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The Impact of Firm Performance on the Business Transfer Mode

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ABSTRACT

This paper analyzes the impact of family firms' past and future economic viability on the incumbents' decision on the business transfer mode. Using the German IAB Establishment Panel and estimating logistic regression models we show that the decision on the business transfer mode rather depends on the expected future performance than on the past one. Moreover, family businesses that are exclusively managed by their owners are more likely to be planning an intra-family succession. However, ambiguity about the future performance overrides the original intention and induces the incumbents to sell the business.

JEL-Classification: L25, L26, M2

Keywords: family businesses, business succession, transfer mode, performance

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INTRODUCTION

The decision on the business transfer mode is of particular importance in the business succession process because most subsequent decisions depend on this initial decision (e.g. Boyd, Botero & Fediuk, 2014; Wennberg, Wiklund, Hellerstedt & Nordqvist, 2011). Despite its relevance, family business research only started to systematically address this topic a decade ago (De Massis, Chua & Chrisman, 2008; Royer, Simons, Boyd & Rafferty, 2008). Since then, conceptual papers (e.g. De Massis, Chua & Chrisman, 2008; DeTienne & Chirico, 2013) as well as empirical ones have emerged (e.g. De Massis, Sieger, Chua & Vismara, 2016; DeTienne & Chirico, 2013). They emphasize the influence of individual, relational, context, financial and process factors on the decision on the business transfer mode (De Massis, Chua, & Chrisman 2008). Likewise, factors lying in the sphere of the family certainly affect the business transfer mode (Battisti & Okamuro, 2010; Wiklund, Nordqvist, Hellerstedt & Bird, 2013). However, prior research remains unclear what role the firm's economic viability plays. While Battisti & Okamuro (2010) found that performance has an impact on the business exit mode, Wiklund, Nordqvist, Hellerstedt & Bird, (2013) did not. They, however, believe that performance is important for understanding ownership transition. Following up on this, they also assume that it is not simply earnings or owners' salaries which influence the transfer mode. Other factors may moderate performance measures' impact, too. This includes the socio-economic wealth that family business owners gain from maintaining family control over a firm (DeTienne & Chirico, 2013; Wiklund, Nordqvist, Hellerstedt & Bird, 2013). Moreover, since a company's value is not determined by its past but its future performance, it seems worthwhile also to investigate how expectations of the future performance affect the business exit mode (Hauser, Kay & Boerger, 2010; Wiklund, Nordqvist, Hellerstedt & Bird, 2013). Thus, the present paper aims to analyze the impact of both past and future economic viability on the decision on the business transfer mode. In order to better understand this specific decision making process of family business owners, we additionally investigate at which stage of the business transfer process business performance mainly affects the respective decisions.

HYPOTHESES DEVELOPMENT

Drawing on the socioemotional wealth (SEW) model, we assume that family firms generally prefer intra-family successions because it grants them to perpetuate owner's control und influence over the firm's affairs which is sine qua non for preserving SEW (Gomez-Mejia, Haynes, Nunez-Nickel, Jacobson & Moyano-Fuentes, 2007; Berrone, Cruz & Gomez-Mejia, 2012). Nevertheless, there are factors that prevent intra-family succession (e.g. De Massis, Chua & Chrisman, 2008), among others, low performance. While it is well established that the thresholds of performance differ across companies (Gimeno, Folta, Cooper & Woo, 1997), we argue that owners reconsider their exit strategy when the economic performance falls below a firm-specific threshold because they do not intend to put the burden of a failing business on family successors. We therefore propose that:

> H1: Poorly performing family businesses are less likely to planning an intra-family succession than any other transfer mode.

In this way of thinking past performance is considered as an indicator of the future performance or future viability of a firm. But even though the past performance determines its future economic viability to a certain extent, it is not a perfect predictor. We therefore posit that expectations of a firm's future performance capture its prospective economic viability in a more appropriate way. In line with this argument, we hypothesize that:

> H2a: The expected future performance has a bigger impact on the decision on the business transfer mode than the past one.

Up to now, we have assumed that family firms are always able to form expectations of their future performance. But there might be situations in which family firms simply cannot estimate their future performance. Such situations might occur when, for example, a strategic supplier or customer got lost and it is not foreseeable which other supplier or customer will substitute it. Another, more critical example would be a kind of disruption. That is, the main product or the whole business model is not viable in the medium-term and a substitute is not found yet. Whatever reasons induce the lack of clarity regarding a family firm's future performance we expect that this lack of clarity affects the general assessment of the future viability of the firm negatively. In consequence thereof, incumbents reconsider their exit strategy, exhibiting a decreasing intention of keeping the business in the family.

> H2b: Family businesses which are not able to estimate their future performance are less likely to planning an intra-family succession than any other transfer mode.

The succession process consists of several stages (e.g. Le Breton-Miller, Miller & Steier, 2004). In the context at hand, we are interested in the planning stage at which the incumbent makes, among others, the following three consecutive decisions: on transferring the business within a specific period, on any kind of transfer mode and, finally, on a specific transfer mode. The firm's past or future performance may affect all three decisions but to different degrees. Since the necessity of a business succession results from factors that lay in the sphere of the incumbent and not in the sphere of the firm (Hauser, Kay & Boerger, 2010) we assume that the firm's performance does not impact the general decision on transferring the business. As far as the personal reasons for the business succession allow for it – for example reaching retirement age – business performance, however, might have an impact on the date of the succession within a narrow space of time. Given the above-mentioned arguments, we suppose that performance has a larger impact on deciding on both any kind of transfer mode and a specific transfer mode.

> H3a: Business performance has a larger impact on the decision on any kind of transfer mode and on a specific transfer mode, respectively, than on generally transferring the business in the near future.

With regard to the special case of a firm not being able to estimate its future performance we suppose that this has a particular impact on the decision on any kind of transfer mode. After all, there is no expectation on the future performance that can offer any guidance with respect to the business transfer mode. This should result in a decreasing likelihood that incumbents have made a decision on any business transfer mode.

> H3b: Family businesses which are not able to estimate their future performance are less likely to have made a decision on any kind of business transfer mode.

METHOD

To test our hypotheses, we use the waves 2009 to 2013 of the IAB Establishment Panel provided by the Institute for Employment Research (IAB). The panel is based on a stratified random sample of establishments from the population of all German establishments with at least one employee covered by social insurance. In 2012, the survey comprised a set of questions on business succession. Since these questions have not been included in any subsequent waves of the IAB Establishment Panel yet, our analyses rely on the 2012 cross-section. However, we also exploit the longitudinal structure of the data as we use information from waves prior to 2012 when information on past performance is needed, for example. Finally, all questions regarding business succession refer to the enterprise or firm level, respectively, while due to the sampling frame only establishments are observed. Therefore, we examine only establishments which do not have any subsidiaries so that there are technically no differences between enterprises and establishments.

Since we observe different enterprises at different stages of the decision making process, we utilize logistic regressions in order to investigate the impact of performance on the three mentioned decisions. While all enterprises are included in the first one, the remaining estimations contain enterprises which stated in the 2012 survey that there will be a business succession in the near future. In terms of the second decision, we contrast establishments that had already decided upon the transfer mode with establishments that had not yet come to a decision. The focus regarding the third decision is on specific business transfer modes. Though information on different transfer modes is available in principle, there is only a sufficient large number of observations on family successions and sales. We therefore focus on these two most prominent business transfer modes at the final stage of our analyses.

Each model contains a set of performance indicators. One indicator captures the firms' expectations on short-term performance changes. This is, technically speaking, the expected sales trend in the year in which the survey was conducted compared to the prior year. However, we use a dummy variable to identify establishments that do not know whether sales will rise, decrease or remain unchanged in the short-term and therefore lack some clarity regarding their future development. In addition, we use information on sales per capita as well as subjective assessments of the profit situation in previous years. One indicator (a dummy variable) refers to insufficient profits in the previous year, another one refers to the number of years with insufficient profits in the period 2009 to 2011. Finally, we include information on the standard deviation of annual sales in the years 2009 to 2011 so as to capture their volatility.

Additional control variables refer to the size of the establishments, the proportion of women in the executive board, the involvement of the firm's owners in management, the existence of a (very) high state of technology, the proportion of export in total sales, the validity of a collective agreement, gross wages per capita, the age and the legal form of the enterprises, the region as well as the population density at the location of the enterprise, and finally the industry.

RESULTS

Our results show that, all other things being equal, performance plays a role in the decision making regarding business succession (see table 1). Using different performance measures, our results also indicate that it is not performance per se, but its evaluation by the decision maker which affects the decision making. Thus, it is important to look at the results regarding the impact of performance in the context of business succession in more detail.

Contrary to our expectations, performance has an impact on the first stage of decision making, on transferring the business in the near future (see table 1a). The more years a business has suffered insufficient profits the more likely it is to planning a business succession. Furthermore, the higher the sales per capita the less likely a business is to planning a business succession. The estimated coefficients of the other performance variables are not statistically significant. The decision on the second stage, on any intended transfer mode, is also influenced by performance (see table 1b). Family business owners who suffer insufficient profits in the year prior to the survey are more likely to have not decided yet on any transfer mode. In addition, the more years prior to the survey the business has suffered insufficient profits, the higher is the likelihood of not having already made up one's mind on the transfer mode. Again, the estimated coefficients of the other performance variables are not statistically significant. Finally, the decision on the third stage, on a specific transfer mode, is also affected by performance (see table 1c). In this case, it is not the past but the future performance that plays a role. Business owners who are not able to assess their business' future performance are more likely to planning a sale of the business than to hand it over to a family member. Businesses exclusively managed by their owners are, all other things being equal, more inclined to keep the business in the family. However, an additional estimation based on the subsample of owner-managed businesses only (table not included), reveals that they are then more likely to sell the businesses, too. Finally, we conclude with regard to our hypotheses that our results only support hypotheses 2a and 2b, and in some respects hypothesis 1. All other hypotheses are rejected.

DISCUSSION AND IMPLICATIONS

Investigating the impact of performance on the decision making regarding business succession, our results provide evidence that performance indeed plays a role. However, largely it does not play the expected role. Contrary to our expectations, performance has a minor impact on the decision on the transfer mode. Instead, it is more important with regard to planning a business succession at all and to deciding on any kind of transfer mode. Generally speaking, the outcomes indicate that not (only) relatively poor performances, but rather severe economic states affect incumbents' decision making. In this regard, the owner's individual assessment of a hard to tolerate performance, reflected by the performance measure "insufficient profits", seems to be a more suitable predictor than objective measures. This is in line with the threshold theory (Gimeno, Folta, Cooper & Woo, 1997), saying that surpassing an individual threshold induces family business owners to contemplate parting from their business in the near future. This way, they contain the decline of the chances of transferability and possibly avoid a closure. However, these family business owners are less likely to have already made up their mind on the transfer mode. We argue that this finding suggests that these family business owners not only contemplate transferring the firm to whomever but also entertain the idea of shutting it down. Otherwise the variable "insufficient profits" would also influence the decision on intending to sell the enterprise or not (which it does not).

As expected, the future performance bears more importance than the past one regarding the intended transfer mode. However, it is again only a rather specific and severe economic situation that affects this decision: Family businesses which are not able to estimate their future performance are less likely to planning an intra-family succession than to sell the business. Therefore, family business owners perceive unclear economic prospects, as expected, negative. Otherwise these family business owners would be more likely to have not decided yet on a transfer mode. But this is not the case.

Drawing on the SEW-model we supposed that family firms generally prefer intra-family succession. Our results indeed suggest that family businesses (especially when they are exclusively managed by their owners) do not intend to sell the enterprise. In fact, the past performance has no impact on this intention. However, the future performance plays a decisive role: Ambiguity about the future performance seems to override the original intention to hand over the business to a family member and yield a sale of the family business.

Our findings support the assumption of Wiklund, Nordqvist, Hellerstedt & Bird (2013) that it is not simply earnings or owners' salaries which influence the transfer mode. Indeed, specific performance measures seem necessary to catch the individual business owner's performance threshold. In this regard, their inability to estimate the future performance proves to be an appropriate indicator. Even though we were not able to represent the mid- and long-term future performance, the specific measure we used appears to have caught at least a rather precarious outlook on the future of a family firm. Future research on the decision making regarding business succession should take into account that the impact of performance is not as simple and straightforward as it firstly appeared.

APPENDIX

Table 1: Main results

1a: Characteristics of establishments with an upcoming business succession			
	I	II	III
Unclear business expectations	0.702 (0.188)	0.707 (0.189)	0.696 (0.186)
Sales per capita (log.)	0.720*** (0.074)	0.735*** (0.078)	0.734*** (0.074)
Insufficient profits in previous year	0.910 (0.246)		
Standard deviation of annual sales (2009-2011)		0.999 (0.00004)	
Number of periods with insufficient profits (2009-2011)			1.177* (0.114)
Establishment founded before 1990	2.221*** (0.287)	2.224*** (0.277)	2.228*** (0.277)
Management exclusively by owners	1.337 (0.287)	1.326 (0.288)	1.362 (0.293)
Number of observations	2,989	2,989	2,989
1b: Characteristics of establishments that have not yet chosen a certain business transfer mode			
	I	II	III
Unclear business expectations	2.768 (2.484)	2.696 (2.085)	2.297 (2.029)
Sales per capita (log.)	0.889 (0.474)	0.854 (0.457)	0.943 (0.489)
Insufficient profits in previous year	5.842** (4.207))		
Standard deviation of annual sales (2009-2011)		1.000 (0.00004)	
Number of periods with insufficient profits (2009-2011)			2.199** (0.696)
Establishment founded before 1990	0.322** (0.166)	0.345** (0.173)	0.301** (0.153)
Management exclusively by owners	6.989*** (5.165)	6.512** (4.804))	7.086** (5.358)
Number of observations	281	281	281
1c: Determinants of the choice of business transfer mode (sale vs. intra-family succession)			
	I	II	III
Unclear business expectations	7.075*** (5.072)	7.585*** (5.514)	7.552*** (5.491)
Sales per capita (log.)	0.592 (0.221)	0.602 (0.225)	0.614 (0.240)
Insufficient profits in previous year	0.188 (0.220)		
Standard deviation of annual sales (2009-2011)		1.000 (0.00006)	
Number of periods with insufficient profits (2009-2011)			1.000 (0.357)
Establishment founded before 1990	0.488 (0.253)	0.463 (0.240)	0.466 (0.239)
Management exclusively by owners	0.225** (0.136)	0.246** (0.143)	0.245** (0.147)
Number of observations	208	208	208

*Notes: Robust standard errors are in parentheses. ***, **, * denote statistical significance at the 0.01, 0.05, and 0.10 levels. Additional control variables included. Source: IAB Establishment Panel, waves 2009 to 2013; own computations.*

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