Journal of Business Venturing 29 (2014) 193–209

Contents lists available at ScienceDirect

Journal of Business Venturing

# The role of information asymmetry in the choice of entrepreneurial exit routes

Tobias Dehlen, Thomas Zellweger *, Nadine Kammerlander, Frank Halter

*Center for Family Business, University of St. Gallen, Dufourstrasse 40a, CH-9000 St. Gallen, Switzerland*

ARTICLE INFO

*Article history:*
Received 21 March 2012
Received in revised form 4 October 2012
Accepted 4 October 2012
Available online 9 November 2012

Field Editor: D. Shepherd

*Keywords:*
Entrepreneurial exit
Exit routes
Succession
Information asymmetry
Emotional attachment

ABSTRACT

Our quantitative study investigates the determinants of internal versus external exit routes in family firms. Building on information asymmetry theory, we examine how an owner's inferior knowledge about the abilities of potential external entrants (in contrast to family internal successors) renders a family internal transfer more likely. This information asymmetry, however, can be mitigated by activities such as owners' screening and transfer candidates' signaling efforts to reveal the candidates' abilities. Our data exhibits a positive effect of signaling and an inverted U-shaped effect of screening on the probability of external exit routes. Firm age, as a driver of emotional attachment, weakens these effects.



## 1. Executive summary

The transfer of ownership and management from an incumbent entrepreneur to his or her successor is an important and often studied phenomenon. Prior literature (Wennberg et al., 2011) shows that the choice of exit route is highly influential on the future firm prosperity.

Thus far, we still lack a comprehensive understanding and quantitative evidence about what factors determine to whom the entrepreneur transfers the business. We aim to contribute to filling this gap by studying how economic and non-economic factors independently and interactively affect whether ownership and management of a company are transferred to an intra-family successor or to an external individual.

Building on information asymmetry theory, we first argue that incumbents have an inherent preference for family internal successors because they have superior knowledge about the abilities of those succession candidates as compared to external ones. In consequence, they prefer to hand the business over to an offspring or another relative because they are more confident that these new entrepreneurs will be likely to successfully continue firm operations. We further argue that mechanisms that increase the incumbent's knowledge about external candidates' abilities heighten the probability of a transfer to an external entrepreneur. Important mechanisms to reduce asymmetric information are the candidate's active revelation of his or her abilities ('signaling'), for instance through educational achievements or prior work experience, as well as the incumbent's active search for information on the candidate's abilities ('screening').

* Corresponding author. Tel.: +41 71 224 7100; fax: +41 71 224 7101.
*E-mail address:* thomas.zellweger@unisg.ch (T. Zellweger).

0883-9026/$ – see front matter © 2012 Elsevier Inc. All rights reserved.
http://dx.doi.org/10.1016/j.jbusvent.2012.10.001

In a second step, we theorize how non-economic factors, in particular firm age which entails emotional attachment to the firm, affects exit route choices. We lay out how entrepreneurs of older firms develop socioemotional wealth and become increasingly attached to their company and show reluctance to pass the business to an outsider. We hence propose that firm age reduces the probability of an external transfer.

In a final step, we integrate economic and non-economic rationales and discuss how firm age alleviates the effects of signaling as well as screening. In particular, we argue that firm age and emotional attachment induce a status quo bias, which in turn leads to selective cognitive attention and to quality discounts on information on the external candidate's abilities. As a result, the hypothesized effects of education, work experience, and screening are weakened by firm age.

We test our hypotheses based on a sample of 1036 owner-managers of small- and medium-sized Swiss, German and Austrian enterprises, who have recently taken over control of their firm. A logit regression with supplementary graphical interpretation confirms the proposed hypotheses. Additional analyses (e.g., multiple imputation) indicate the robustness of our findings.

The theoretical and empirical findings of this study contribute in particular to three streams of literature. First, we add to entrepreneurial exit literature by showing how elements that characterize the dyadic relationship between incumbent and successor (DeTienne, 2010) impact entrepreneurial exit choices. As one of the first, we apply information asymmetry to explain variance in exit route choices.

Second, we contribute to family business research by providing a more holistic picture on the determinants of family-internal vs. external succession. Instead of considering only emotional factors, we consider economic and non-economic determinants independently as well as in interaction.

Third, we contribute to research on information asymmetry by applying it to a sparsely studied context (incumbent's perspective in entrepreneurial exits). Moreover, our study reveals a ‘flip side of the coin’ of excessive screening mechanisms. As we argue and empirically show, high levels of screening result in discouragement of the screened individuals and subsequent lower probability of firm transfer to those candidates.

## 2. Introduction

Entrepreneurial exit – the transfer of control over an entrepreneurial firm to one or several individuals or an organization, alternatively the liquidation of the firm – is an important entrepreneurial phenomenon that affects not only the entrepreneur and the firm but also the industry and, in some cases, even the regional economy (DeTienne, 2010). Each firm owner must eventually exit his or her business; however, there are various exit routes to choose from. The choice of a specific exit route influences the future prosperity of the firm. For example, a recent study by Wennberg et al. (2011) on Swedish family firms indicates that family internal successions as compared to external transfers of control are associated with higher likelihood of survival but inferior short- and long-term performance.

Despite these advances in the field, particularly with respect to the performance implications of various exit routes, the determinants of an entrepreneurial owner's choice of a specific exit route still remain largely unexplored (DeTienne and Cardon, 2012). Entrepreneurship scholars have only recently begun to investigate the influence of determining factors such as the owners' entrepreneurial characteristics (DeTienne and Cardon, 2012), their motivations (DeTienne and Chandler, 2010), and their framing (Wennberg et al., 2010) on entrepreneurial owners' exit route decisions. Until now, this stream of research has focused primarily on the incumbent's perspective and has ignored the dyadic setting of firm-transfer processes (DeTienne, 2010; Graebner and Eisenhardt, 2004). Family business scholars, on the other hand, have long emphasized the tendency of owner-managers to pass on their businesses within the family (e.g., Le Breton-Miller et al., 2004; Lee et al., 2003) due to nepotism (Barach et al., 1988; Gersick et al., 1997) and have even included ‘transgenerational intention’ in the definition of family businesses (Chandler, 1990; Chua et al., 1999; Ward, 1987). In family business research, variance in the choice of exit routes is ascribed primarily to the presence of several individual, relational, financial, and contextual factors that impede the preferred internal succession (De Massis et al., 2008); however, most of the respective studies are either conceptual or qualitative in nature.

Enhancing knowledge of the antecedents of exit route decisions is crucial because such choices fundamentally affect firm performance after the transfer (Wennberg et al., 2011). In this study, we build on information asymmetry theory to explain variance in the exit route decisions of the owner-managers of privately owned firms. Information asymmetry is a theoretical lens that has recently gained substantial attention in the entrepreneurship field (e.g., Dawson, 2011; Wennberg et al., 2011). We therefore follow the emerging stream of family business research that draws on economic–rational explanations to investigate succession processes (e.g., Lee et al., 2003; Royer et al., 2008) by arguing that firm owners are economically motivated to apply measures that reduce information asymmetry which, in turn, affect the owners' exit decisions. However, family business scholars, particularly those who address socioemotional wealth considerations (e.g., Gómez-Mejía et al., 2007), have long emphasized that an owner's attachment to his or her firm is particularly rooted in non-economic reasons, such as legacy concerns, which grow stronger over time (Zellweger et al., 2012). To also account for this perspective, we next investigate how such non-economic rationales affect entrepreneurial exits. In a final step, we examine the interactive effect of economic and non-economic factors.

We thus aim to answer three research questions: (1) How do economic factors, such as signaling and screening that reduce information asymmetries affect the choice of entrepreneurial exit routes? (2) How do non-economic rationales such as firm age, which is a key driver of emotional attachment, affect the choice entrepreneurial exit routes? (3) How do economic and non-economic factors in combination affect the choice of entrepreneurial exit routes?

To answer these questions, we probe survey responses of owner-managers of SMEs in three European countries, who have recently taken over the management and ownership of their firms.