INTERGENERATIONAL OWNERSHIP SUCCESSION

- Ex post performance measurement or ex ante efficiency requirements?

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ABSTRACT

Aim of the paper

Intergenerational successions in family-owned businesses (FOBs) are complex for many reasons, which means that we have no established goals or success factors for this process. Previous research has mainly dealt with leadership transfers, while we focus on intergenerational ownership succession. The success of leadership succession has been measured through ex-post approaches, either in the form of close stakeholder (family members) satisfaction with the process or in relation to business performance. Building on this previous research we propose an alternative way to look at intergenerational ownership successions, namely adopting a pre-ownership transfer approach. This means a set of efficiency requirements for the succession process which are molded in a way that will enhance the realization a satisfactory succession and running of the business afterwards. Thus, we are content if the requirements can contribute sequentially to stakeholder satisfaction and business performance.

The handover of ownership is as critical and important as leadership transfers, since the majority owner(s) hold the ultimate power in the business. S/he or they decide on strategic goals, either directly or through electing the members of the company board. The aim of this paper – based on a literature review and descriptive results from an empirical study – is to explore the intergenerational succession of ownership and possible goals for this process.

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<u>Contribution to the literature</u>

Comparing our findings with the reasoning found in previous research, we stress pre-succession efficiency requirements as an alternative to post-succession measurements. We would claim that the latter approach is too vague when it comes to intergenerational ownership succession. The variables are too many, too dynamic and too complex, as well as too difficult to assess in terms of mutual interaction. All families and businesses are different, as are all stakeholders. Not one case fully resembles another. Additionally, the markets and business opportunities are constantly changing. No month will be equal to another. Furthermore, there are national differences not only concerning legal matters, but also regarding economic, cultural and social contexts (see further by Pitcher et al, 2000). There are also fundamental differences between an ownership and leadership succession. Close stakeholder satisfaction is seen as very important after a leadership change as, for example, it is crucial for the cooperation on daily routines. This satisfaction is not as decisive for ownership changes. Shareholder cooperation do seldom involve daily considerations. Instead, for example, the ability to form majority constellations (in voting power) is of vital importance. Furthermore, the single most important person for a business performance, the CEO, is indirectly appointed by the active owners. All all close stakeholders (not only family members) and often some non-close stakeholders must be included in the reasoning. Co-owners, who together hold a majority of the shares, for example, can obstruct the appointment of a new CEO, but not if they are in a minority position. In case of an ownership succession any co-owner can, with the support of transfer restrictions, inhibit all possibilities to transfer shares to a person in the younger generation. An example of non-close stakeholders are tax authorities that have an interest (e.g. taxes on capital gains and gifts) in an ownership succession, but can be expected to ignore a leadership change.

<u>Data and results</u>

The paper is mainly conceptual but our reasoning is supported by descriptive data from an empirical study of 143 majority shareholders in Swedish FOBs about their opinions on ownership succession. The survey deals with factors which either promote or hamper succession. The questionnaire was sent to 425 owners of FOBs which all had experienced a succession in ownership, with a response rate of 34 per cent. One third of the majority shareholders were the older generation handing over the shares and two thirds from the younger generation taking over the majority ownership. The succession had taken place during the lifetime of the older generation on 127 instances (88.8%). All the successions occurred between 1979-2009 (with 76% after 1998). It should be emphasized that our survey only used questions related to factors which may have enhanced or hampered the succession process.

An alternative to the dominating ex post approach in the succession literature is to establish efficiency requirements that should be reached *before* a succession is completed. These requirements cannot constitute a way to measure success, since this must be done after the succession process is finished. It is rather a tool to boost the preparation of a succession and, among other benefits with this approach, eventually to contribute to ex post satisfaction and business performance.

We propose that the efficiency requirements should support the following four strategic goals:

1. Avoiding a negligently performed ownership succession which can alert potentially powerful close stakeholders, such as co-owners supported by transfer restrictions, and distant non-close stakeholders, such as tax authorities relying on mandatory legislation (Sund & Melin, 2013; Bjuggren & Sund, 2013).
2. Decisively enhancing the possibility of an intergenerational ownership succession and running the business afterwards (e.g. Bjuggren & Sund, 2005).
3. Contributing to achieving satisfaction among close stakeholders, in order to enhance future cooperation in the interest of the business (Sharma et al, 2003a).
4. Contributing to promoting business performance (Pitcher et al, 2000). In this sense, also the opinion of non-close stakeholders, such as suppliers and customers, can make a difference (Sund & Melin, 2013).

In our opinion the efficiency requirements include the following activities or aims:

- Ensuring the readiness of the incumbent owner to step aside and the willingness of the successor(s) to take over (e.g. Davis & Harveston, 1999).
- Providing adequate compensation, when necessary, for the older generation in order to uphold their standard of living, as well as for the siblings that do not become new owners (e.g. Bjuggren & Sund, 2005).
- Ensuring that the total cost of the succession does not affect the willingness of the owners to take risks and the capacity of the firm to make investments (e.g. Astrachan & Tutterow, 1996).
- Ensuring that the new owner(s) receive a majority ownership. It is important to establish such a powerbase if s/he or they wish to function as active owner(s).
- All close stakeholders should – at least – accept the potential outcome of the ownership succession (e.g. Sharma et al, 2003a).

Discussion and practical implications

In our opinion, it is a too vague assumption to strive for satisfaction or business performance after an intergenerational ownership succession, not least since each stakeholder can be expected to be mainly occupied with promoting their own self-interest. Instead there are convincing reasons to address the efficiency factors before the event. These requirements are created in order to promote intergenerational ownership successions during the lifetime of the older generation and to help form a fruitful succession process. With regard to ownership transfer to outsiders, as well as succession through intestate inheritance, the scenario is different. Additionally, it should be emphasized that there are more factors that can influence cases like this, especially challenging role changes and know-how transfer from incumbent to successor. These factors, that are decisive for the outcome of a leadership succession, are also relevant for an ownership change. But compared with e.g. estate taxes and obstructing co-owners we find that they are, in most cases, not prioritised.

One more step, that may improve the chances of reaching the strategic goals, is to let all the close stakeholders act as intermediaries. They will be given the chance to declare that they are pleased with the requirements of the change of majority ownership, i.e. the efficiency requirements. These should be moulded in a way which can be expected to decisively enhance an intergenerational ownership succession and, especially, to avoid disasters due to interventions from stakeholders, as well as to continue running the business afterwards. This way post succession estimates, that are difficult to predict and reach and which will always exceed pre-succession knowledge, can be replaced by certain specific requirements that can be achieved before the handover takes place. Obviously, the requirements cannot always be attained and they will not automatically lead to the realization of a succession. However, the degree of uncertainty appears – with pre-succession requirements – considerably lower than if we in advance attempts to make family members (or close stakeholders) satisfied with the process, as well as improving business performance (neither of which can be measured until after the handover). We anticipate that ex ante requirements in most cases will contribute to reaching favourable ex post results.

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