Jurnal Riset Manajemen Sains Indonesia, 15 (2) 2024, 86-90

Jurnal Riset Manajemen Sains Indonesia

http://journal.unj.ac.id/unj/index.php/jrmsi

OPTIMIZING FINANCIAL MANAGEMENT IN SMALL AND FAMILY-OWNED ENTERPRISES: A LITERATURE REVIEW ON SIGNALING AND AGENCY THEORIES

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Article Info

Article history:
Received: May 24, 2024;
Accepted: May 28, 2024;
Published: September 1,2024.

Keywords:
ownership structure, agency relationship, financial signals, small and family firm financial management

ABSTRACT

This research explores the role of ownership structure, agency relationship dynamics, and the implementation of financial signals in the context of small and family firm financial management. Employing the Systematic Literature Review method, a literature review was conducted to gather, filter, and analyze relevant literature on the topic. The research findings indicate that a deep understanding of ownership structure enables firms to design more efficient risk management policies and decision-making. Additionally, an understanding of agency relationship dynamics allows firms to manage conflicts of interest more effectively through the development of appropriate oversight mechanisms and incentives. The proper use of financial signals was also found to enhance transparency and external stakeholders' trust in the firm, thereby opening doors to better access to external capital. The conclusion drawn from this research is that effective financial management practices are crucial for the long-term success of small and family firms. The implications of these findings emphasize the need for firms to continuously update their knowledge and skills in financial management and actively apply proven principles in their own context. Thus, they can remain competitive in an everchanging business environment and meet their long-term objectives.

INTRODUCTION

Financial management is a vital aspect that ensures the sustainability and growth of a company. However, the challenges faced in managing finances are not evenly distributed across all types of businesses. Small and family owned enterprises, with their unique ownership structures and differing decision-making dynamics, often encounter distinct challenges in optimizing their financial management. One of the challenges frequently faced by small and family-owned businesses is limited access to financial resources, as highlighted by Yunus (2021) in their research on small companies' access to capital markets. They noted that small businesses tend to rely on internal funds or loans from local banks, which can constrain their financial flexibility. Additionally, the distinctive ownership structure in family-owned businesses can also pose its own challenges, as emphasized by Ramadhani et al. (2023) in their study on family businesses. They found that non-economic factors, such as family relationships and loyalty, can influence financial decision-making, which may not always be optimal financially. To address these challenges, small and family-owned businesses need to adopt a proactive approach to their financial management, as suggested by Agung et al. (2023) in their book on financial management for small businesses. This includes building sufficient liquidity reserves, developing funding diversification strategies, enhancing transparency in financial decision-making, and improving financial literacy among owners and other key decision-makers. By doing so, small and family-owned businesses can strengthen their financial foundations and enhance their ability to survive and thrive in a competitive

ISSN 2301-8313 (online) DOI: doi.org/10.21009/JRMSI.015.2.09

business environment.

The ideal condition in managing finances for small businesses and families involves adopting efficient and effective strategies to ensure the optimal utilization of limited financial resources. According to Solehudin et al. (2023), under ideal circumstances, small businesses and families can integrate meticulous financial management practices, including thorough budget planning, strict cost control, and appropriate capital allocation, to achieve sustainable growth. However, the reality often depicts a significant gap between the ideal condition and actuality. According to a study conducted by Siagian & Safitri (2024), many small businesses and families face challenges such as limited access to financial resources, lack of knowledge and skills in financial management, and the complexity of the business environment. To minimize the gap between the ideal condition and reality in managing finances for small businesses and families, an integrated and theory-based approach is becoming increasingly important. Previous studies, such as those conducted by Nuansari & Ratri (2022), have highlighted the importance of agency theory in the context of the relationship between owners and managers and its impact on financial decisions of the company.

Taking into consideration the gap between ideal conditions and reality, and drawing upon existing ideas and theories, this research aims to delve deeper into the optimization of financial management in small and family businesses. Through this study, we hope to provide better insights and implementable solutions in the practice of financial management for small and family enterprises.

RESEARCH AND METHODOLOGY

The Literature Review method is chosen as the primary approach in this study to gather, sift through, and analyze relevant literature concerning the theory of signals and agency in the context of small and family firm financial management. This approach is selected because it provides a systematic framework for carefully investigating existing literature and identifying significant findings.

RESULT AND DISCUSSION

In this study, the results of a systematic literature review on the theory of signals and agency in the context of financial management of small and family-owned businesses have revealed several significant findings that can provide profound insights into optimizing financial management in this context.

The Role of Ownership Structure in Financial Management

The role of ownership structure in the financial management of small and family businesses is a crucial aspect affecting investment decisions and growth strategies. Research by Gerlitz & Hülsbeck (2023) highlights that variations in ownership structure can have significant impacts on financial decision-making. For instance, family firms often have a more centralized ownership structure, where control over the company is concentrated within the founding family or the family holding the majority of shares. This can influence long-term investment decisions and company growth strategies.

The study by Li (2022) adds an important dimension to our understanding of the role of ownership structure in corporate financial management. They found that companies with more concentrated ownership tend to have lower dividend policies and less debt policies, as dominant owners may prefer to retain profits within the company or use internal funds for investments. Furthermore, a study by Molly & Michiels (2021) highlights that diverse ownership structure, where company ownership is dispersed among several institutional shareholders or individuals, can result in different incentives in financial decision-making. This can affect corporate strategies related to risk, innovation, and growth.

Tao-Schuchardt et al. (2022) added that different ownership structures can also influence a company's access to external financial resources. Companies with concentrated ownership may find it easier to access venture capital or bank loans, while companies with dispersed ownership may rely more on internal funding or the capital markets. Overall, this research highlights the complexity of the role of ownership structure in managing the finances of small and family-owned businesses, as well as its implications for investment decision-making, growth strategies, dividend policies, financial access, and more. A profound understanding of these factors can assist stakeholders in designing more effective and sustainable financial strategies.

The Agency Relationship Challenge in the Context of Family

The Agency Relationship Challenge in the Family Context is an important aspect of family business financial management that deserves serious attention. Conflicts of interest between owners and managers in this context can lead to agency behaviors detrimental to the company. A study by Curado & Mota (2021) highlights that the dynamics of the agency relationship in family businesses can result in unfavorable behaviors, such as excessive use of company resources or irrational risk-taking.

Furthermore, research by Mai & Abdul (2021) also indicates that family firms tend to have higher levels of

agency conflict compared to non-family firms. This is due to personal intervention in corporate decision-making, which can blur the line between personal interests and the overall interests of the company. Another study by Mundi et al. (2022) adds another important dimension to the challenges of agency relationships in family firms, namely the differences in goals and visions between different generations within the owning family. These divergent perspectives often lead to disagreements in strategic decision-making, which can disrupt the stability and growth of the company.

Furthermore, a study by Rao et al. (2021) highlights that psychological factors, such as feelings of identity and family pride in their heritage, can also influence the dynamics of agency relationships within family firms. This can lead to resistance towards ideas and management practices proposed by non-family managers, thus complicating efforts to achieve efficiency and innovation within the company. Consequently, agency conflicts in the context of family businesses become complex and multidimensional challenges that require deep understanding and appropriate strategies to manage them effectively.

The Implementation of Financial Signals in Decision Making

The implementation of financial signals in decision-making is a crucial aspect of small and family-owned business financial management. Financial signals, such as dividends or stock offerings, can serve as effective communication tools for companies to convey information about their financial performance and future projections to external stakeholders, such as investors or creditors.

A study by Heubeck (2024) highlights the importance of dividends as financial signals in determining the health and stability of a company's finances. Stable and consistent dividends can signify to stakeholders that the company has a healthy cash flow and is capable of distributing profits to shareholders, thereby enhancing investor confidence and interest.

Furthermore, research by Stock et al. (2024) indicates that stock offerings serve as crucial financial signals in evaluating a company's future projections. Successful stock offerings can indicate that a company has robust growth plans and confidence in its future prospects, thereby attracting investor interest for additional investment.

The study by Ha (2022) also emphasizes the importance of financial signals in shaping the market's perception of a company's value. Small and family-owned businesses capable of sending positive financial signals can enhance their company's value in the eyes of investors and creditors, thus strengthening their market position and gaining easier access to financial resources. Therefore, the proper implementation of financial signals in decision-making can serve as an effective instrument for small and family-owned businesses to reinforce their financial performance, enhance stakeholder trust, and create added value for the company.

The importance of implementing financial signals and having a deep understanding of ownership structure and agency dynamics has significant implications in the practice of financial management for small and family-owned businesses. Discussion of these findings not only provides insights into the factors influencing financial decision making but also prompts consideration of how companies can enhance their financial performance and strengthen their position in the market.

First and foremost, a deep understanding of ownership structure is key in designing more efficient risk management policies and decision-making. Different ownership structures can provide different incentives to owners and managers, influencing investment decisions, funding, and profit distribution. With a good grasp of ownership structure, companies can identify potential agency conflicts and develop appropriate oversight mechanisms and incentives to minimize risks and enhance efficiency in decision-making. For instance, if a company has a fragmented ownership structure, shareholders may have diverse interests, which can hinder consistency in dividend policies or long-term growth strategies. In such cases, companies need to design strategies that accommodate the diverse interests of shareholders in a balanced way, to ensure long-term business sustainability.

A deep understanding of agency dynamics enables companies to manage conflicts of interest between owners and managers more effectively. Agency conflicts often arise due to differing objectives between owners (who may be more interested in maximizing company value) and managers (who may be more focused on maximizing personal interests or maintaining power). By comprehending the origins of agency conflicts and the factors influencing them, companies can develop oversight mechanisms, such as independent audit committees or performance-based compensation structures, to minimize such conflicts. Moreover, a profound understanding of agency relationships can also assist companies in designing appropriate incentive systems that encourage managers to act in the owners' interests.

The importance of using appropriate financial signals can enhance transparency and trust from external parties towards small and family businesses. Financial signals, such as stable dividends or successful stock offerings, can provide indications to investors and creditors about the financial performance of the company and its future prospects. By sending positive financial signals, companies can enhance stakeholders' trust in the company's ability to manage risks and achieve sustainable growth. Furthermore, increasing transparency and trust can open doors to better access to external capital, both in the form of loans and investments, which in turn can enhance competitiveness and financial stability of the company.

Overall, the discussion of these findings underscores the importance of effective financial management in facing the challenges encountered by small and family-owned businesses. By understanding and wisely applying these concepts, companies can enhance their financial performance, strengthen their position in the market, and achieve sustainable long-term growth

CONCLUSION

Conclusion section is not supposed to be a summary! Please do not use subtitles here! Conclusions are the author's original thoughts and evaluation of the obtained results including the items as follows:

This research has unveiled the importance of a profound understanding of ownership structure, agency relationship dynamics, and the utilization of financial signals in the practice of small and family firm financial management. Within the context examined, these findings bear significant implications for firms in devising policies, managing risks, and building trust with external stakeholders.

Firstly, a deep understanding of ownership structure enables firms to identify potential risks arising from conflicts of interest between owners and managers. Consequently, firms can develop appropriate oversight and incentive mechanisms to minimize conflicts and enhance decision-making efficiency.

Secondly, a profound understanding of agency relationship dynamics allows firms to manage conflicts of interest more effectively. By developing suitable oversight and incentive mechanisms, firms can minimize agency conflicts and ensure that financial decisions are made with the owners' interests in mind.

Furthermore, the importance of employing appropriate financial signals in communicating with external stakeholders cannot be overstated. By sending positive financial signals, firms can enhance investor and creditor trust and interest, thereby strengthening the firm's financial position and opening doors to better access to external capital.

Therefore, the conclusion drawn from this research is that effective financial management practices play a key role in ensuring the long-term success of small and family firms. By understanding and wisely applying these concepts, firms can improve their financial performance, minimize risks, and achieve sustainable growth. Thus, it is crucial for firms to continuously update their knowledge and skills in financial management and actively apply proven principles within their own contexts. By doing so, they can remain competitive in a constantly changing business environment and meet their long-term objectives.

Acknowledgements

The researcher would like to express heartfelt gratitude to all parties who have provided their support and contributions to the completion of this research. Thanks to the teaching team and staff of the Department of Financial Management for their guidance, advice, and support throughout the research process. The researcher also wishes to thank researchers, academics, and practitioners who have shared their knowledge and experiences in relevant literature, which have aided in summarizing significant findings. Thanks to friends and family for their invaluable moral support and motivation during this research. Finally, the researcher would like to extend gratitude to institutions and parties that have provided financial support for the implementation of this research. Thank you for all the assistance and support that has been given.

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