SMALL BUSINESS TRANSFER DECISIONS; WHAT REALLY MATTERS?
EVIDENCE FROM IRELAND AND SCOTLAND

by

Dr. Geraldine Ryan, Lecturer, School of Economics,
University College Cork, Ireland
Dr. Bernadette Power, Lecturer, School of Economics,
University College Cork, Ireland

AIM OF THE PAPER

Small firms are quickly becoming the driving force of the modern economy (Audretsch and Thurik 2001). Within the EU-27, for example, the majority (98.7 per cent) of firms employ less than fifty employees and are classified as small firms. These firms employ 50.4 per cent of the workforce and generate 39.9 per cent of the total value added. Today many of these small firm owner-managers have a similar concern – they are getting older (Small Business Service 2004) –and, as a result, many choose to or are required to retire. These owner-managers have a number of exit options available to them(Birley and Westhead 1993; Petty 2000)which may or may not result in the continued operation of the firm:they may transfer the business to a family member, sell the business to a third party (e.g. an employee, a latent or experienced owner-manager or via Initial Public Offering) or close down the business and dispose of its assets. While the decision to exit the firm by the owner-manager is a key business decision, few scholarly studies have accounted for or tried to explain the multifaceted nature of this exit decision, referred to in the literature as 'entrepreneurial exit', from the entrepreneur's perspective (DeTienne and Cardon 2012; Wennberg et al. 2010). In an attempt to fill this gap in the literature, this paper examines how factors such as the age, size, sector, exit plan and location of the firm impact on the exit decisions of 236 Scottish and Irish small firm owner-managers.

In 1994, the European Commission acknowledged that small business transfer was a major issue of concern. Currently, 450,000 firms within the EU-27 successfully transfer between owners each year(European Commission 2011). Of the 1.7 million firms which close each year 620,000 (or 37 per cent) attempt to transfer prior to closure; 470,000 of these firms fail to transfer for economic reasons (i.e. they have no valuable assets), while the remaining

150,000 (representing 600,000 jobs) close due to inefficiencies in the transfer process. As a result, the Commission argues that we need to make it easier for viable businesses to transfer. Understanding the factors which lead an owner-manager to choose a particular exit strategy may help us to improve the number of successful transfers, which in turn may increase the number of active firms in the economy, leading to economic and employment growth.

We are fortunate to have new data on mature small firms in two regions, Ireland and Scotland. While some consultancy reports(European Commission 2011; European Commission 2006; Martin et al. 2002; Small Business Service 2004) advise policy makers of the risks associated with transferring a business few authors compare their findings across regions. In this paper using a multinomial probit model we examine the influence of firm and regional variables on the expected exit strategy of the owner-managers for both regions so that similarities and differences in the findings can be identified.

CONTRIBUTION TO LITERATURE

Many authors, including DeTienne (2010)and Brockner et al. (2004),argue that owner-manager exit is an important part of the entrepreneurial lifecycle. This is particularly the case in small businesses where the owner-manager is likely to either own or have a large ownership stake in the firm. While Graebner and Eisenhardt (2004) argue it is imperative that we understand the owner-manager's perception of their exit strategy, to date much of the research in this area has focused on larger firms, and on the exit choices of chief executive officers of publicly traded organisations(Wasserman 2003; Kesner and Sebora 1994; Carroll 1984). With the exception of intergenerational succession (Burkart et al. 2003; Miller et al. 2003; Sharma et al. 2004; Dyck et al. 2002; Bjuggren and Sund 2002)few have examined the exit choice of small firm owner-managers. DeTienne (2010)argues that, in an SME, these choices are influenced to a large part by the owner-mangers' perceptions of exit. In this paper we build on recent work by DeTienne and Cardon (2012), who found that threshold theory combined with the theory of planned behaviour can help us understand the different exit choices..

Given that the vast majority of firms in our sample are long-lived firms human capital theory explanations for their exit choice cannot be verified as many of the owner-mangers are planning to retire, to engage in some aspects of entrepreneurial recycling (DeTienne and Cardon 2012; Mason and Harrison 2006) or to engage in renascent entrepreneurship (Stam et al. 2009). Therefore, rather than relying on human capital theory for the formulation of testable hypotheses, we broaden the range of factors along the lines of Leroy et al. (2007), who include personal, social, business and industry-related variables. Our paper contributes to the scant empirical literature which examines the different facets of entrepreneurial exit (DeTienne and Cardon 2012) and puts forward possible explanations to explain the owner-managers' expected exit choice. This is important as all owner-managers experience exit.

DATA AND RESULTS

Data for Ireland was gathered in telephone interviews using structured survey instrumentation with a sectorally representative random sample of 1,320 owner-managers of SMEs (companies with less than249 employees) in Ireland selected from Kompass Ireland between

October 2008 and February 2009. Three hundred and sixty-seven businesses took part in the study (a response rate of 28 per cent), of which 177 were long-lived small firms. Similar data gathered earlier for 59 long-lived small firms in Scotland using face-to-face interviews conducted between October 2001 and February 2002. These firms were interviewed from a sample of 90 surviving firms in Scotland which were traced from three parent samples of small businesses (n=396) which were interviewed in previous fieldwork studies undertaken in the 1980s and 1990s.Long-lived small firms were defined as being small at start-up (less than fifty employees, though the vast majority were micro enterprises, with no more than ten employees) and having traded for at least ten years.

We use a multinomial probit model to examine how each of the factors (i.e. age, size, exit plan, etc.) impact on the owner-managers' expected exit choice (i.e. whether s/he intends to transfer to family, sell the business or shutdown the business). Only two of our seven hypotheses are supported in both regions, these are H_2:larger firms are *more* likely to expect to transfer and H_8:firms located closer to the capital city are *more* likely to expect to transfer. In Ireland, we find that owner-managers of larger firms are more likely to expect to transfer their business to a family member rather than close it, whilst in Scotland owner-managers of larger firms are more likely to sell their business rather than close or transfer it to a family member.

In Irelandalone we find some support for H_1 (younger firms are *more* likely to expect to transfer)but we reject H_3 (service sector firms are *less* likely to expect to transfer) and conclude that service firms are more likely to transfer. While in Scotland alone we find support for H_5 (those with an exit plan are *more* likely to expect to transfer) and for H_6 (those with pecuniary motives are *more* likely to transfer).These results suggest that while there are some similarities across the regions in terms of the size and location of the firms there are also some important differences. One possible explanation for these differences is the disparate inheritance tax policies being implemented across the regions at the time of interview.

In Ireland, there currently favourable tax incentives for those wishing to transfer their firm to a child whilst there no incentives for those who wish to transfer to an employee. We find evidence that while having a *capable child*working in the firm impacts the owner-managers exit intension having a*capable employee* has no impact.The fact that this variable does not impact an owner-manager's decision is notable since management buy-in (MBI) and management buyout (MBO) are seen as viable transfer strategies in many countries.

DISCUSSION AND PRACTICAL IMPLICATIONS

Business transfer failure is an international phenomenon (see, for example, studies in Belgium: Leroy et al. (2007); Canada: Bruce and Picard (2006); Netherlands: Van Teeffelen et al. (2005); the UK: Martin et al. (2002); and the US: Wennberg et al. (2010). The failure of businesses to transfer successfully from one generation to another presents a potential threat to the survival of SMEs and, therefore, to output and employment growth. As the number of family business transfers declines worldwide it is important that owner-managers examine alternative transfer strategies. Since very little is known in the literature about what characteristics influence an owner-manager's choice of exit strategy it is difficult to develop policies which will enable viable businesses to transfer successfully. This paper attempts to address this void.

Our results suggest that the factors impacting an owner-manager's expected exit choice vary considerably across regions. This suggests that policy makers need to pay close attention to firm and market dynamics when designing business transfer policies and it indicates that a one-size-fits-all policy within the EU-27 will not work. In Ireland, we find that owner-managers who expect to transfer their business rather than shut it down are more likely to be operating younger firms, larger firms, service sector firms and firms located closer to the capital city, and be female. In Scotland this set of owner-managers are more likely to be operating larger firms, be male, have an exit plan, have founded their firm for pecuniary motives, and be located closer to the capital city. Each of these variables is independent of each other and a firm would not have to display all characteristics in order to be more likely to transfer.

Our research raises awareness about the factors that impact the small business owner-managers expected choice of exit mode and may serve as the prelude to future research activities. If viable small firms are to survive to the second generation and beyond it is critically important for academic researchers, business consultants and small business owner-managers to understand how the succession process unfolds. Succession is not an accident or an event but a sophisticated process occurring over a long period of time. It is a long-term dynamic issue that requires an ability to adapt constantly in the light of evolving circumstances.

Future research needs to look at ways of raising awareness of the importance of succession planning among SME owners. It is also important that nascent entrepreneurs are made aware of the opportunities and advantages of purchasing an existing business rather than starting a business from scratch. Policy makers have an educational and advisory role to play: they could make owner-managers of older firms and smaller firms more aware of the potential exit choices available to them. Consideration should be given to the idea of one-stop shops, mentoring processes and self-analysis toolkits. One-stop shops, for example, could give out information on all aspects of the transfer process and could signpost people on to relevant intermediaries.

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