Internal Versus External Ownership Transition in Family Firms: An Embeddedness Perspective

by

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1 Aim of the paper

We build a longitudinal data set from a sample of 3,829 family firms and their ownership transitions. Our theorizing and findings regarding ownership transitions complements the abundant research on management succession and therefore constitutes an important contribution to the literature.

Succession continues to be the most extensively researched topic within the family business literature (see Yu, Lumpkin, Sorenson, & Brigham, 2012). To the extent that ownership transition is considered (as opposed to management transition), the succession literature assumes that transition of ownership to the next generation is the preferred choice. However, as an alternative to passing on the ownership of their businesses to the next generation, owners can choose to exit ownership and sell their firms to outside parties if they regard this as a more attractive option. Rather than viewing external ownership transition as a last resort, we posit that the choice between internal and external ownership transfers among family firms depends on the owner-family's structure and involvement. Our argument is that these circumstances have an impact on the family's likely commitment to the business as well as family members' interest in keeping business ownership within the family. In this article we investigate factors that influence family business owners' choice between passing ownership within the family or to new external owners. Taking an embeddedness perspective focusing on owner-family structure and involvement, we hypothesize that ownership dispersion, number of potential heirs, multigenerational involvement, and whether the chief executive officer is a family member influence the choice of an internal or external transition of ownership.
2 Contribution to the literature

Our research provides important contributions to the entrepreneurship and family business literatures. First, we focus on ownership transition rather than management succession. While the drivers and consequences of appointing a new chief executive officer (CEO) is a recurring theme in the family business succession literature, factors driving the choice between internal or external transition of ownership and the consequences thereof have not received much attention in the literature (cf. Long & Chrisman, 2014; Ucbasaran, Westhead, & Wright, 2001). Given the extensive literature on succession, the paucity of research on the determinants of internal versus external ownership transitions is highly surprising for two main reasons.

Our second contribution relates to the understanding of the interplay between the business and the family. While most family business research still utilizes theoretical perspectives from the business side, we suggest that the family exerts a substantial influence on the family firm (cf. James, Jennings, & Breitkreuz, 2012). Drawing on the embeddedness literature (Granovetter, 1985; Moody & White, 2003), we posit that the business is embedded in the family and that family and business are intertwined. Therefore, the choice between internal and external ownership transitions is influenced by owner-family structure, family involvement, and relationships within the owner-family. Our theorizing and findings regarding these factors provide a valuable counterweight to research examining business-related influences on family business transitions.

Third, we rely on variables related to the structure of the family and family members' involvement in the business (e.g., ownership dispersion, the presence of young and adult family members who do not hold ownership positions, intergenerational ownership, and family CEO) as indicators of family structural cohesiveness and the embeddedness of the business in the family (cf. Moody & White, 2003). These variables represent tangible aspects of the family. Access to such information should be reasonably available compared with perceptive measures of structural cohesion and/or embeddedness. For example, in this research, we were able to rely on secondary data for gleaning this information.

3 Data and results

In order to answer the research questions we constructed a longitudinal data set by combining five longitudinal databases maintained by the official census bureau in Sweden. All of these databases contain annual information about individuals and/or firms as well as links between individuals (spouses, siblings, children, etc.). Our sample and analyses are based on annual data observations. We focus on all privately held firms with 10 employees or more that were in existence in Sweden in 2004 and followed them until 2008. We followed all family firms and recorded ownership changes for each consecutive year. From one year to another, a firm could either (1) remain intact without any ownership transition, which we labeled continuation; (2) go through an internal ownership transition; (3) go through an external ownership transition; or (4) experience a firm dissolution, which is labeled shutdown. The result is a sample of 3,829 family firms, corresponding to 12,125 firm-year observations.

Our findings show that there is a positive and statistically significant effect of ownership dispersion on the probability of internal ownership transition (.154, \[ p < .01 \]). This effect is opposite to what we anticipated in hypothesis 1. In a post hoc test we added a square term of the ownership dispersion variable to the equation. The findings show that a low to moderate
The number of owners is positively associated (.269, \( p < .001 \)) with internal transfers, while a high level of ownership dispersion (corresponding to a larger influence of the squared term) has a negative effect (−.005, \( p < .01 \)) on internal transfers. Thus, we find partial support for hypothesis 1.

According to hypothesis 2a, we expect that the number of potential young heirs (17 years or younger) will increase the probability of an internal transfer. The coefficient for young heirs has a positive but statistically nonsignificant effect on the probability of internal transfers (.06, \( p > .05 \)). Thus, hypothesis 2a is not supported. There is, however, a negative and statistically significant effect for the number of adult potential heirs on the probability of intrafamily ownership transition (−.259, \( p < .05 \)), supporting hypothesis 2b, which stated that the larger the number of potential adult heirs, the smaller the probability of an internal ownership transition. The coefficient for multiple generations has a positive and statistically significant impact on internal transfers (1.919, \( p < .001 \)). These results lend support for hypothesis 3, which anticipated that the probability of internal transfers (compared with external transfers) will increase when multiple generations are involved in the business.

Finally, hypothesis 4 posits that the probability of internal ownership transitions (compared with the probability of external ownership transitions) will decrease with the appointment of an external CEO. The coefficient for internal CEO is positive and statistically significant (1.349, \( p < .001 \)), meaning that having an internal CEO increases the probability of internal transfers. Put differently, the existence of a nonfamily CEO decreases the probability of internal transfers. Thus, our results support hypothesis 4. In sum, our results fully support hypotheses 2b, 3, and 4 and provide partial support for hypothesis 1.

4 Discussion and practical implications

We found an inverse U-shaped relationship between ownership dispersion and probability of internal ownership transfers. Initially, greater ownership dispersion actually increased the probability of internal transfer, but beyond a certain level, greater ownership dispersion increased the probability of external transfer. This finding provides some support for our idea that as the group of family owners becomes larger, it becomes more difficult to maintain strong ties and solidarity and thus to agree on a shared agenda for business development and governance. In this situation, conflicts may emerge, and the alternative of selling to outsiders becomes relatively more attractive (Eddleston & Kellermanns, 2007). However, this effect only seems to become present beyond a certain level of ownership dispersion.

Next, we hypothesized that the number of young (below 18 years of age) and adult (18 years or older) potential heirs would have opposite effects on internal and external ownership transitions. Only hypothesis 2b was supported. It thus appears that number of adult heirs better predicts the choice between internal and external ownership transitions than young heirs. Our research heeds the call for taking into account the family members' life stage to understand the choice of ownership transition type (Hoy & Sharma, 2010).

The finding that a higher number of adult potential heirs decreases the likelihood for internal ownership transfer, although the pool of potentially competent heirs is larger, while young heirs has a positive nonsignificant effect, may indicate that the life stage of potential heirs is an important dimension when understanding ownership transitions in family firms. It is plausible that the potential future involvement of the next generation as owners creates...
different dynamics with regards to embeddedness and cohesion compared with the dynamics between *de facto* owners.

**Hypothesis 3** was also supported. We found that internal ownership transition is more probable than external ownership transition when multiple generations are involved in the business. This is in line with our theoretical argument that when two or more generations of the family jointly own the firm, they are more likely to develop an intergenerational perspective of their involvement in the firm and create a vision that embraces the choice of keeping the firm within the family.

Taken together our results give empirical support to previous suggestions in the literature that planning for succession should start early and that it is a process that takes time (Le Breton-Miller et al., 2004; Sharma, 2004).

Regarding **hypothesis 4**, we found that firms with a CEO from the owner-family are more likely to be passed on to other family members than firms with an external CEO. This supports our general theoretical assumption that with strong family presence in the highest executive decision-making position of the firm, firms are characterized by more commitment to family values and interests in strategic choices than firms with an external CEO. Having a family CEO is also a way to select one family member who has the authority to navigate business development even if ties and structural cohesion is weakening between owner-family members.

5 Key reference list


