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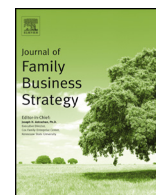

Intergenerational ownership succession Shifting the focus from outcome measurements to preparatory requirements

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ABSTRACT

This article contributes to the family business succession literature by (1) addressing ownership succession rather than management succession, (2) recommending a combination of legal and psychological perspectives on ownership to advance our understanding and (3) suggesting a preparatory approach to succession. Measuring the success of management succession has mainly been undertaken by assessing outcomes. Learning retrospectively why a succession was (un)successful may deepen our understanding of the process, but it is not particularly helpful to the business in question. We propose an alternative method for ownership succession: a preparatory approach that establishes requirements to fulfill before the succession takes place. These requirements are presented in a model that considers both the legal/financial and the psychological aspects of ownership and are formulated to improve intergenerational ownership succession and the post-succession prosperity of the firm.

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1. Introduction

Family-owned businesses are important to the economies of most countries (Stavrou & Swiercz, 1998). Furthermore, research suggests that a family firm's performance diminishes when it is acquired by a larger, (often) publicly listed, and more bureaucratic company. Loyalty to the family and local community may be lost, and long-term commitment to the business may not be maintained (Astrachan, 1988; Bjuggren & Sund, 2001; Pollak, 1985). However, despite the importance of family-owned businesses, only about 30% are transferred to a founder's descendants (Beckhard & Dyer, 1983; Lansberg, 1988; MassMutual, 2002), although recent research results indicate that the 'survival' rate from the first to the second generation of family-owned businesses may be higher (Stamm & Lubinski, 2011). Nevertheless, a low rate of intergenerational ownership succession highlights the importance of improving our understanding of ownership succession to facilitate the process for business families.

Based on a literature review and the descriptive results from an empirical study, this article aims to both elaborate upon the intergenerational succession of ownership and propose ways to foster this process. We contribute to knowledge about family business succession by addressing ownership succession – as opposed to the more commonly studied management succession – by recommending that legal and psychological perspectives of ownership be combined to advance our understanding and by suggesting a preparatory approach to facilitate effective successions. For purposes of this study, we define a family business as one in which family members dominate the ownership so that the family is in control of succession decisions. Furthermore, we focus on the first and second generation of a family firm and intergenerational succession of the majority ownership during the lifetime of the first generation. Research shows that the first generation does less succession planning than subsequent generations (Sonfield & Lussier, 2004). However, behavior related to managerial characteristics and practice remains similar over generations (Sonfield et al., 2005), and the influence of the founder remains strong in both the second and third generations (Sonfield & Lussier, 2004), which means that our reasoning is applicable to businesses in later stages.

Research on the key factors in effective succession generally addresses only management succession (e.g., Sharma, 2004). The relation between ownership and management in family-owned businesses can be described and analyzed from a variety of angles, including legal, financial, power-based and/or psychological perspectives (e.g., Koiranen & Karlsson, 2003). The interdependencies, similarities and differences between management and ownership succession have received little attention. At the outset, *interdependence* is striking because the majority owner(s) can

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directly or indirectly (via the board) appoint a new chief executive officer (CEO). For example, the majority owner(s) in the older generation can appoint a new CEO in the younger generation and at a later stage, can implement ownership changes to suit the interests of the new leader and the development of the business. The process can also proceed in reverse, beginning with ownership succession and perhaps providing the potential new CEO with a majority ownership position. Either way, the process is dependent on the specific situation and the personal choice of the incumbent owner. The *similarities* seem obvious because management and ownership successions concern the same company and family. Furthermore, the stakeholders can appear – at first glance – to be the same with respect to both management and ownership succession, although this is not always the case (we revisit this issue below). Furthermore, some succession preparations can be similar. For example, promoting good relations and communications between close stakeholders (such as family members) can enhance an incumbent's willingness to relinquish both ownership and the CEO position. The *differences* among the stakeholders in the two types of succession are not as obvious and can even be quite subtle. This article is based on the following observed differences between management and ownership successions:

1. The satisfaction of close stakeholders with the outcome of management succession is more important than it is for the outcome of ownership succession because the former is assumed to be crucial for cooperation in daily operations. Business matters that directly depend on ownership positions are less common – except for strategic decisions, including the appointment of a new CEO.
2. A majority owner can decide – either directly or via the board – who will become the new CEO, and any co-owner (however small) supported by transfer restrictions in the articles or shareholders' agreement can prevent any particular transfer of share ownership (Sund & Bjuggren, 2007, 2011, 2012).
3. Management succession will not typically have tax implications, whereas ownership succession may be subject to gift tax and/or capital gains tax provisions. Thus, the tax authorities may be interested in ownership succession as a non-close stakeholder but can be expected to ignore management succession (Bjuggren & Sund, 2005).
4. Challenging role changes and know-how transfers from an incumbent to a successor can be decisive success factors in management succession (Haag, 2012; Melin et al., 2007) but may not be as important to ownership succession, in which other considerations, such as tax considerations and obstructive co-owners, may play a role.

This article is primarily conceptual, but our reasoning is partially supported by descriptive data from an empirical study of 127 majority shareholders in Swedish family-owned businesses that inquired about their opinions on ownership succession. For further details, see Appendix 1. The survey addresses factors that may enhance or inhibit succession. These factors guided us to focus on preparations for ownership succession through preparatory requirements, which are developed further below, particularly in the section on *preparing ownership succession*.

In the next section, we describe the general features of succession, discuss certain aspects of success in terms of ownership succession in this context, introduce our theoretical reasoning on legal and psychological ownership, and discuss the usefulness of outcome measurements. Section 3 addresses our preparatory approach for ownership succession, with an overview of possible strategic goals and preparatory requirements for successful ownership succession – based partly upon the descriptive results of our survey – that are relevant to pre-succession preparations. In the last section the preparatory factors are summarized together with their antecedents in a model for the effective intergenerational succession of ownership. Further, we discuss the outcome and preparatory approaches for successful ownership succession, emphasizing the advantages of the latter. We conclude with comments on limitations and future research.

2. Family business succession

2.1. Features of succession

Succession is one of the most frequently discussed topics in the family business literature (Litz, Pearson, & Litchfield, 2012; Lussier & Sonfield, 2012) and is described as a primary concern of family business managers (Chua, Chrisman, & Sharma, 2003). It is depicted as a difficult process that requires careful preparations (Gersick, Davis, Hampton, & Lansberg, 1997; Handler, 1994; Sharma, 2004). However, research also shows that most owners of family businesses are not at all well prepared for what to do with their companies when they retire (Gersick et al., 1997; Handler, 1994; Lansberg, 1988). A considerable portion of the literature strives to understand better the factors that influence family business succession, but further research on the matter is required (Le Breton-Miller, Miller, & Steier, 2004; Long & Chrisman, 2013; Sharma, 2004).

Family businesses are characterized by the intertwined relationship between the family and the business they own, which leads to multiple goals, and success is a combination of a profitable business and family harmony (Sharma, 2004). Succession in family business is about the '*actions, events, and organizational mechanisms by which leadership at the top of the firm, and often ownership, are transferred*' (Le Breton-Miller et al., 2004: 305). It is primarily governed not by market values but by the internal relationships and values in the family business (Churchill & Hatten, 1997). Ownership succession and management succession are two different but tightly intertwined processes in family firms (Haag, 2012). Both types of succession may have been carefully planned for decades, or they might be imposed by a sudden event, such as the death of a family member. Ownership can be transferred through external sales or internal transactions, such as gifting or inheritance, that are regulated differently depending on the legal system (e.g., there are different gift and inheritance taxes in different countries). In a succession, managerial roles can be given to both family and non-family members, with the latter recruited either internally or externally. Increasing the use of non-family managers is not a simple solution; although it leads to the professionalization of management practice, it is shown to have a negative effect on the formulation of specific succession plans (Sonfield & Lussier, 2009). All these issues render succession in the family business context highly complex. As discussed above, in this article, we focus on intergenerational ownership successions during the lifetime of the older generation while using the related and (thus far) richer literature on management succession.

The financial and legal aspects of ownership transition belong to the formal side of succession and are found to be easier for practitioners to address once the first hurdle of raising the question has been overcome. Emotions, relations, and the transfer of values and knowledge are examples of areas of succession that belong more to the informal side (Melin et al., 2007). Informal aspects cannot be planned for in the same way as formal aspects. For example, tax issues are regulated by law, and a consultant can be hired to assess the relevant alternatives.

The succession process is commonly depicted as consisting of several phases, such as initiation/preparation, integration, joint management and the predecessor's retirement (Murrey, 2003).

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