

Family business financing in South Africa: A supply-side perspective

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Dates:

Received: 01 Apr. 2025

Accepted: 03 June 2025

Published: 13 Nov. 2025

How to cite this article:

Asah, F.T., 2025, 'Family business financing in South Africa: A supply-side perspective', *Southern African Journal of Entrepreneurship and Small Business Management* 17(1), a1143. <https://doi.org/10.4102/sajesbm.v17i1.1143>

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Background: Despite family businesses being the dominant form of business in South Africa, more than 60% of family businesses fail before the second-generation family members assume responsibility for the business. Current literature highlights that most family businesses in South Africa struggle to access credit from formal financial institutions.

Aim: This study explores the financing of family businesses in South Africa from a supply-side perspective.

Setting: The study explores how formal financial institutions (FFIs) perceive investing in family businesses, how the FFIs assess credit applications from family businesses and the challenges faced by the FFIs in providing credit to family businesses in South Africa.

Methods: The study objectives were achieved through the application of a qualitative research design using an interpretivistic research paradigm. Implementing the five-step process of content analysis defined by Terre Blanche, Durrheim and Kelly, data were collected from 16 credit and business managers at head offices of eight formal financial institutions using purposive sampling and analysed.

Results: The findings revealed that FFIs are very supportive when it comes to providing credit to family businesses that meet the lending criteria. Equity contribution, collateral, credit profile and audited financial statements are critical to family business financing.

Conclusion: As the most dominant form of business, financing family businesses presents a good investment opportunity for most FFIs. However, FFIs also face many challenges when considering investing in family businesses.

Contribution: This study provided insights on how FFIs perceived investing in family businesses, the credit criteria used by FFIs to assess credit applications, and the challenges faced by FFIs in providing credit to family businesses in South Africa. Additionally, using qualitative research design further contributed from a methodological perspectives to the literature on family business financing in South Africa.

Keywords: Formal financial institutions; credit access; supply-side; family business; South Africa; qualitative research.

Introduction

Though research on family business is still at an early stage and undergoing rapid development, these have been noted to be crucial to the socio-economic development of most economies. Moreover, they are affirmed to be the most dominant form of businesses, contributing more than 70% of global gross domestic product (GDP) (Family Firm Institute 2015; Firfray & Gomez-Mejia 2021; Nordqvist & Gartner 2020). Attributes such as a strong desire among family members to maintain control of the enterprise, an emphasis on managing the enterprise with longevity in mind (as a legacy to preserve for future generations) and a desire for business information to remain confidential are some of the unique attributes that distinguish family businesses from other businesses (Comino-Jurado, Sanchez-Andujar & Parrado-Martinez 2021; Maharajh, Dhliwayo, & Chebo 2023). Though literature affirms family businesses as the most dominant form of business (Family Firm Institute 2015; Nordqvist & Gartner 2020; Ntari & Deliwe 2023), family businesses are globally acknowledged for playing a central role in building strong economies through economic development (Johansson, Karlsson & Malm 2020), employment creation and poverty reduction and creating more opportunities for other small and medium businesses (Reck, Fischer & Brettel 2021).

To affirm the dominance of family businesses, the Family Firm Institute (2015) noted that family businesses account for approximately 80% of all businesses in the United States (US) and are

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responsible for almost 50% of the GDP and approximately 20% of the workforce. Additionally, the Family Firm Institute (2015) highlighted that family businesses in Europe account for approximately 70% of all businesses and contribute approximately 65% to Europe's GDP. For instance, in Germany, Poza (2014) noted that family businesses account for approximately 79% of all businesses and employ approximately 44% of the working population. In Italy, India and Latin American countries, Poza (2014) further advances that approximately 90% of all businesses are family businesses, accounting for approximately 80% of all employment, as supported by Visser and Chiloane-Tsoka (2014).

In South Africa, given the lack of a reliable up-to-date database on the number and contribution of family businesses to the national economy, extant data estimates that family businesses constitute about 80% of all businesses (Maharajh et al. 2023; Miroshnychenko et al. 2020; Reck et al. 2021). Additionally, approximately 60% of the companies listed on the Johannesburg Stock Exchange (JSE) are family businesses. Cumulatively, family businesses, according to Reck et al. (2021), account for approximately 50% of the economic growth of South Africa. Given the foregoing statistics, one of the best ways to address the high unemployment challenge in developing countries like South Africa is to leverage the potential of employment creation through family businesses and promote the development of family businesses (Family Firm Institute 2015; Nordqvist & Gartner 2020). Additionally, the Family Firm Institute (2015) maintains the development and contributions of family businesses to the socio economic development of South Africa can play an important role in achieving the Vision 2030 of the National Development Plan to reduce the unemployment rate to less than 10%.

However, despite the noted socio-economic contribution of family businesses to the economy of South Africa highlighted above, scholarly work with a focus on entrepreneurship literature highlights that their growth and survival into the next generation is seriously compromised due partly to financial constraints, as more than 60% of family businesses fail before the second-generation family members assume responsibility for the business (Hayrapetyan & Simon 2024; Maharajh et al. 2023; Ntari & Deliwe 2023). These authors further highlight that less than 40% of family businesses survive to the second generation, only about 15% survive to the third generation, with only 3% surviving to the fourth generation and beyond. As such, family businesses experience growth challenges because of their inability to access debt capital from credit providers such as formal financial institutions (FFIs) that align with their family values.

KPMG's (2025) business report titled 'Personal Perspectives' iterates that credit providers such as FFIs find it quite challenging to finance family businesses, especially in a period of economic downturn or an economy experiencing low or no growth such as South Africa. According to the report, credit providers such as FFIs usually charge high interest on credit, and borrowers who do not meet the strict credit criteria are most often denied credit access. The Trade and Industrial

Policy Strategies (TIPS) (2025) support policy adds that the transaction costs and lending risk during such a period often increase. As such, research by Asah (2019) cautioned that SMEs, including family businesses experiencing low sales during such economic times, should use less debt in their capital structure. Furthermore, the fact that traditional credit procedures often demand first-class collateral from the borrower in order to manage and reduce the lending risk, the Banking Association of South Africa (BASA) (2023) contend that most small businesses, including family businesses, will struggle to access debt capital from FFIs given that they do not have sufficient capital, complete business and financial information and a first-class collateral to pledge when applying for credit.

Consistent with the views of the BASA (2023), KPMG (2025) supports that lack of sufficient capital is the prime reason why family businesses often depend on credit from FFIs. Cirillo et al. (2020) and De Massis and Rondi (2020) advanced that most family businesses generate their start-up capital from family members, and such finances are often not sufficient for growth and expansion. Additionally, family businesses are more hesitant to pursue financing that limits their ability to act independently. KPMG (2023) adds that most family businesses in South Africa struggle to access credit from FFIs. Access to credit facilities by most family businesses remains the principal impediment to family business development, as COVID-19 has forced most FFIs to restrict credit facilities to family businesses (Hayrapetyan & Simon 2024; KPMG 2023). Cirillo et al. (2020) also add that though finance is the spinal cord of every business seeking capital to finance their development, the exclusively long-term standpoint most members in a family possess when managing their businesses, together with the unwillingness to surrender control and the quest for discretion, implies that acquiring capital that matches their requirements can be a daunting challenge.

Some of the reasons why FFIs are unenthusiastic to provide credit to family businesses (supply-side) in developing economies like South Africa include the high cost of credit, stagnant economy, imperviousness of borrowers (Jansen et al. 2023; Maharajh et al. 2023), governance issues in family businesses, imperfections involved in lending to family businesses and information asymmetry between FFIs and family businesses (Azizi, Bidgoli & Taheri 2021; Firfray & Gomez-Mejia 2021). Contradictory, research by Croci, Doukas and Gonenc (2011) and Carney (2005) argued that the cost of debt in family businesses is lower than in non-family businesses because of their long-term orientation and excellent relationship with their stakeholders and their desire to mostly pursue low-risk investment portfolios. Given such conflicting findings, extant literature (Asah & Hove-Sibanda 2024; Jansen et al. 2023, KPMG 2023; Comino-Jurado et al. 2021) reveals that there is a lack of empirical evidence on FFIs financing of family businesses in South Africa from a supply-side perspective using qualitative methodology. Moreover, the absence of an effective legal and regulatory framework that holds credit defaulters accountable and the fact that family businesses are not compelled to report their financial

performance in a standardised format, as noted by the BASA (2023), further discourages FFIs from offering them credit facilities. Given the impact of the COVID-19 pandemic and the stagnant South African economy, the credit-risk tolerance of FFIs has drastically reduced as FFIs have become more credit cautious, a phenomenon described in contemporary finance as 'credit rationing' (BASA 2023; KPMG 2023).

The fact that contemporary literature suggests that the inability of family businesses to access credit from FFIs is principally a supply-side problem, most family business owners express their dissatisfaction with FFIs, as they are not certain of what it is that FFIs really expect from them in order to access credits (Comino-Jurado et al. 2021; Molly et al. 2019). KPMG (2023), Johansson et al. (2020) and Miroshnychenko et al. (2020) contend that with sufficient financial support, family businesses have the potential to boost entrepreneurship development in a developing economy like South Africa and turn its stagnant economy around. The fact that most family businesses are unwilling to use investment capital that dilutes their perceived control over the business such as external equity, using too much credit will increase the risk profile of the business. This illustrates the complexity of the financing decisions in family businesses. As a result, the primary aim of this study is to investigate the financing of family businesses in South Africa from a credit provider perspective. From this research aim, the following research problem is developed:

- *Why do family businesses find it challenging to access credit from FFIs in South Africa?*

From the above research problem, the following research objectives are developed:

- *To explore how FFIs perceive investing in family businesses in South Africa;*
- *To investigate the criteria used by FFIs to assess credit applications from family businesses in South Africa; and*
- *To explore the challenges faced by the FFIs in providing credit to family businesses in South Africa.*

Literature review and theoretical construct

The concepts of family business, family-owned enterprises, family company and family entrepreneurship as highlighted in contemporary literature have been recognised as similar and used interchangeably because there is no single definition of these concepts. Reason being, there exist diverse business models in different nations (Cirillo et al. 2020; De Massis & Rondi 2020; Family Firm Institute 2015; Firfray & Gomez-Mejia 2021) thus, there is no single definition of these concepts due to the existence of diverse business models in different nations. The Family Business Association of Southern Africa (FABASA) defined a family business as an enterprise in which the majority of the voting rights belong to the family of the founder or acquirer of the business (or by his or her spouse, parents, children or children's direct heirs), with a member or two of the founder's family be committed to and

holds a managerial position in the business and where the business is listed. Further to this, the individual who founded or established or bought the business (or his or her family) is entitled to 25% or more of the voting rights, given the amount of capital contribution to the business and one family member is an active board member (FABASA 2014). Researchers in South Africa define a family business as one where two or more family members are actively involved in the management of the business, and a single family owns the majority of shares (more than 50%) in the business (Farrington & Jappie 2016). Given that FABASA acts as the official ambassador of family businesses in Southern Africa, this study adopts the definition proposed by FABASA as supported by Visser and Chiloane-Tsoka (2014).

Commonly, a family business can be labelled as a distinct type of business in which the control over the business operations is grounded within one family, and decisions are made through a majority vote. As distinctive features of any family business, any involvement of the family in business operations is recognised, particularly by executive management, ownership and inheritance, succession and governance. The noted distinctive characteristics of family businesses, according to Azizi et al. (2021), are a source of competitive advantage compared to non-family businesses. These peerless and unique characteristics spur family businesses to achieve superior levels of financial performance over time on sustainable bases.

Such superior levels of financial performance, according to Jansen et al. (2023), are usually not enough for families that want to expand their operations, go international and sustain a competitive advantage. Moreover, because of the fact that most families want to keep control of their business, the use of external equity such as angel and venture capital is not an option they would consider. Hence, their reliance on and demand for external debt financing from FFIs, which allows them to maintain control over their business and still achieve their growth objectives. The Pecking Order Theory (POT) advocates that family enterprises with insufficient profits and internal equity for growth should go for maximum available debt finance before resorting to external equity (Maharajh et al. 2023). With internal equity and debt finance being the two primary sources of finance for family businesses, capital structure theories by Modigliani and Miller (1958, 1963) suggest that family businesses should take advantage of the tax shield and go for a 100% debt capital structure. Though the POT by Myers (1984) reiterates the fantasy of a well-defined optimal capital structure, the Static Trade-Off Theory (STOT) advocates that family businesses can achieve optimal capital structure when the net tax advantage of debt financing balances financial distress and leverage costs, without altering the enterprise's assets and investment decisions portfolios. Meaning that issuing equity according to the STOT will signify deviating from the optimal capital structure, which is, in effect, considered to be an incorrect decision. The high and competitive demand for credit has prompted FFIs to develop and implement rationing and discriminatory behaviour as theorised by Becker (1971) in the book titled 'Economics of Discrimination'.

The theory of 'Economics of Discrimination' brings to light pertinent concerns on the rationing and discriminatory behaviour of FFIs, as argued by Arzubiaga et al. (2023), that FFIs are not interested in financing family businesses, most especially in developing nations like South Africa. The BASA (2023) argues that the credit rationing behaviour of FFIs is because of information asymmetry. These views are supported by the POT (Myers 1984). The incomplete financial information of family businesses available for FFIs increases the risk and cost of lending. However, it should be noted that the highest costs arise with the issue of equity, as the risks for the investors will be higher with this financing type because investors cannot tell if the enterprise is overvalued or not. Hence, the reason why family businesses rely more on credit from FFIs for strategic purposes such as investment in fixed assets is to increase working capital, productivity and growth purposes.

Some researchers advance that family businesses have better access to debt finance from FFIs because of their high ownership concentration, given that the family's commitment to the business is considered an asset that positively impacts the performance (Gerken et al. 2022; Jansen et al. 2023; Martinez, Scherger & Guercio 2019). Agreeably, FFIs enable family businesses to access credits at a lower cost. The assumption that family values, such as trust and paternalism, could inspire an atmosphere of commitment to the enterprise and the long-term orientation of family businesses with little or no agency problem because of the merits of ownership and management helps to reduce credit providers' perception of risk, which, as a result, reduces the lending costs (Comino-Jurado et al. 2021; Croci et al. 2011; Carney 2005; Gerken et al. 2022).

Contrarily, Jansen et al. (2023) and Ntari and Deliwe (2023) argue that family businesses could suffer from inefficiency and governance challenges, which could result in an increase in FFIs' risk perception, thereby promoting an increase in the lending costs. The increase in lending costs often results in credit rationing amongst family businesses by FFIs. Additionally, Arzubiaga et al. (2023) and Hayrapetyan and Simon (2024) warned that enterprises with low operating cash flows, low profitability and high operating leverage should use less debt finance in their capital structure, as such enterprises are considered to be underperforming. The KPMG (2023) argued that the underperformance of family businesses is the reason behind the low credit accessibility experienced by family businesses in South Africa.

A report by the BASA (2023) highlights that FFIs in South Africa are reducing their credit facilities to the private sector because of the country's stagnant economy and households coming under increased pressure. The report adds that FFIs are becoming very cautious in lending to the private sector because the high interest rates and inflation are hurting the local banks through the increase in bad debt and the inability of businesses to repay their credit. This study sought to contribute to the body of knowledge on family business financing by providing possible answers to the research objectives stated above using qualitative methodology. Using a qualitative research approach provided rich insights on the phenomena which assist family

businesses' access to credit from FFIs and help boost the financing of family businesses in South Africa.

Research approach, methods and design

This study used a qualitative approach, guided by descriptive and explorative strategies positioned in the interpretivistic research paradigm, so as to provide greater insights on the financing of family businesses by FFIs (Tomaszewski, Zarestky & Gonzalez 2020). The adoption of a self-reflective attitude enabled the researcher to explore, understand and interpret the meaning of the lived experiences and perspectives of the credit and business managers at head offices of the different FFIs of the phenomenon of interest (Braun, Clarke & Hayfield 2022).

Sampling method and size

BASA (2023) affirms that there are a total of 27 commercial banks that constitute the South African formal financial sector. For the purpose of this study, only the largest eight banks were considered. The eight FFIs are responsible for about 85% of all liabilities and about 91% of all assets in the commercial banking sector, with a total of about 106 credit and business managers positioned at the head offices of these banks based in the Gauteng province. A non-probability purposive sampling method, namely criterion sampling, was employed in identifying and selecting the participants at the banks' head offices. The head offices were chosen by the researcher because credit and business managers there are better informed and proficient on credit issues, as they are responsible for articulating and drafting lending policies and guidelines for their respective FFIs. It is for this reason the researcher chooses to interview a credit manager and a business manager from each FFIs as interviewing more than one credit and business manager from the same institution at head office would most probably result in data saturation, meaning that, this study's sample size constitutes eight credit managers (PC1–PC8) and eight business managers (PB1–PB8). Interview consent was obtained from each FFI and the participants before the commencement of the interviews.

Data collection

Semi-structured interviews were conducted using a combination of face-to-face and telephonic interviews so as to allow the researcher to cover a broader range of contexts. Additionally, interviews were conducted only in English, with each interview lasting for about 45–50 min, and using semi-structured interviews also assisted the researcher to maintain consistency when posing questions to the interviewee. The interview guide designed to achieve the research objectives was aligned with the literature review and theoretical construct. The researcher encouraged the participants during the interview to reflect, elaborate and extend their responses, rather than provide short, direct and closed responses. All the participants were guaranteed respect, integrity, anonymity, confidentiality and the option to withdraw from participating at any point in time.

Data analysis

After all the interviews were transcribed verbatim, the five-step process of content analysis proposed by Terre Blanche, Durrheim and Kelly (2006) was adopted. This comprised, namely, familiarisation and immersion (this first step requires the researcher to study the transcription in detail to understand the content and be able to identify recurrent themes, reading and re-reading each transcribed text, repeatedly listening to the audio recordings, developing portraits and reflective notes to gain in-depth understanding of the research); inducing themes (this second step required the researcher to scrutinise the themes in details); coding (the coding process, which was the third step started by defining the coding units and organising the data into manageable portion, identifying and grouping aspects of the data that relate to the research problem); elaboration (the fourth step demanded that the researcher explores the themes more closely so as to build a wholistic picture of the data for clearer and simple understanding) and interpretation and checking (the fifth step required the researcher to examine the different themes for possible meaning). Additionally, it should be noted that the researcher grouped the data into themes and sub-themes using different codes as coding occurred simultaneously with developing themes. Braun et al. (2022) support that the reviewing of themes is dependent on the continuous analytical inspection of the data so as to assist the researcher in refining the themes by ensuring that each theme makes a distinctive contribution that helps in the achievement of the research objective.

Qualitative research criteria and limitations

Validity (credibility), reliability (dependability), objectivity (confirmability) and external validity (transferability), according to Braun et al. (2022), are the 'quality research criteria' that guide researchers when analysing and evaluating qualitative data. A succinct and concise explanation of the analysis, supported by a well-articulated research design, data

analysis and a comprehensive explanation of the research process, significantly contributed to the 'quality' of the research findings as supported by Braun et al. (2022). Additionally, the fact that value and believability (credibility) of every study establishes confidence in the findings and builds trust with the research participants, the extensive experience, level of education and the skills of the researcher in conducting research and interviews in an academic setting, and the participants' expertise and extensive knowledge on the subject guaranteed the dependability and credibility of the study findings (Braun et al. 2022). On the other hand, given that the participants were all working at the head offices of the eight selected banks, it implies the findings can only be generalised to the eight banks (transferability).

Ethical considerations

Ethical clearance to conduct this study was obtained from the Rhodes University Department of Management Ethics Sub-Committee (No. 2018 MAN 01.03).

Results

A glance at the gender composition of the participants showed that nine (56%) of the 16 participants were male (five credit managers and four business managers) and seven (44%) were female (three credit managers and four business managers). While 11 (68.75%) of the participants were Black African people (in terms of race), 12 (75%) had at least a bachelor's degree, as highlighted in Table 1.

In terms of age, 8 (50%) of the participants were between the ages of 41 and 45 years, and 13 (81.25%) had more than 10 years of experience in the banking industry. Though all the participants were South African citizens, 11 (68.75%) of them had been working in the same bank throughout their banking careers. The findings of this study, aligned with addressing the study objectives highlighted above, are presented in the sections as follows:

TABLE 1: Biographical information of participants.

Participants	Nationality	Gender	Age range (years)	Ethnic group	Current position	Current position duration (years)	Highest level of education
PC1	South African	Male	35–40	Black African person	Credit manager	5	Degree
PC2	South African	Female	30–34	Black African person	Credit manager	3	Diploma
PC3	South African	Male	41–45	White person	Credit manager	7	Degree
PC4	South African	Male	35–40	Black African person	Credit manager	6	Degree
PC5	South African	Female	35–40	Black African person	Credit manager	6	Advanced Diploma
PC6	South African	Male	41–45	Black African person	Credit manager	4	Degree
PC7	South African	Female	35–40	Black African person	Credit manager	6	Degree
PC8	South African	Male	35–40	Black African person	Credit manager	6	Degree
PB1	South African	Female	35–40	Black African person	Business manager	7	Degree
PB2	South African	Female	35–40	White person	Business manager	4	Degree
PB3	South African	Female	30–34	Indian person	Business manager	5	Postgraduate Degree
PB4	South African	Male	50–55	White person	Business manager	11	Matric
PB5	South African	Male	41–45	White person	Business manager	5	Degree
PB6	South African	Female	41–45	Black African person	Business manager	8	Advanced Diploma
PB7	South African	Male	35–40	Black African person	Business manager	6	Degree
PB8	South African	Male	35–40	Black African person	Business manager	4	Degree

Secondary objective one: How formal financial institutions perceive investing in family businesses in South Africa

Most FFIs post-COVID-19 pandemic have constricted credit lending to family businesses. When participants were requested to explain their perception of financing family businesses, interestingly, all eight FFIs harmonised their desire to finance family businesses, as they are considered as viable business opportunities. Participant PC3 explained that:

'In my experience working in this bank for more than five years now, supporting family businesses is one of our investment priorities that is very lucrative to the bank. The family commitment to the business, and even the family name, is one of the attributes that really motivates us to support family business compared to other form of businesses.'

Participant PB1 noted that:

'Most family business accounts that we have are doing quite well. The commitment of the family and family assets to the business and the legacy the families strive to build makes family business very attractive and somehow less risky than non-family businesses in terms of the business administration and performance.'

Participant PC2 mentioned that:

'As I explained to you before, one of the criteria we consider for issuing credit to businesses is that the business owners should be able to provide about 40% of the equity capital. But most family businesses accounts we have contribute about 50% or even more of the starting capital. For those that provide less than 50% of their starting capital, say 30 or 40%, they also pledge collateral. When the value of the collateral is added to the starting capital, it becomes worth the value of the credit or sometimes even more than the value of the credit they are requesting from us. This tells you that the family is commitment to the business, and they want the business to succeed.'

Though all eight FFIs view family businesses as good business opportunities, when a follow-up question was asked regarding the credit approval rate for family businesses, most of the participants were in agreement that at least six or seven out of every 10 processed credit applications were approved. For example, participant PC6 asserted that:

'Well, though your question is hard to give a definitive answer, but I can say an average of about six or maybe seven in every ten credit applications were approved. That give us an average approval rate of about say 60%. Like I said, your question is hard to give a definitive answer because sometimes the approval rate can increase to say 80% or it can even reduce to 50% if the bank has other investment opportunities that demands huge capital budgeting.'

Given the noted assertions above, and contrary to literature that FFIs are not interested in financing businesses in South Africa, it is evident that FFIs are very supportive of family businesses despite the impact of COVID-19 on the economy.

Secondary objective two: Criteria used by formal financial institutions in evaluating and providing credit to family businesses

This study also explored the criteria used by the FFIs to evaluate and provide credit to family businesses. Table 2 highlights a summary of the participants' perspectives on the criteria used by FFIs in evaluating credit applications from family businesses.

As highlighted in Table 2, the participants' perspectives on the criteria used by formal financial institutions (FFIs) in evaluating and providing credit to family businesses from the most to the least frequently cited are provided. In the left column, the code and number of participants are highlighted; the particular criteria are in the middle column and the frequency of citation is in the right column.

As highlighted in Table 2, it is apparent that FFIs consider family contribution ($n = 16$), collateral ($n = 16$), credit profile ($n = 16$) and audited financial statements ($n = 16$) as the most essential criteria when evaluating credit applications from family businesses. For families to commit personal finances and pledge family assets is a signal of commitment to the success of the business that most FFIs view as critical to the success of the business, as participant PC2 stated in the previous section. According to the participants, FFIs most often consider fixed investment accounts, fixed assets, contract agreements, surety and life insurance policies. Participant PC5 explained that:

'We usually consider collateral like business property, investment accounts, contract award letter if the person wants money to finance a contract, or even life insurance policy. However, for us to consider a life insurance, we first do background checks with

TABLE 2: Perspectives of participants on the criteria used by formal financial institutions in evaluating credit applications from family businesses.

Participants	Criteria used by FFIs in evaluating credit applications from family businesses	Frequencies (n)
PB1; PB2; PB3; PB4; PB5; PB6; PB7; PB8; PC1; PC2; PC3; PC4; PC5; PC6; PC7; PC8	Family's contribution (equity)	16
PB1; PB2; PB3; PB4; PB5; PB6; PB7; PB8; PC1; PC2; PC3; PC4; PC5; PC6; PC7; PC8	Collateral	16
PB1; PB2; PB3; PB4; PB5; PB6; PB7; PB8; PC1; PC2; PC3; PC4; PC5; PC6; PC7; PC8	Credit profile	16
PB1; PB2; PB3; PB4; PB5; PB6; PB7; PB8; PC1; PC2; PC3; PC4; PC5; PC6; PC7; PC8	Audited financial statements	16
PB1; PB2; PB3; PB4; PB5; PB7; PB8; PC1; PC2; PC3; PC4; PC5; PC6; PC7	Annual turnover	14
PB1; PB2; PB4; PB5; PB6; PB8; PC1; PC2; PC3; PC4; PC5; PC7; PC8	Quotation from supplier	13
PB2; PB3; PB4; PB7; PB8; PC1; PC2; PC3; PC5; PC7; PC8	Entrepreneurship education	11
PB2; PB3; PB4; PB7; PB8; PC1; PC2; PC3; PC5; PC7	Business experience of the founder	10
PB1; PB3; PB4; PB7; PC1; PC2; PC3; PC5	Relationship with the bank	8
PB2; PB3; PB4; PC1; PC2; PC4; PC5	Permanent resident permit (PRP)	7
PB3; PB5; PB6; PC1; PC3; PC4	Location of the business	6
PC2; PC3; PC5	Family image	3

FFIs, formal financial institutions.

the insurance company to know if the person has not defaulted payment in the past and the conditions under which the insurance policy is not valid. We then create an auxiliary account in the client's name and let the insurance company know that the monthly payments can be deducted from this account in case the other account doesn't have enough cash.'

The credit profile of the business and the family person(s) managing the business help provide pertinent information regarding the credit history of the family and the business, and such information is used to evaluate the creditworthiness of the application. Participant PC2 noted that:

'The credit profile of the business and the person managing the business gives us an idea of the riskiness of the credit application. That is to say, if the person or the business has been awarded credit in the past and if there was no defaulted payment or is it a client who has not been awarded credit before. We consider clients without past credit history as high-risk clients. Hence, we take a lot into consideration before considering such clients.'

Audited financial statements provide valuable information regarding the cashflows of the business, as participants PB5 revealed that:

'As a business manager I often asked for six months financial statements if the business is less than three years and three months statement for a business that is more than three years because I will want to see the cashflows of the business, how the family has been managing the cash, and the extent the family has been using business money for personal use.'

Annual business turnover reveals the sales of the business. Analysing the sales and the costs incurred, FFIs can tell if the business is making sufficient profit that can be used to service the credit as participant PC1 noted that:

'As a credit manager annual business turnover is important because it helps me to understand if the business is generating sufficient sales to cover the cost because without sufficient sales, you cannot make sufficient profit that can service the loan you are applying for. So, in case the business is not generating sufficient sales, then, I will want to investigate why and advise the customer accordingly.'

Quotation from suppliers emerged as another vital criterion that FFIs consider when evaluating credit applications from family businesses, especially those who want to buy an equipment or a car for business use, as participant PB5 explained that:

'Like I explained to you before, I will ask for at least two quotations from the clients when they submit their credit application in case, they want us to finance something like an equipment or even a car. I will then contact other suppliers that we have on our system to see if we can get a better deal for the client. However, if our supplier can agree to supply the client the product at a better price, we will recommend the client to discuss with our supplier.'

Entrepreneurship education and business experience of the founder are important to FFIs because both attributes help the founder to nurture that commitment and build resilience to succeed in business and be able to write a good business plan. Relationship with the family business owners is also an

important criterion considered by FFIs when considering lending, as it helps to reduce information asymmetry and, somehow, builds trust between the FFIs and the business, as participant PC1 noted that:

'For businesses that have accounts with us, it becomes very easy for us to process their credit applications because we have all the information about the performance of the business, and we know the business. Sometimes you can write a motivation to support the credit application because we have that relationship with the client.'

Some FFIs highlighted that they were worried when it comes to financing family businesses that are owned by foreign residents. Five of the eight FFIs indicated that the founder of the business must have a permanent resident permit and a South African Identity Document (SAID) before they can consider giving them credit, as participant PB4 explained that:

'It is very risky for us to give credit to businesses that are owned by non-South African. What if they take the loan and leave the country... how are we going to reach them? It is the reason why you must have a permanent resident permit and a SAID so that we have background information about you before we can consider giving you credit.'

Because of the high crime rate in South Africa, the location of a business is one criterion considered by FFIs when considering financing family businesses. Statistics South Africa (2023) shows that household crimes such as housebreaking and home robbery are the highest in the country and continue to rise, and FFIs are becoming very cautious and reluctant to finance family businesses located in high-crime areas. Some participants mentioned that the family image also plays a huge role when it comes to accessing credit, as FFIs are very cautious when dealing with credit applications from family businesses with a reputation for engaging in illegal business dealings or a family that had conned a bank in the past of a loan that was never paid.

Secondary objective three: Challenges faced by the formal financial institutions when evaluating credit applications from family businesses

The views of the participants on the challenges experienced by FFIs when evaluating credit applications from family businesses are summarised in Table 3.

Poor financial records of family businesses are the most serious challenge experienced by FFIs when evaluating family businesses' credit application. All the participants noted that family businesses are very dodgy when it comes to disclosing their actual financial records as participant PC7 stated that:

'Based on my banking experiences, most family businesses for some reasons do not actually like to disclose their true complete financial records. Most often, as a bank we only know of the card sales with us. But, what about the cash sales? They often do not want to disclose the actual sales figures as most of them have more than one business accounts with different banks. If you go to their business premise, you will see that some of them are using two speed point machines from different banks.'

TABLE 3: Participants' perspectives on the challenges experienced by formal financial institutions when evaluating credit application from family businesses.

Participants	Participants on the challenges faced by the FFIs	Frequency (n)
PB1; PB2; PB3; PB4; PB5; PB6; PB7; PB8; PC1; PC2; PC3; PC4; PC5; PC6; PC7; PC8	Poor financial record	16
PB1; PB2; PB3; PB4; PB5; PB7; PB8; PC1; PC2; PC3; PC4; PC5; PC6; PC7; PC8	Poor credit record	15
PB1; PB2; PB3; PB4; PB5; PB6; PB7; PC1; PC2; PC3; PC4; PC5; PC6; PC7; PC8	Lack of first-class collateral	15
PB2; PB3; PB5; PB6; PB7; PB8; PC1; PC2; PC4; PC5; PC7	Defining family business	11
PB1; PB2; PB3; PB8; PC1; PC2; PC3; PC4; PC6	Poor management knowledge	9
PB2; PB3; PB7; PC1; PC2; PC3; PC4; PC6; PC8	Lack of investment capital	9
PB1; PB4; PB6; PC2; PC3; PC5; PC6	Family conflict	7
PB2; PB3; PC3	Competition for finance	3

FFIs, formal financial institutions.

Poor credit records and lack of first-class collateral are the second most serious challenge experienced by FFIs when evaluating family businesses' credit application. For instance, FFIs use credit records of family businesses to assess whether the business has default payment of any credit taken in the past or if the business is a first-time credit applicant without a credit history, as participant PB3 noted that:

'One thing I have realised with family businesses is that a number of family businesses do not have any credit record. They run their businesses primarily using their family finances. As you know, we consider businesses without credit record as high-risk businesses because we do not know if they will be able to manage the credit well.'

On the other hand, some family businesses lack first-class collateral to add to the little starting capital (40% or less) contributed to the business in order to cover the cost of the credit. According to some of the participants, FFIs often demand to hold collateral as some sort of a guarantee to mitigate the lending risk and, somehow, strong-arm the borrower from defaulting, as participant PC1 stated that:

'As I explained before, with us collateral is very important when it comes to lending because when a borrower pledges collateral, that tells you the seriousness and commitment of the borrower and his willingness to pay back the loan. So, to us holding collateral helps to reduce the risk of default because if he defaults, he knows that the bank will own the collateral and most properly auction it to recover the loan.'

Another challenge some of the participants specified was the definition of family business. Given that there is no clear and concise definition of family business in the literature from a South African perspective, some families actually started their business as a family business, as the name, the capital and the management of the business were solely provided by a family. However, the businesses became transformed into a partnership or corporation or limited liability company after the family sold shares to non-family members (public) and even changed the Black Economic Empowerment (BEE) certificate to include the new shareholders or directors. Although the name of the business might not have changed, such a business can be called a family business, especially if the other shareholder(s) have the majority shares in the business, as participant PC4 cited that:

'Well, let me say that if a family decides to sell some shares of the business to the extent that the family does not have that strong hold of the business and cannot make fundamental decision without the approval of the other shareholders, then we do not consider such business as a family business. Such business is more like a partnership or corporation, not a family business.'

Poor management knowledge and lack of investment capital were also challenges noted by some of the participants. According to the participants, using business finances to finance family projects that do not bring income to the business, though the business is experiencing a cash flow problem, is a very poor management decision. Additionally, some family businesses often struggle to access credit from FFIs simply because they cannot afford to contribute a reasonable amount of the starting capital, as most FFIs often demand about 30%–40% of the starting capital plus collateral to cover the credit cost and reduce the credit risk. Family conflict, on the other hand, is another challenge associated with family businesses, as mentioned by some participants, as participant PC5 stated that:

'Family conflict is sometimes the reasons why we do not give credit to some family businesses because of the disagreement between the family members. I will give you an example. We had a case where a father wanted to buy a car for the son, but the son didn't like the car. He wanted another car that was more expensive. Even though the son was willing to put forth a sum to reduce the monthly instalment for the car he wanted, the father didn't agree on the increase instalment payment of the car the son wanted. Since the business was going to finance the car, and though the son works with the father in managing the business, the father was not willing to increase the monthly instalment as that was going to strain the business cashflows. So, we rejected the application.'

Competition for finance was the least challenge noted by some participants, as FFIs have other investment priorities that demand financing, and it is for the same reason that FFIs practice credit rationing, as financing SMEs is not their only investment priority. Hence, FFIs often consider the return on investment, and the risk involves before deciding on which investment option to consider.

Discussion

The findings of this study presented in the section 'How FFIs perceive investing in family businesses' reveal that FFIs perceive family businesses as a viable and profitable business opportunity despite the lending risk involved. As the STOT (Modigliani & Miller 1963; Myers 1984 states, 'the greater the risk, the greater the reward', the participants contend that the risk in financing family businesses is somehow reduced given the dedication of the family and the investment of the family financial resources and assets as collateral. There is evidence that the average credit approval rate of about 60% aligns with the POT by Myers (1984) (the use of external debt before external equity) and the theory of Economics of Discrimination by Becker (1971), as FFIs have developed credit rationing behaviour. However, in case FFIs feel the risk involved in financing a

family business is equal to or greater than the credit requested, FFIs do not hesitate to reject such a credit application. Hence, the risk-averse lending characteristics demonstrated by most FFIs (Martinez et al. 2019).

As per the findings presented in the section 'Criteria used by FFIs in evaluating credit applications from family businesses', all the participants noted that a family's contribution (equity), collateral, credit profile and audited financial statements are the most important criteria used by FFIs in evaluating credit applications. Considering these criteria, it is evident that FFIs are very risk averse given that family contribution and collateral are aimed at increasing FFIs' confidence and mitigating lending risk (Jansen et al. 2023). Additionally, the fact that FFIs are demanding about 40% of the starting capital before they can consider financing such a business directly contradicts the STOT by Modigliani and Miller (1963), who advocated that enterprises should go for 100% debt in their capital structure, given that no FFIs will consider financing any enterprise that does not contribute a significant portion of the starting capital. Conversely, credit profiles and audited financial statements indicate the creditworthiness of the business and its owner. Additionally, all four criteria also help reduce information asymmetry and moral hazard (Jansen et al. 2023). The four criteria are further strengthened by the '5 Cs' of credit (collateral, capital, character, condition and capacity). The principle of the '5 Cs' of credit is to establish the creditworthiness of a borrower. The principle further iterates that while no one 'C' is more important than another 'C', all 'Cs' are relatively equal and together help to form an entire picture of the project and client.

The annual turnover report is used by FFIs to analyse the past and present performance and also forecast the future performance of the business in order to determine whether the business has the capacity to finance the credit (Azizi et al. 2021). For family businesses requesting credit to finance the purchase of business assets such as machinery or cars or other supplies, FFIs usually demand two to three quotations from different accredited suppliers before deciding on which supplier to use. This is because FFIs do not accept quotations from nonaccredited suppliers. Entrepreneurship education and the business experience of the founder are fundamental elements of business growth that assist FFIs to assess the entrepreneurial boldness, mindset and vision of a family regarding the business, if the family can properly manage the growth aspect of the business and how the family can identify and explore viable business opportunity (Martinez et al. 2019). An established relationship with FFIs helps to eliminate information asymmetry, build trust and increase the legitimacy of the business (Molly et al. 2019). While PRP of immigrant family business owners is to assist FFIs in establishing a credit profile and gathering all the relevant biographical information of the family, location of the business is meant to assess the level of risk (burglary and theft) the business is exposed to from the surrounding environment. Family businesses located in high-crime areas

will often find it difficult to access credit from FFIs (Maharajh et al. 2023). Positive family images act as an attractive signal to FFIs, leading to better access to credit (Arzubiaga et al. 2023).

The findings on the 'Challenges faced by the FFIs when evaluating credit applications from family businesses' presented in 'Secondary objective three: Challenges faced by the formal financial institutions in providing credit to family businesses in South Africa' Section reveal that a poor financial record is the most serious challenge experienced by FFIs when evaluating credit applications from family businesses. Providing complete financial records of the business to key stakeholders such as FFIs will enable FFIs in making informed and cautious decisions when evaluating credit applications as advocated by the stakeholder theory (Chirapanda 2020). Complete financial records also help FFIs in determining where family businesses are not meeting their expectations and take the necessary steps to assist them, which is in accordance with the legitimacy theory (Martens & Bui 2023). The poor credit record of family businesses can be attributed to the fact that most family businesses' starting capital is internally generated (within the family), which is often not sufficient for growth, and the primary reason why family businesses are looking for debt. Lack of first-class collateral implies that the interests of the borrower (family business) with that of the lender (FFIs) will not be aligned, as the credit risk will be too high. In such circumstances, FFIs are likely to decline the credit application given their risk-averse characteristics (Comino-Jurado et al. 2021). The fact that there is no commonly agreed definition of family business in contemporary literature makes the financing of family business very challenging, as FFIs cannot establish a common criterion to assess all credit applications (Farrington & Jappie 2016). Poor management knowledge, according to Mantje, Rambe and Ndofirepi (2023), is the brain behind the inefficient use of strategic resources such as financial capital from FFIs, narrow vision, poor service delivery and lack of innovation and growth in family businesses. According to Mantje et al. (2023), firms that exhibit such characteristics have no sustainable goals and are most likely to fail. Meanwhile, lack of investment capital reduces confidence, increases lending risk, reduces business growth opportunities and also limits innovation (Jansen et al. 2023). Family disputes over the control of the business can be very costly, as power dynamics can force a family member to pursue personal goals that are not in the best interest of the firm (Lweger & Kammerlander 2015). Such conflict compromises the management of the business and discourages FFIs from investing. However, given the current turbulent business climate in South Africa, FFIs will try to avoid many losses by diversifying their investment, and hence the competition for finance.

Managerial implications

Despite the unstable economic climate in South Africa, characterised by high crime and unemployment rates and low economic growth, FFIs continue to play a significant role in

boosting economic growth in South Africa by financing family businesses that can provide about 40% – 50% of the starting capital and also pledge valuable collateral, as evidenced by the 60% average credit approval rate. Family businesses are called to be investment ready not only by providing first-class collateral or equity capital but also by investing in the family image and using it as a marketing tool in reinforcing their expected family business image as a resourceful competitive advantage, as it is considered a credible signal of trustworthiness and status. Additionally, strengthening the family business image can help reduce information asymmetry between family businesses and FFIs, especially in circumstances where FFIs are not aware of the characteristics or behavioural intentions of the family business. Reducing information asymmetry theoretically helps to improve and build trust between FFIs and family business owners, thereby reducing the lending risk. This also helps to boost FFIs' willingness to finance family businesses, thereby reducing the risk perception FFIs have when considering financing family businesses (first research objective).

Furthermore, family business owners are also encouraged to take on professional entrepreneurship education qualification courses to better improve their managerial knowledge and skills, given that sound management knowledge and skills assist family business owners in optimal decision-making, understanding how to keep proper financial records and also boosting their managerial experience. It is also essential to develop and consider succession planning when considering training family managers to succeed the founder in order to deal with family conflict, as a clear path is designed for the next generation and successor of the business. Given that the findings also revealed that supporting family businesses is one of the investment priorities that is profitable to FFIs, and the fact that all eight FFIs harmonised their desire in financing family businesses, signifies a viable business opportunity for FFIs. Given such opportunity and the risk-averse attitude of FFIs, the lending risk can be reduced by appointing bank agents or supervisors to keep a close eye on the performance of the business and even provide guidance to family business owners. Such guidance will boost the cash flow, business experience and the family businesses' relationship with the bank, thereby increasing the creditworthiness of the business. Such a relationship will also benefit family business owners to comprehend the credit criteria put in place by FFIs (second research objective).

For family businesses that are reluctant to use debt, family business advisers are encouraged to consider ways of reducing family business owners' fear of losing control by enhancing their financial management knowledge in order to foster growth. These will help address credit challenges (third research objective) such as poor management knowledge and poor financial record keeping of family business owners, thereby improving their chances of securing credit from FFIs. For instance, family business advisers should educate business owners that the

continuous use of debt does not necessarily imply a higher risk of bankruptcy. Such lessons might inspire a positive attitude in the owners towards the use of debt in optimising their capital structure. The fact that family business goals are likely to change when the business transits from one generation to another, the financing challenge is likely to become more significant over generations. To mitigate such a challenge, family businesses are encouraged to inform FFIs of their succession plan, and the family member they have in mind to lead the business to the next generation must be fully engaged in the day-to-day running of the business. Having an expert as a consultant who can provide invaluable perspectives on a regular basis can help family businesses address family conflicts. Family businesses are also encouraged to network with potential investors, as some investors would prefer to invest in family businesses on a personal, rather than a more formal basis.

Study limitation

Though the findings of this study cannot be generalised to other FFIs operating in South Africa, the findings could be useful to other FFIs operating in South Africa and other developing nations in formulating their credit policy.

Area for further research

Further research could investigate in greater depth the extent to which different family business ownership structures and family conflicts impact their access to credits from FFIs and other credit providers.

Conclusion

Conclusively, the lack of a uniform definition and policy on the formation and structure of family businesses makes it difficult for family businesses to attract funding from diverse investors. So, policymakers and FFIs are encouraged to come up with a uniform definition that can be used by researchers and investors. Additionally, through media platforms, television and radio, FFIs should educate the business community and family business owners on the criteria they used to evaluate credit applications. With the current high crime rate in South Africa, family business owners should avoid operating in high-crime areas if they wish to access credit from FFIs.

Acknowledgements

Competing interests

The author declares that there are no financial or personal relationships that may have inappropriately influenced the writing of this article.

Author's contributions

E.T.A. is the sole author of this research article.

Funding information

This research received no specific grant from any funding agency in the public, commercial or not-for-profit sectors.

Data availability

The data that support the findings of this study are available from the corresponding author, F.T.A., upon reasonable request.

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