

# **Transfer of Ownership in Private Businesses**

*- Introduction to the conference theme*

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# **The purpose of this conference**

- To present the current state of knowledge about transfers of ownership**
- To show experiences from practice, through case illustrations, and from policymaking**

## **The aim is that the conference sessions will**

- address and evaluate the impact of various measures implemented in recent years for facilitating business transfer, including tax abolition**
- report on remaining obstacles, including financial/legal and relational/emotional challenges**

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# We focus on Private Businesses

*Family ownership dominates in private businesses!*

## Example from one county in Sweden:

**Companies listed on the Sw. stock exchange**      **3%**

*(1/3 family controlled)*

**Companies with foreign ownership**      **5%**

*(mostly listed, some family controlled)*

**Privately held companies**      **90%**

- **One owner (with family involvement)**      (31%)
- **Family ownership; several owners**      (41%)
- **Non-family owners; partners**      (22%)

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# **Family businesses: most common form;** **both large *and* small; privately held *and* publicly listed**

- **Family businesses represent 50-90% of the GDP in all free market economies, contributing to growth**
- **Within the SME population, family businesses represent 70-80% in many countries, eg. 75% in Holland**
- **Family firms in US generate 60 % of all private employment**
- **Fifteen family groups in Chile represent over 50% of the market value on the Santiago stock exchange**
- **In Finland over 30% of the big 500 corporations are family firms**
- **In India sixteen family groups make up 65% of the total assets in the private sector**
- **In Austria, Germany and Belgium 60-65% of all listed companies are under majority control, with families representing the voting blocks**

# The family business is a global phenomenon

but there are *many types* of family businesses



BERTELSMANN  

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media worldwide



PORSCHE



E&J Gallo Winery

Atteviks



ALESSI

Marriott

FAMILJEN  
DAFGÅRD

# Do family businesses survive in the long run?

*Just 35% go to the 2nd and 10% to the 3rd generation*

## Family firm disadvantages hampering their survival

- Often *messy governance* structures; overlapping roles
- *Nepotism* before competence when appointing new leaders
- *Family conflicts* intervene into many issues and arenas
- *Spoiled kid* syndrome, next generation is not 'hungry'
- *Resistance to change*, the successful history turns into inertia
- *Financial constraints*, because of limited capital sources
- *Succession dramas*, transfer processes destroy relations

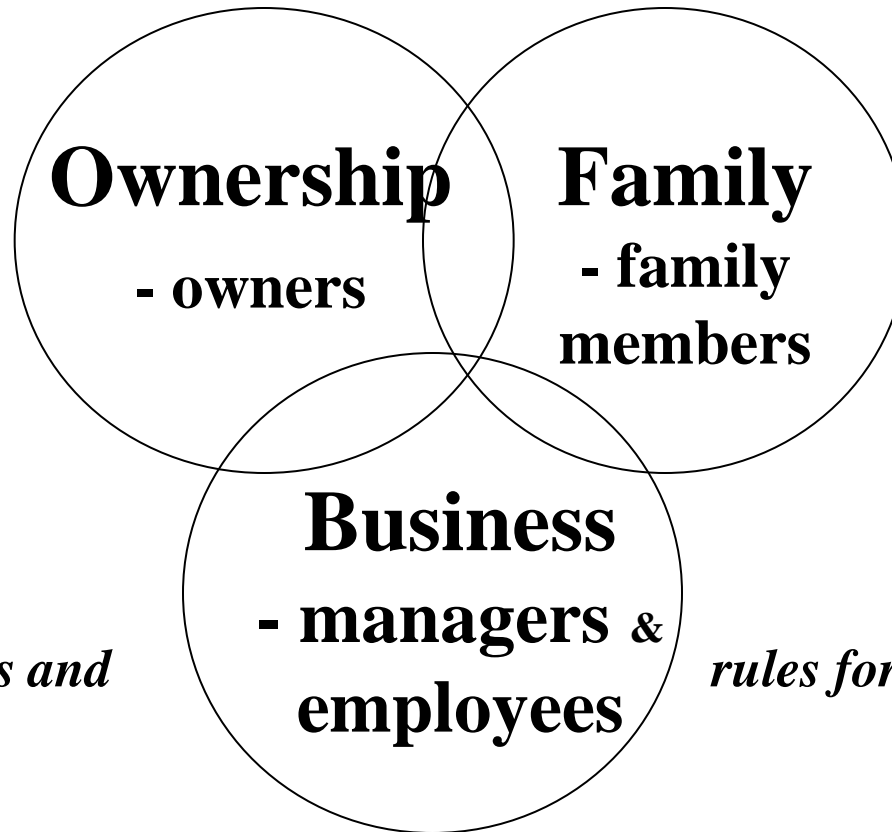
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# *Overlapping roles in the sub-systems of the family business*

*- most distinguishing feature of family businesses*



*Different norms and*

*rules for each sub-system!*

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# In general, *self-destructive habits* threaten to invade good companies

- **Competitive myopia**
  - Nearsighted view on competition
- **Territoriality**
  - Internal cultural wars
- **Denial (of problems)**
  - Cocoon of myth and orthodoxy
- **Arrogance (towards change demands)**
  - Pride before the fall
- **Complacency**
  - Success breeds failure

*(Jagdish Sheth, 2007)*

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*“CEOs are directly responsible for the self-destructive habits their companies develop. This is most likely to be the case with founding CEOs, and/or CEOs who refuse to retire, and/or who ‘clone’ their successor.”*

*“Family-run businesses, where the ‘genetic influence’ is strong, are likely to fall into such self-destructive habits.”* (Sheth, 2007)

*The family business is seen as an outdated, conservative form of enterprising* (Chandler, 1990)

# **BUT there is another picture:** *The successful family business*

**Systematic evidence is emerging about the FOB edge:**

Simon (1995) discovered that of 500 mid-sized European firms that persistently dominated their markets, over 75% were controlled and run by families.

McConaughy et. al. (2001) found that FOBs had higher profit margins, more stable earnings, and better cash flow and sales per employee than the Business Week Top 1000.

Kang (1996) showed that (textile) firms in which families owned a large block of shares had higher returns on sales and more investments.

(Miller & Le Breton-Miller, 2005)

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# More evidence on the beauty of family owned businesses...

Bornstein (1983) found FOBs to outperform non-family counterparts in share appreciation by 2 to 1.

Mackie (2001) found they survived *twice as long*.

Junge's study revealed that FOB's ROI averaged 3% higher than the S&P 500 over 20 years.

Anderson and Reeb (2003) showed that family controlled businesses are more profitable than their non-family business counterparts (all listed on stock exchanges).

# Four C's of successful family businesses

(Miller & Le Breton-Miller, 2005)

- **Continuity: Pursuing the dream**
  - Clear mission, long-term investments, building competences and resources
- **Community: Uniting the tribe**
  - Cohesive, clanlike teams, strong values
- **Connection: Being good neighbours**
  - Enduring, open-ended, mutually beneficial relationships with stakeholders
- **Command: Acting and adapting with freedom**
  - Act independently, quickly and originally to adapt/renew

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# Business ownership – different aspects

- **Legal ownership**
  - Based on contracts; legal rights to shares
- **Financial ownership**
  - Business ownership represents accumulated capital; wealth
- **Psychological ownership**
  - Emotional bonding to the business
  - The individual has a feeling of ownership rights, enacts ownership but also responsibility and commitment
- **Social ownership**
  - Ownership is a social creation existing in social interaction
  - The owner perceive him/herself, and is perceived as an enterprising owner in the social network, and in the community

# Transfer of ownership is crucial for the continuity of the FOB

## Critical issues in the transfer of ownership:

- Different stages in the *transfer process*
- Many and very *different solutions* of the transfer
- The need for *open communication*
- Fruitful *conflicts* and devastating conflicts
- *Gender* issues
- The role of *advisors*
- The importance of context – *no one-best-solution*

# ***Phase 1: Initiate the transfer issue and start preparing/planning***

- **The present owner has the full responsibility to initiate the transfer of ownership process**
- ***” But we don’t need to start planning as the ownership transfer will not take place the coming years”***
  - **Ownership transfers are very time-consuming and the process takes often much more than 2-3 years**
  - **The transfer can be forced by sudden and unpredicted events**
- **It is never too early to start planning/prepare for the transfer of ownership !**

# **Transfer of ownership *and* succession of leadership**

- **Basically two different, but closely related processes**
- **The solution on one doesn't give the evident solution on the other**
- **The leadership succession happens most often before the transfer of ownership is completed** - testing the management capacity of next generation before transferring the ownership power
- **Transfer of ownership is a gradual process**
  - The old and next generation own together for long periods!



## ***Phase 2: Acquire knowledge about and reflect on different solutions***

**Many alternative solutions regarding many issues:**

### **I. Who will be the new owner?**

- 1) Transfer within the owner family**
- 2) Ownership is transferred to employees**
- 3) Sale to external buyer**
  - Individual entrepreneur**
  - Business firm**
  - Investment group/Private equity fund**

# To whom is ownership transferred?

<b>Transfer within the owner family</b>	<b>35%</b>
<b>Ownership is transferred to employees</b>	<b>&lt;5%</b>
<b>Sale to external buyer</b>	<b>50%</b>
<ul style="list-style-type: none"><li>• <b>Individual entrepreneur</b></li><li>• <b>Business firm</b></li><li>• <b>Investment group/Private equity fund</b></li></ul>	
<b>Closing the business firm</b>	<b>5-10%</b>

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## ***Phase 2: Acquire knowledge (cont.)***

- II. *How much* shares will be transferred?**
- III. *At what time* should and can the transfer take place?**
- IV. What will the present owner *do after* transferring the ownership?**

**There is no general best solution,  
what is best is what satisfies the involved actors!**

## ***Phase 3: Choice of transfer solution***

- **The choice is depending on the objective present owner has for his/her enterprising, eg.**
  - **Running the business for profitable exit**
  - **Building a business, a lifetime achievement that should be taken care of**
- **Before deciding on transfer solution, an open dialogue is needed within the group of owners,**
  - **Dialogue takes time**
  - **Listening to and show respect for other views**
- **Advisors are helpful in this stage**
  - **Different advisors have expertise on different issues**
  - **This expertise direct the advise**

## *Phase 4: Implement chosen transfer solution*

- **Different solutions require different analyses**
  - **External sale:**
    - **What model for evaluating the company's value?**
    - **What buyer is a 'good' buyer?**
    - **How can the buyer finance the acquisition?**
  - **Transfer within the family:**
    - **Gift (54%), will (4%) or sell it (20%)?**
    - **Sale, to what price?**
    - **Should all in the next generation take over?**
    - **How to manage the fairness aspect between the children?**
    - **Is someone from the next generation taking a managerial role?**
    - **Changing governance? The role of the board? Family council?**

## ***Phase 4: Implement chosen transfer solution***(cont.)

- **How should knowledge, personal network and culture be transmitted to the new owner(s)**
  - *Tacit knowledge* of the former owner-manager
  - Important *business relations* are closely connected to the former owner-manager, in power for several decades
  - What *values* should be building stones also for the future and what values may be problematic for future development?
- **The role of the old generationen after the ownership has been passed over?**
  - What do I want to do?
  - What role in the business could suit me, without disturbing the next generation that has taken over?

# Transfer of ownership is a potentially very complex and dynamic process

- **Finding solutions on legal and financial issues**  
(incl. tax issues)
- **Formal negotiations**
- **Economic transaction(s)**

*...but also...*

- *Values* are questioned and reviewed
- *Relationships* are strengthened and/or weakened
- *Roles and identities* are changed and transformed
  - Letting go problem!
- *Emotions* are oppressed and/or made visible

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# What do research say about transfer of ownership

- **Not much!**
- **Succession, meaning transfer of leadership is the most researched area in family business research...**  
**...while research focusing on succession of ownership is more rare (but growing)**
- **But what does the succession literature say?**
  - **A lot of problems are preventing the (leadership) succession from becoming successful.**



# **Examples on factors preventing intra-family succession** (De Massis et al, 2008)

- **Low ability and/or lack of motivation of potential successor(s)**
- **Strong attachment of the incumbent with the business and satisfaction of being an entrepreneur**
- **Conflicts/rivalries in parent-child or sibling relationships**
- **Lack of trust in the potential successor(s)**
- **Conflicts between family and nonfamily members and non-acceptance of potential successor among nonfamily members**
- **Failing to train potential successor(s)**
- **Decrease in the scale of the business**

**Most of these hampering factors are valid for ownership succession, as well!**

# Tax influence on succession of ownership, an important issue but still...

- Our study (presented tomorrow) shows that the *abolition of gift, inheritance and wealth taxes motivates* family businesses to work more actively and purposefully with their transfer.
- But even if there are no gift, inheritance and wealth taxes, *preparation* for the ownership transfer is still key
- Ownership transfer is a *gradual, incremental process* over a period of time (3-10 years) where open dialogue and respect for different views are crucial.
- Lack of *specialized knowledge* is a major reason why the transfer of ownership process is carried out in an unsuccessful manner.

# *The Family Ownership Logic*

- *Active and visible ownership*
- **Stability in ownership and power**
  - Often implying a strong culture
- *Long term strategic perspective and direction*
- **Multiple ownership goals**
  - Including CSR-related goals
- *Skepticism to and/or limited availability of capital markets*
- **Flexibility in governance structures**
  - Including fast decision making
- *Identification - Psychological/emotional bonding*

## Stability in ownership and power

- *I think that the power and the control I have over the capital and the possibility to do whatever I want with this capital is a freedom – there is a sense of freedom for this responsibility that I would not easily let go.*
- *Our main track is absolutely to keep this company as a family business over the generations. Offers to sell come about once every six months...but why should I?*

## Long term strategic perspective and direction

*You must think 10 to 20 years ahead. The goal is to have a long-term survival structure... We may never, never ever, go to rest in our ambition to develop the company. If we start to wait and see we will be 'dead meat' for competitors.*

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## **Identification – psychological bonding**

*Ownership is more metaphysical, much more an idea.  
I have difficulties explaining it, but I have no need to sit and  
look at my shares – that is totally uninteresting.  
To me it is rather the process of developing the company  
that is exciting, not the amount that it is worth.*

*”Despite the successful growth, we need to continue to see H&M as a small business firm.*

*We need to continue to be in close contact with our customers and understand what they want. The way to future success must happen through our proved practices”*



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# The H&M business recipe

- **Culture and vision**
- **Market responsiveness**
- **Flat organization, small and multi-disciplinary project teams**
- ***Continuous experimentation***
  - **Seeks questions/problems every day to find new solutions**
  - **Explores different views (explorative learning)**

# By devoting too much attention to challenges and problems of FOBs, we miss what they can teach us:

- Role model for achieving competitive advantage
- Leadership that is *independent and courageous*, rather than imprisoned by quarterly financial targets
- Strategies that are orchestrated for *long run capabilities*, rather than distracted by tangential opportunities; *strategic persistence*
- Cultures that are *cohesive, caring* and single minded, rather than individualistic or bureaucratic
- *Enduring relationships* with the external environment, rather than fleeting transactions with it; social capital

(Miller and Le Breton-Miller)

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**Still, the capacity for change in the family business, to overcome inertia, is crucial...**

**...in strong and stable family business cultures**

- Importance of being aware of and question taken-for-granted values, norms and traditions**

**...in successful strategic ways of thinking**

**...in established power positions among the family owners**

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# Finally,

Researchers and policymakers pay little attention to  
*the family as a unit of analysis* and  
*a context for entrepreneurial activities*

The family business, the *dominant form of business organization*, represent *a massive pool of resources* for entrepreneurial initiatives!

*The succession process in the family business should be further facilitated by policy measures, fostering transgenerational entrepreneurship*

