THE IMPACT OF OWNER'S IDENTITY ON CORPORATE CAPITAL STRUCTURE

***Josephat Lotto*[1]**

ABSTRACT

This paper examines how the identity of corporate owners affects corporate leverage in the UK. Using data from a sample of 643 listed UK firms, the results show that family-controlled firms have higher debt ratios than companies controlled by financial institutions. The implication is that family-controlled companies prefer debt to equity in their capital structure due to either a control-enhancing mechanism and/or firm's protection from take-over threats. The paper, further confirms that corporate control contestability has also a positive impact on debt ratio. In essence, a smaller value of control contestability signifies more equal distribution of the voting power between the two largest shareholders. This finding is in line with the monitoring hypothesis of the second largest shareholder, hence suggesting that the involvement of the second largest shareholder in monitoring the activities of the largest shareholder reduces the second-order agency costs, the agency conflict between minority and majority shareholders.

Keywords: *leverage, owner' identity, ownership, control*

INTRODUCTION

This paper explores the impact of owners' identity on corporate leverage. Many of the studies, which have addressed the role of large shareholders as a monitoring device thus far, have tended to consider the influence of ownership concentration on corporate financial decisions while ignoring the role of different types of owners. As a result, the identity of firm's owners, which has a great influence on the intensity of monitoring, has been largely unexplored (McConnell & Servaes, 1990; Dalton *et al*., 2003;, Joher *et al*., 2006; Sanchez-Ballesta & Garcıa-Meca, 2007).

Yet, Anderson, Mansi and Reeb (2003), Anderson and Reeb (2003) and Mishra and McConaughy (1999) all indicate that different firm owners have different motives and unique interests and that the diverse group of share owners have different levels of monitoring competency, wealth, preferences about how they like receiving returns on their investments, cultures and many cross-border

[1] Josephat Lotto ,Senior Lecturer ; Institute of Financial management, Tanzania (E-mail: tathioga@yahoo.co.uk

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differences (Thomsen & Pedersen, 2000). The identity of the firm's owners might determine their goals, which in turn might have a significant impact on the firm's behaviour, which ultimately affects the firm's financial decisions and corporate leverage in particular. For instance, the interest of financial institutional investors may be to realise short-term returns on their investments and they would just sell their shares when a firm suffers a downturn whereas corporations or non-financial institutions may be more focused on the long-term relationship, hence making efforts to participate in a restructuring process (Douma *et al*., 2006). Share ownership by corporations, mutual funds, banks, insurance companies, government and individuals are typical examples. Apart from the ownership identity Douma *et al.* (2006) present, Unsal *et al.*, (2009), Luo *et al.* (2009) and Mersland *et al.* (2011) claim that the categorisation of institutions, whether foreign or domestic, make a difference and confirm that the performance of foreign enterprises had been higher than local ones.

Recent literature has tended to take for granted the board structure and managerial ownership as the only internal corporate governance mechanisms. In fact, much of the relevant literature has traditionally considered it that way, especially in non-US markets, specifically the UK in this case. Generally, debt as an internal corporate governance mechanism has not received proper attention in recent literature. This paper includes debt as one of the important corporate governance internal mechanisms in addition to providing an empirical support to the common notion in literature, especially US-based literature, to the effect that the identity of owners coupled with their monitoring role such as strong institutional owners reduces the managerial ownership concentration as well as debt ratio in the UK's public corporate firms as previously highlighted in Lotto (2013).

The paper suggests that UK firms consider the institutional shareholdings especially those in hands of corporations, mutual funds, banks and insurance companies as the controlling mechanism for unfavourable levels of managerial ownership and debt ratios in an attempt to reduce both agency costs of debt and equity.

Furthermore, just as minority shareholders are ignored in firms' managerial decisions, writers tend to give less attention to the existing literature on the conflict of interest between minority and majority shareholders; instead much focus is placed on the conflict between managers and the company's shareholders. This orientation sheds light on the relevance of corporate leverage to mitigate the agency conflict between majority and minority shareholders. In published works, very few, if any, studies in UK address the influence of owners' identity on corporate leverage, hence the likelihood of neglecting of the true nature of ownership. This paper intends to throw light on this issue.

LITERATURE REVIEW

Theoretical Perspective of the Study

Corporate Control Dominance and Contestability

Previous literature suggests that the conflict of interest between majority and minority shareholders can best be solved by the presence of a reasonable number of multiple large shareholders. Unlike a single large controlling shareholder, multiple large shareholders are unlikely to make a decision which is against the firm's interest and, in so doing, also protect the minority shareholders' interests (Gomes & Novaes, 2005; Laeven & Levine, 2008; Maury & Pajuste, 2005). In fact, Bennedsen and Wolfenzon (2000) contend that a single block holder does not have sufficient power to control a firm and, therefore, several block holders need to combine their voting power and agree on the matter in hand before making any decision.

The number of members forming a controlling group matters significantly (Bennedsen & Wolfenzon, 2000). These authors state that agreements on some issues, such as policy change, which may attract private benefits to controlling shareholders, become more difficult as members of the coalition increase. After all, some members benefit less from the deal than others and, therefore, may not volunteer to accept a particular decision at the expense of the firm's efficiency, even though it might be in the collective interest of most the group members.
Apparently, large block holders' size of the voting power determine the corporate control structure. According to Leech and Leahy (1991), the size of voting power of large block holders exceeding 50% might dictate the control of the firm even if the remaining block holders might have a possibility of exerting monitoring control. However, attaining a full control is rare especially for countries such as the UK in which dispersed ownership structure dominate. This fact may be supported by the UK Takeover Code, which requires that owners with at least 30% stake should make a takeover offer of the remaining equity.

In a situation where ownership is dispersed and multiple block holders are common there tend to exist a struggle for block holders to accumulate votes from other shareholders so as to attain a majority vote to control the strategy and decision-making of the companies (Bennedsen and Wolfenzon, 2000; Bloch and Hege, 2001). Different control contestability models are suggested in the literature. These models are as follows:
The first model assumes that the first largest block holder is the firm's ultimate controller. According to Pagano and Roell (1998), the model suggests the

possible way in which multiple block holders monitor the control shareholders. The second largest block holder might be for a considerably capable candidate to contest for the control dominance exerted by the largest block holder. Gomes and Novaes (2005) assert that, for control to be shared between different shareholders successfully the size of their holdings should not vary significantly and the shareholders should preferably be of a similar type. Similarly, Maury and Pajuste (2005) go further and suggest that a controlling group or coalition, whose members include financial institutions, extract less private benefit than a coalition with a family firm because financial institutions are subject to control from regulatory authorities and so they may be reluctant to become involved in extracting private benefits, for fear of being easily detected. Therefore, to prevent the corporate value reduction, the controlling group formation should include different types of block holders. The second largest block holder might be motivated by the shared control benefits and the cash flow incentives. A group of block holders may also contest the control power of the largest shareholder instead of just the second largest shareholder. Indeed, Pagano and Roell (1998) suggest that all or some block holders form a group to monitor a controlling large block holder. The monitoring costs are borne by all block holders (ibid.). The sharing of costs among all block holders encourages the monitoring of controllers.

The second model, as suggested by Bloch and Hedge (2001), assumes contestability within a coalition presenting a coalition of two large block holders. These block holders differ in their capacity to define corporate strategy, monitor the manager and compete for acquiring the votes of minority block holders to attain control. Towards this end, the winning block holder should define a firm's strategies and both parties should be fully involved in monitoring in addition to bearing the monitoring costs. The authors suggest that the battle for the vote of others encourages them to reduce their private benefits and this might boost the shareholders' dividends.

Related Empirical Literature and Hypotheses Development

Literature on family ownership affirms that families have the same desire for control as any other group of corporate owners. Usually, families traditionally have a long-lasting commitment to their firm which goes beyond financial performance. According to Chami (1999) and Becker (1981), founding families do not just consider their firm in terms of cash generated but also passing on ownership to future generations of family members. This desire affects a family block holder's exercise of control over a firm's decisions, as emotion may play a part, as will the impact of any decision on future generations.

Anderson and Reeb (2003) assert that, since most of the family block holders concentrate their investments into a few industries, they are more likely to be

associated with a relatively higher firm-specific/industry-specific risk. To avoid such a risk, strong controls should be in place. According to Harris and Raviv (1988), an increase in debt may be seen as an attempt to block the takeover of the company, hence protecting their control. As long as the families' votes exceed the incumbents', the increase in debt reduces the likelihood of takeover, although too great an increase in debt may also open the possibility of bankruptcy, which has the dramatic impact of losing accumulated control (Harris & Rajiv, 1998).

Anderson and Reebs (2003) identify institutional block holders as a group of block holders with high control motives over firms' decisions. Along a similar line, King and Santos (2008) contend that family firms and institutional firms both have higher debts in their capital structure. Although institutional block holders have motives for control, they are outperformed by family block holders (ibid.). Such family block holders are usually active managers of the firm as opposed to institutional block holders who, in the US and many other countries, are legally banned from sitting on the board of directors of the firm in which they have holdings.

More support of this view is provided by Tufano (1996) who asserts that, institutional investors usually own shares in different companies; hence, they have to split their monitoring time between their various investment portfolios. Furthermore, Karpoff (2001) insists on the ineffectiveness of institutional investors in monitoring firms and state that institutional investors' activism contributes little to a firm's governance change. Thus one can confirm that the monitoring motives exerted by institutional block holders may be relatively lower than the ones exerted by family block holders, which is ample enough to influence the capital structure of the firm.

Furthermore, although institutional investors tend to be driven by what can be explained under agency theory, family owners tend to be governed by what can be explained by the stewardship theory as they the stewards of the firm. The contention is that under a stewardship perspective managers' interests extend beyond economic self-interest. Literature on stewardship further suggests that family owners have a deep emotional investment in firms they control (Bubolz, 2001). In this regard, the prosperity of family firms, their personal fulfilment and public reputation are attached to the business (ibid.). In consequence, family firms struggle to exert more control and avoid issuing equity to maintain control. When the requirement for funds arises, family firms traditionally prefer issuing debt. Due to the inherent difference in control motives between family block holders and institutional block holders, we suggest the following testable implication:

Companies with control in the hands of family block holders are expected to have higher debt ratio than their counterparts controlled by institutional block holders.

Multiple large shareholder structure can constitute a corporate governance device, which reduces the tendency of controlling shareholders to expropriate the minority shareholders (through monitoring effect). Some family-controlled firms may also have institutions in their ownership structures. Therefore, it is worth establishing the ability of these institutions in limiting families using their accumulated powers to expropriate the interests of the minority shareholders. According to King and Santos (2008), family block holders use debt as a mechanism for accumulating more decision-making power in the firm. On the other hand, institutional block holders may intervene in the family block holders' plan to issue more debt when the firm requires funds.

Bennedsen and Wolfenzon (2000) suggest that the formation of a ruling controlling group is relatively hard if the members of the groups are not of the same type. More specifically, the collusion effect becomes easier implying that the marginal cost of extracting private benefits seems to be lower for the controlling group comprising both the second largest and the largest shareholder in family companies as opposed to coalition groups where the largest shareholder is a family company with the second largest being an institution (especially a financial institution) (Maury and Pajuste, 2005). Because a family firm is composed of members of the family with similar goals and trust, they can agree on any plan even if it does not benefit the firm as a whole.

On the other hand, it is difficult for the largest shareholder, for instance in a family company, to collude with financial institutions to extract private benefits because this action becomes more costly if such a deal is exposed (Maury and Pajuste, 2005). In fact, doing so is risky for financial institutions as the opportunity cost of being caught diverting a firm's resources is higher for them than other parties since they are being supervised by regulatory authorities. In relation to this argument one may predict the following testable implication:

Firms whose first two controlling shareholders are family companies employ more debt in their capital structure than firms where the largest block holder is a family whereas the second largest is a financial institution.

Theoretically, according to monitoring effect, apart from the largest shareholder, the existence of other large shareholders with relatively large stakes in a business creates an incentive for them to monitor the largest shareholder to limit his/her extraction of personal benefits (La Porta *et al.*, 1999; Pagano & Roell, 1998). In so doing, the interests of the minority shareholders are protected, resulting into the maximisation of shareholders' wealth. The control ability of the second largest shareholder depends on the difference between the stakes of the second largest and the largest. According to Maury and Pajuste (2005), the smaller the difference, the greater is the control ability of the second largest shareholder, and vice-versa. The relative size of shares owned by the controlling shareholder and

other block holders tends to influence the extent to which the largest shareholder expropriates minority shareholders.
Bloch and Hege (2001) contend that, low contestability reduces the control competition among large shareholders leading to less commitment to refrain from private benefit extraction. According to Zwiebel (1995), extraction of private benefits by larger shareholders is proportional to their respective control stakes. In other words, the higher the contestability, the more powerful is the largest shareholder, and the lower the contestability, the less powerful is the first largest shareholder, hence reflecting lower probability of the expropriation of minority shareholders' interests. The literature on expropriation recognises debt as one of the control-enhancing mechanisms, which ultimately leads to expropriation. The largest shareholder whose voting rights exceed cash-flow rights would prefer to take more debt to explore more risky projects which may be detrimental to the owners' wealth. However, in many cases such projects are not beneficial to the minority shareholders. Because the largest shareholder's cash-flow rights are relatively lower, in an extreme case where the firm becomes bankrupt as a result of default risk, she/he has little to lose. This results into the formulation of the following testable implication:
The size of the second largest shareholder's voting rights relative to the largest is positively related to the corporate debt ratio.

Methodology

Data collection and sample selection

The sample used in this study comprises UK public companies listed on the London Stock Exchange. The raw data is adapted from Faccio and Lang (2002) which comprises 5,232 firms in 13 Western European countries between 1996 and 1999 after excluding all the companies with no ownership data, firms which use nominee accounts and foreign affiliate companies whose ownership chain could not be traced. In this study 1,953 UK firms are selected from the raw data and screened. After eliminating financial companies we are left with 1,511 non-financial companies. In all, 442 financial companies were eliminated as literature recommends excluding financial companies, as their reporting style and regulations differ from those of non-financial firms. When financial data was matched with ownership data only 643 companies remained in the sample.

The source of raw ownership data used in this study is similar to the one used in assessing the complex ownership and firm valuation in Laeven and Levine (2008), which focused on Western Europe and Attig *et al.* (2008), who examined the relationship between multiple large shareholders, control contest and the implied equity cost. This study focuses on the UK for several reasons: First, the UK is a relatively developed market compared to other Western European countries included in the raw sample and previous literature such as Frank *et al.* (2009) and La Porta *et al.* (1998) consider the UK to have better investor

protection levels than many other European countries. Therefore, assessing the level of expropriation, while mixing the UK with other countries may not actually provide an actual picture of the expropriation levels in the UK, hence dealing with the UK separately is an ideal option.

Second, the disclosure level for UK companies is relatively higher than those of other Western European countries; hence the quality of UK data is also expected to be relatively better. This view is supported by Faccio and Lang (2002) who put it thusly when tracing the ultimate ownership of unlisted companies of the companies in Western Europe:

> Where the ultimate owner of a corporation is an unlisted firm, owners were traced using all available data sources. It was not easy to have complete success because most of the sample countries do not require unlisted firms to disclose their owners. One exception is the UK, where the 3% disclosure rule also applies to unlisted firms. If we failed to identify the owners of unlisted firm, then we classified them as a family.

Variable Construction and Definitions

Financial leverage

Previous studies related to debt financing claim that the effectiveness of monitoring by debt holders depends on the debt level. Debt holders become effective monitors when the debt level reaches a critical threshold. The study uses the Debt to Asset ratio to measure financial leverage similar to several previous studies such as Maury and Pajuste (2005) and Laeven and Levine (2008).

Ownership and Control Characteristics

In this study, the largest fraction of voting rights is used to measure the impact of the decision making power of investors as adapted from Faccio *et al*. (2011). Thomsen and Pedersen (2000) applied this measure when dealing with the ownership identity. In this study, a company's controlling owner constitutes the owner who has over 10 percent of the company's votes like in Laeven and Levine (2008) as adapted from La Porta *et al.* (1999). Controlling over 10 percent of company's shares provides sufficient power for influencing a firm's decisions with more control consolidated by increasing their stakes in the company. If more than one category owns individually above 10 percent of the firm's shares, each of them is considered as a large shareholder in his or her own right. In this regard, the one with higher votes is the controlling shareholder. When a firm has no owner with a stake of more than 10 percent, such a firm is a widely held firm. Other cut-off such as 20 percent (Faccio & Lang, 2002) and 25 percent (Cronqvist and Nilsson, 2003) are also employed.

Using Laeven and Levine's (2008) definitions, the study employs the following variables to measure ownership and control;

Control-Largest equals the control-rights of the largest shareholder with control of 10 percent or more of the voting rights.
Control-2ndLargest equals the control-rights of the second largest shareholder with control of 10 percent or more of the voting rights.
Cash flow-Largest equals the cash-flow rights of the largest shareholder with control of 10 percent or more of the voting rights.
Cash flow-2ndLargest equals the cash-flow rights of the second largest shareholder with control of 10 percent or more of the voting rights.
Control Contestability equals the difference between the voting rights of the largest shareholder and second largest shareholder.

Control Variables
The following table summarises the control variables in this study as suggested in various literatures:

Table 1: Summary table for control variables

VARIABLE	DEFINITION	ADAPTED FROM
Growth Opportunities	Three years Sales growth rate	Laeven and Levine (2
Free Cash Flows	Free cash flows scaled by total assets	Boone *et al.* (2007).
Leverage	Book value of all long-term liabilities divided by total assets	Maury and Pajuste (2 Levine (2008) Gugl (2003).
Firm size	The natural logarithm of total assets	Maury and Pajuste (20 Levine (2008) and Yu Farinha (2003)
Investment ratio	Ratio of capital expenditure to fixed assets	Bhattacharya and Gra Short (1994)
Profitability	Measured as Return on Assets (ROA)	Jensen *et al.* (1992) French (2001)
Volatility	Standard Deviation of Share prices	Jensen *et al.* (1992 French (2001)

Empirical Method

This section carries out cross-sectional regression. Because the argument of this paper is, in essence, cross-sectional, this methodology is the most suitable one. The use of panel regression is also common in capital structure studies, but one potential problem encountered when applying panel regression is the relative time-invariance of ownership variables, which is a problem in our case, as ownership variables of this study are taken at one point in time between 1996 and

1999. Consistent with Faccio and Lang (2002), La Porta *et al*. (1999) and Laeven and Levine (2008), we observe that ownership does not change significantly over time. However, to apply this comprehensive data set a confirmation of the claim that corporate ownership structure rarely changes over time was done. To do this a pilot most recent (2010-2012) data set was constructed and the corporate ownership was compared with the one in the comprehensive data set used. In this study, at some point, a t-test statistics was run to determine whether companies owned by financial institutions and those owned by families have different debt ratios. Some previous studies such as Rajan and Zingale (1995) and Bevan and Danbolt (2002) employed Tobin regressions in works similar to this due to the presence of some observations on debt ratio with zero values. Hence, censored regression was necessary in this case. However, their results are consistent with the results generated from the clustering correction method. In fact, about 13 percent of the debt ratio observations in this study have zero value and, therefore, the study uses Tobit regression for testing the robustness and consistency of the reported results. Our model is a pooled OLS regression specified as follows:

$$\mathbf{DT_{i,t}= \alpha + \beta_1 * CONTEST_{i,t} + \beta_2 * ROA_{i,\,t} + \beta_3 * FSZ_{i,\,t} + \beta_4 * VOLAT_{i,\,t} + \beta_5 * SGR_{i,\,t} + \beta_6 * FCF_{i,\,t} + e_{it}}$$

Where;
$\mathbf{DT_{i,t}}$ =Leverage at time t
$\mathbf{CONTEST_{i,t}}$= Control Contestability
$\mathbf{FSZ_{i,\,t}}$=Firm Size
$\mathbf{VOLAT_{i,\,t}}$ =Volatility (Variations of corporate returns)
$\mathbf{ROA_{i,\,t}}$=Returns on Assets
$\mathbf{FCF_{i,\,t}}$=Free Cash Flows
However;

$$\mathbf{DT_{i,t}} = \begin{cases} \mathbf{DT^{*}_{i,t}} & \mathbf{If\ \ DT^{*}_{i,t} > 0} \\ \mathbf{0} & \mathbf{If\ \ DT^{*}_{i,\,t} <= 0} \end{cases} \qquad \text{----------} \qquad \mathbf{(2)}$$

RESULTS AND DISCUSSIONS

The study starts by examining whether the shareholder's identity matters in as far as corporate financial decision-making is concerned. Different owners can have different objectives, goals and motivations (Thomsen & Pedersen, 2000). Major groups of firms with controlling shareholders are selected, namely widely-held financial institutions and family companies. To reveal how these two owner groups prefer different debt levels, the study uses t-test statistics to determine whether companies owned by financial institutions and those owned by families have different debt ratios.

Table 2 shows that, companies controlled by families have higher debt ratios than companies controlled by financial institutions. The debt ratio difference between the two groups of companies is statistically significant at one percent. This indicates that, when companies controlled by families need external funds, they do not prefer to issue equity and instead issue debt. The first possible reason for this decision is suggested by some strands of the literature such as Ellul (2008) who contends that, family companies become reluctant to introduce more equity holders, because their control may be diluted and, therefore, debt is used by family companies as a control-enhancing mechanism. Another reason may be protecting their firms from hostile take-over threats as highlighted in Harris and Raviv (1988) and Stulz (1988).

To determine whether the identity of the largest and the second largest shareholder matters in corporate leverage, the study employed two sample mean comparison t-test. It subdivided a sample of firms with multiple large shareholders into two groups: the first group comprising the companies where both of the first two largest shareholders are family firms and the other group of companies whose largest shareholder is a family and the second largest is a financial institution. The results of the means comparison test is presented in Table 2

The results show that, companies with both of the first two largest shareholders being family firms use more debt in their capital structures than companies whose largest shareholder is a family and the second largest is a financial institution. The difference in debt ratios between the two groups is statistically significant at 10 percent.

This finding is consistent with the control incentives of family companies. In an attempt to retain control, family companies prefer to use more debt in their capital structures to issuing shares so as prevent dilution of their accumulated control, particularly in circumstances where there is a need for external funds. This action eliminates take-over possibilities. With the assurance of control, family firms make some corporate decisions which are beneficial to family members and not necessarily to the company as a whole.

These decisions are motivated by the need to pass on ownership and control of the company over to coming generations. As the hypothesis development section has made it clear, the increase in the voting rights of the second largest shareholder increases the opportunity for the second largest shareholder to collude with the largest shareholder. Using the relative size of the voting rights values of the first two largest shareholders (the difference between the voting rights of the largest shareholder and the second largest shareholder), this study examines the impact of the second largest shareholder in monitoring the largest shareholder's selfish behaviour in corporate debt level choice.

The sample of companies with multiple large shareholders is split into those companies with smaller relative size or lower control contestability (below-mean value of difference between the voting rights of the largest shareholder and the second largest) and those with larger difference (higher control contestability/larger relative size). The analysis starts by testing the statistical mean difference of the debt ratio between the two groups of companies. Table 2 shows that companies with higher contestability use more debt in their capital structures than those with lower contestability with the mean difference statistically significant at 5%.

Table 2: Univariate Tests on the Debt Ratio

VARIABLES	FAMILY VS. FIN	HCC VS. LCC	FAM-FAM VS. FAM-FIN
DEBT RATIO	3.54***	2.16**	1.64*

Note: In this table the mean Debt Ratios are compared using standard t-tests on means. Information from Worldscope and firms' annual reports for the period

*1996-1999 is used to build the values of debt ratios. For a particular firm, DEBT RATIO is the ratio between the total debt and total assets. The mean values of the debt ratios for observations related to Family companies are compared with the mean value of debt for financial institutions (FAM VS FIN.), firms with higher control contestability and those with lower control contestability (HCC VS LCC) and companies whose control coalition has both the largest shareholder and second largest, families and those with the largest a family and the second largest a financial institution.(FAM-FAM VS FAM-FIN). *, ** and *** stand for statistically significant at 10%, 5% and 1%, respectively.*

To shed more light on the relationship between control contestability and debt ratio, a linear regression is run with control contestability as an independent variable followed by various common factors which affect the dependent variable, debt ratio. Table 3 reports regression results which show a positive and statistically significant relationship between control contestability and debt ratio. The relationship is reported to be statistically significant at one percent. This outcome supports the contention that the relative size of the voting rights between the largest and the second largest has a positive impact on debt ratio. As the gap between the voting rights of two groups widens, the largest shareholders become more powerful and capable of exercising their power without any active monitoring from the second largest shareholder.

This deduction is supported by the mean comparison t-test results as reported in Table 2 that companies with lower control contestability have lower debt ratios than firms with higher control contestability. Generally, the second largest shareholder gains more power to monitor the behaviour of the largest shareholder when the deviation between the voting-rights of the two decreases. In essence, smaller values of control contestability signify more equal distribution of the voting power between the two largest shareholders. This finding is in line with the monitoring hypothesis of the second largest shareholder, which suggests that the involvement of the second largest shareholder in monitoring the actions of the largest shareholder reduces the second-order agency costs, the agency conflict between minority shareholders and majority shareholders**.**

Table 3 further reports that some of the control variables show statistically insignificant coefficients such as free cash flows and growth opportunities. The coefficient for firm size is positive and statistically significant at 1%, implying that larger firms use more debt because they are reputable; hence their borrowing capacity is higher. Likewise, the relationship between profitability and debt is reported to be negative and statistically significant at 1%. This is consistent with the pecking order theory of Myers (1977), which contends that companies with good profitability use the internal funds available before taking a borrowing option. Hence, profitable companies use less debt, which is consistent with Titman and Wessels (1988) and Friend and Lang (1988).

Finally, the table shows a negative and statistically significant relationship between corporate earnings volatility and debt ratio. The relationship is statistically significant at 10%. This finding shows that money lenders such as banks are reluctant to offer loans to risky companies due to worries about default risk. Therefore, a corporate risk profile is an important parameter for lenders to consider before issuing a loan to any company. As a firm's earnings volatility increases, the debt ratio decreases as its borrowing capacity falls and vice-versa.

Table 3: OLS model: Control Contestability and Debt ratio

Independent Variable	*The Dependent Variable : Debt Ratio*
	Model
CONTEST	0.026***(3.31)
SIZE	0.002***(3.84)
FCF	-0.001(-0.80)
GRTH	0.001(0.11)
VOLAT	-0.021*(-1.68)
PROF	-0.008***(-3.74)
CONSTANT	1.510***(5.51)
R^2 /Pseudo R^2	0.256
F-stat	7.98***
INDUMMY	Yes
Observations	198

*Note: This table reports the estimates for OLS regression of the dependent variable DEBT RATIO (Total debt over total assets) on several independent variables. The regressions are run on sample firms with controlling shareholders. The sample period is 1996-1999. The regressions include size of control-rights of the largest shareholder relative to the second largest (CONTEST). The data necessary to build the variables is extracted from Thomson DataStream and WorldScope. The ownership variables are constructed from Faccio and Lang (2002) ownership database. For a particular firm, the variables SIZE, FCF, GRTH, VOLAT and PROF are computed using information as of the end of the fiscal year one year after the year in which the ownership variable is extracted. SIZE is the natural logarithm of book value of total assets; FCF is the free cash flows scaled to total assets; GRTH is the three years average of sales growth rates; VOLAT is standard deviation of share price measuring firm risk; and PROF is the EBIT scaled to total assets. For each independent variable, the table shows the coefficient estimates and the t-statistic accompanied with *, **, or **** to represent the statistical significance at 10%, 5% and 1% significant level, respectively, and t-statistics in bracket. The table also reports the number of observations and the value of the log-likelihood function for every regression. Industry dummies are included in the models and reported as INDUMMY.*

CONCLUSION

This study recognises two competing hypotheses about the relationship between family control and debt levels. If a family controlling shareholders desires to limit the risk of its poorly diversified human and financial investments, we expect consequently that the family firms will use less debt than non-family firms. In contrast, if family controlling shareholders need to conserve control and entrench themselves further, we expect that family firms will have higher levels of debt than their counterparts.

The key conclusion which can be derived from this study is that family-controlled companies prefer debt to equity as opposed to companies controlled by financial institutions so as to protect control dilution and protect themselves from hostile takeovers in which case debt is used as a control-enhancing mechanism. It should not be taken for granted that debt is cheaper than equity for all family firms; however, the most important thing for the family firms is to protect the family culture through passing on of the control and ownership of their companies to future generations by any cost, hence debt serves as a tool to facilitate this overriding motive.

These results are consistent with those reported in Stulz (1988) as opposed to those of Friend and Lang, (1988) where family controlling shareholders prefer a low level of debt to reduce the risk of their undiversified financial and human capital investments. Likewise, Harris and Raviv (1988) claim that, family controlling shareholders also prefer employing less debt to limit monitoring by creditors.

As this study was conducted in the UK, it would be imperative to replicate this study in the context of Tanzania as about 55 percent of the country's companies are family owned and 33 percent of them use debt into their capital structure, as reported by Ishengoma (2004). According to Ishengoma, in Tanzania about 57 percent of the family mother companies have their sister companies whose source of capital is the internal financial support. In this case, when the sister company is in financial hardship it gets support from the mother company or from another sister company of the same mother whose financial position is promising. Ishengoma (2004) indicates that soliciting of such financial support is relatively easy because in these companies the managing director and other top management are the same, hence shortening the procedures. This shows that internal financial support is an easier financing option than debt financing. The use of internal financial support appears to constitute a smatter way of protecting the ownership and control while saving on the cost of debt financing. Following Ishengoma's (2004) findings it is worth investigating whether in Tanzania

family-controlled firms employ more debt in their capital structure than their counterpart financial institutions. This type of study is in the pipeline.

Although there are potential limitations with regard to the replication of this study in the Tanzanian environment because the construction of such a comprehensive dataset will be difficult due lack of a detailed presentation of corporate data in Tanzania, the study is nevertheless feasible.

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