



Transfer of family businesses and its impact on a firm's debt and growth rate

Vincent Molly, Eddy Laveren (presenter), Marc Deloof

Eddy Laveren
University of Antwerp
Faculty of Applied Economics
Prinsstraat 13, 2000 Antwerpen (Belgium)
Tel.: +32-3-265.40.86
E-mail: eddy.laveren@ua.ac.be



Outline

- Motivation of the study
- Impact of a succession on the firm's debt rate
- Impact of a succession on the firm's growth rate
- Data & methodology
- Research results
- Practical implications



1. Motivation of the study

- Family business succession is one of the most important but difficult steps in a family firm's life cycle
- A large amount of SMEs will be transferred over the coming decade
- Many companies are unsuccessful in overcoming the difficulties related to a succession
- Impact of succession on the debt and growth rate is unclear
- Most empirical studies regarding family business succession rely on cross-sectional analysis or start from a sample of large public firms
- Many studies do not differentiate between a transfer from the 1st to the 2nd generation and one that occurs in later generations



1. Motivation of the study

Aims of the study are:

- To find empirical evidence of a change in debt and growth rate after a intergenerational transfer within private family SMEs
- To investigate whether the impact of a succession from the first to the second generation differs from a succession between later generations



2. Impact of a succession on the firm's debt rate

Negative impact of a succession on the firm's debt rate:

- Lower ability to attract debt financing:
 - less qualified descendants (Anderson, Mansi, Reeb, 2003)
 - higher level of intra-family conflicts and rivalry (Davis, Harveston, 1999)
 - higher dividend payout ratios (Schwass, 2005)
- Changing risk-attitude and goal orientation over generations leading to a higher reluctance to use debt:
 - “family oriented” firms are more reluctant to use risky debt due to a possible dilution of family control (Reid et al., 1999)
 - higher preference for wealth preservation (Kaye, Hamilton, 2004)
 - lower willingness to bear risk due to equity ownership dispersion (Schulze et al., 2003)



2. Impact of a succession on the firm's debt rate

Positive impact of a succession on the firm's debt rate:

- risk preferences of family owners are in line with those of institutional investors which will lead to a higher willingness to use debt financing (Schulze et al., 2003)
- Next-generation family firms will find it easier to attract debt financing due to long-term relationships and the desire to defend the family name (Gersick et al., 1997)
- Debt may be used as a governance mechanism reducing agency costs over the course of generations (Blanco-Mazagatos et al., 2007)
- A transfer can put a serious strain on the family firm's resources and because of cash withdrawals firms are characterized by a higher demand for debt financing (De Massis et al., 2008)



2. Impact of a succession on the firm's debt rate

→ Hypotheses tested:

- **H1_a**: A family business transfer in first-generation family firms will lead to a negative effect on the debt level of the company
- **H1_b**: A family business transfer in next-generation family firms will lead to a neutral to positive effect on the debt level of the company



3. Impact of a succession on the firm's growth rate

Negative impact of a succession on the firm's growth rate:

- Changing goal orientation and level of conservatism over generations leading to lower growth performance:
 - business oriented firms have a higher capacity to grow (Dunn, 1995; Cromie et al., 1995; Reid et al., 1999)
 - lower entrepreneurial orientation (Martin, Lumpkin, 2004)
 - lower interest in foreign markets (Okoroafo, 1999)
 - changing risk aversion due to ownership dispersion (Schulze et al., 2003)
- Growth performance decreases after a transfer due to successors' lack of competences and skills (Smith, Amoako-Adu, 1999; Pérez-González, 2006; Bennedsen et al., 2007; Cucculelli, Micucci, 2008)



3. Impact of a succession on the firm's growth rate

Negative impact of a succession on the firm's growth rate:

- Increasing information asymmetries between owners and managers after succession hurt growth performance:
 - higher levels of conflict and managerial opportunism (Blanco-Mazagatos et al., 2007)
 - lower cohesiveness among family members over generations (Mishra, Randøy, Jenssen, 2001)
 - incomplete successions due to “founder's shadow” + organizational learning from earlier successions (Davis, Harveston, 1998, 1999)



3. Impact of a succession on the firm's growth rate

Positive impact of a succession on the firm's growth rate:

- Presence of multiple generations in the firm augments focus on wealth increase and strategic renewal (Zahra, 2005)
- Descendant-controlled firms have a lower growth capacity but generate higher profits as they reap the benefits of earlier investments in capital assets and R&D made by the founder (McConaughy, Phillips, 1999)



3. Impact of a succession on the firm's growth rate

→ Hypotheses tested:

- **H2_a**: A family business transfer in first-generation family firms will lead to a negative effect on the growth level of the company
- **H2_b**: A family business transfer in next-generation family firms will lead to a neutral to positive effect on the growth level of the company



4. Data & methodology

- Questionnaire sent out to random sample of 2.500 Flemish SMEs (10 - 250 employees) based on Belfirst database
- A total of 504 responses (20.16%) received:
 - Comparison of sample with original population
 - Comparison of 1st versus 2nd round respondents
→ no non-response bias
- Sample firms can be regarded as family firms based on the ownership and self-perception criterion (Westhead, Cowling, 1998)
- Financial information (balance sheet and profit & loss account figures) gathered for the period 1991-2006



4. Data & methodology

- Selection of 152 family business successions
- Selection of 110 first-generation family firms as control group ~ have not yet experienced a succession
- Fixed effects panel data analysis: unbalanced panel of more than 2,000 firm-year observations across 16-year period

Profile of companies in the sample

Characteristics	Family firms transferred from 1 st to 2 nd generation	Family firms transferred between later generations	Control group: 1 st gen. family firms
Number of firms	86 (57%)	66 (43%)	110
Sector (proportion): manufacturing	30 (35%)	24 (36%)	28 (26%)
construction	22 (26%)	10 (15%)	18 (16%)
trade	18 (21%)	21 (32%)	34 (31%)
services	16 (18%)	11 (17%)	30 (27%)
Company age (mean)	26	71	19
Total assets (mean)	4,070,994	4,499,901	2,929,336



5. Research results

Table 3: Regression analysis: the firm's debt rate

Independent variables	Coef.	SE	Coef.	SE
Controls				
Log size	.11***	.02	.12***	.02
Tangibility	-.09*	.05	-.12**	.05
Gross return on assets	-.31***	.06	-.32***	.06
Growth	.00***	.00	.00***	.00
Intergenerational succession				
Transfer from 1 st to 2 nd generation (dummy)			-.04***	.02
Transfer between later generations (dummy)			.06***	.02
Year (0, 1) indicators	Yes		Yes	
R ²	.09		.11	
Δ R ²			.02***	
F	8.59***		10.10***	
Number of observations	1,970		1,970	
Number of firms	150		150	

Note: SE, Robust standard errors.

***, ** and * indicate significance at the 1, 5 and 10% level, respectively.

Hypothesis 1_a: supported

Hypothesis 1_b: supported



5. Research results

Table 4: Regression analyses: the firm's growth rate

Independent variables	Growth			
	Coef.	SE	Coef.	SE
Controls				
Log size	.19***	.03	.20***	.03
Gross return on assets	.05	.11	.06	.11
Debt				
Intergenerational succession				
Transfer from 1 st to 2 nd generation (dummy)			-.08**	.03
Transfer between later generations (dummy)			.00	.03
Year (0, 1) indicators	Yes		Yes	
R ²	.05		.06	
Δ R ²			.01**	
F	4.66***		4.38***	
Number of observations	1,744		1,744	
Number of firms	139		139	

Note: SE, Robust standard errors.

***, ** and * indicate significance at the 1, 5 and 10% level, respectively.

Hypothesis 2_a: supported

Hypothesis 2_b: not supported



5. Research results

- A family business succession has a significant impact on the firm's debt rate and growth
- Transitions in first-generation family firms differ from those occurring in later generations
- The transfer from the first- to the second generation seems to negatively influence the debt rate of the company. However, in later generations of family firms this effect is reversed.
- The growth rate decreases significantly when a family firm is transferred from the first- to the second generation. However, in next-generation family firms, no significant effect of succession on the growth level can be identified.



5. Research results

- Results could be explained by:
 - changing risk aversion
 - goal orientation to wealth preservation instead of wealth creation
 - ownership dispersion and intra-family conflicts
 - founder's shadow
 - financing issues of a business transfer
- A transfer should not be seen as a negative event in the life cycle of a family business.



6. Practical implications

- It is important to study business transfers to get more insights into best practices how to carry out a succession and into the way in which the business is expected to change due to the transfer.
- Advice to family business founders not to teach their children to shy away from risk in order to preserve the wealth they inherited, but to stimulate the new future business leaders to increase their entrepreneurial spirit to work towards the further growth of their business



6. Practical implications

- A conservative behavior should not be detrimental as such. Family business owners are free to take decisions in accordance with their degree of risk tolerance.
- The government should take some steps towards stimulating family business successions.



6. Practical implications

Possible measures are:

- a reduction of taxation related to a family business transfer.
- introduction of multiple voting rights as it considerably lowers the financial needs
- initiatives that increase the awareness of the problems related to a transfer.