of creditor risk. The higher the value, the higher the indebtedness of the total assets and also the risk of creditors. For this reason, total indebtedness is of considerable importance, especially for long-term creditors. Recommended value according to [13, p. 85] varies between 30% - 60%. The total indebtedness in the years 2014-2021, see Chart No. 3.

Formula: Total Debt = Debt / Assets

Chart No. 3: Total indebtedness of FBs in 2014-2021 (%)



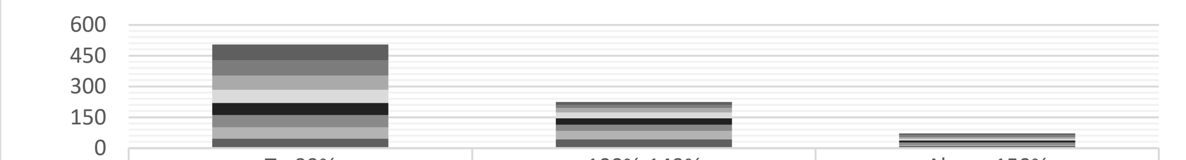
Source: own processing

In the analyzed FBs, except for 2014, the total indebtedness is within the range of the recommended value between 30% - 60%. About 2015, the value has a downward trend. Total indebtedness above 100% has the smallest percentage share according to the scale in all analyzed years. Due to the unavailability of complete financial statements, which would contain data on the amount of leasing, it can be stated that the total indebtedness of FBs could be greater. [14, p. 55] found that the level of indebtedness in FBs is significantly lower compared to non-family type businesses. The risk of transferring control over the company to persons other than family members in the event of default, as well as possible damage to the family's reputation, may be a possible reason for the higher aversion of owners to the risk of indebtedness.

The indebtedness rate is measured by equity capital and debt capital. Time development is important for assessing whether the share of foreign sources is increasing or decreasing. The indicator signals the extent to which creditors' claims could be threatened [15, p. 86]. The recommended value is below 1 (100%); values <1 = low indebtedness because debt capitalis lower than equity capital; values >1 = higher indebtedness because debt capital is higher than equity capital; values > 1.5 = high indebtedness. However, the outcome is highly dependent on the industry. Capital-intensive firms usually have higher leverage ratios. Overview of the debt level in the years 2014-2021, see Chart No. 4.

Formula: Debt ratio = debt capital/ equity capital

Chart No. 4: Indebtedness rate FBs in 2014-2021



	To 99%	100%-149%	Above 150%
2021	76,2	15,3	8,5
2020	75,8	14,1	10,1
2019	68,5	22,6	8,9
2018	64,5	27,3	8,2
2017	59,6	32,2	8,2
2016	58,7	28,6	12,7
2015	53,9	41,6	4,5
2014	46,9	42,5	10,6

Source: own processing

The level of indebtedness of Czech FBs is moderate and within the limits indicated by experts. The smallest percentage representation has those FBs with a debt ratio above 1.5.

Conclusion: Family businesses make up a significant part of countries' economies. Considerable emphasis is placed on their financing with regard to optimal indebtedness. The total indebtedness of Czech FBs is within the range of the recommended value between 30% - 60%. Due to the unavailability of complete financial statements that contain data on the amount of leasing, it can be stated that the total indebtedness could be greater. The level of indebtedness is moderate, mostly hovering at the recommended value below 1 in all the years examined. It can be expected that, in the process of their development, during the implementation of investment decisions, during financial settlements within the framework of generational exchange, during expansion into foreign markets, they will continue to struggle with the choice of appropriate management of the financing structure from either equity or debt capital.

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