

# SUCCESSOR'S SATISFACTION ON BUSINESS SUCCESSION PROCESS

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## **Abstract**

**Purpose of the article** Post succession performance of family owned businesses has become ineffective. Literature specifies that inter-generational succession is the prime cause for succession failures. Due to this, current family owned businesses focus attention on finding alternative, profitable succession modes. The foremost purpose of this research was to compare performances of family and non-family successors.

**Methodology/methods** The study comprises two stages: Exploratory study was used to develop the conceptual framework and hypotheses, and also formal study was used. Sample units were selected through simple random sampling. The data collection modes were a mail survey and in-depth discussions.

**Scientific aim of the study is** to compare family member successors with unrelated manager successors based on the successors' initial satisfaction with the business succession process..

**Findings** According to study findings, not all successors are completely satisfied with the business succession process. Unrelated manager successors have higher satisfaction the family member successors, but neither group exceeds the moderate level. All successors recorded lower performance than the incumbent but unrelated manager successors had better results the family member successors in both indicators

**Conclusions** If family members are not available or unprepared for business succession, unrelated manager successors are a viable alternative.

**Keywords:** Successor, Satisfaction, Business Performance

**JEL Classification:** L26

## PRESENT STATE OF THE STUDY

Family- Owned Businesses (FOBs) dominate the current world economy in particular eras in the past but also at present (Morck and Yeung, 2004). The current degree of business performance, though, is somewhat different. Current FOBs have problems sustaining their business. The reality is of course that FOBs are currently struggling in the worldwide crisis, with their problem of inheriting their business. In other words, they are struggling for long-term survival after a new Chief Executive Officer (CEO) succeeded the business (Chung and Liu, 2007). According to research findings, FOBs give foremost preference to hand over the business to family members because their ambition is to preserve family company ownership. To achieve this, they transfer management and control to the next generation (Morris, Williams, Allen and Avila., 1997; Lansberg, 1999), without considering the level of competence of the successor. The leading argument for this generational succession is the belief that family members can gather social capital, resources and specific knowledge on running the firm in a more efficient and profitable manner (Bjuggren and Sund, 2001). According to Davis, Schoorman and Donaldson (1997) “the family successor could perform better than other managers because they are exposed to higher non-monetary rewards associated with the firms’ success that other successors do not share.” They further argue “to get solid, specific knowledge and high levels of trust from key stakeholders is very difficult to outsiders.”

However, FOBs face one extremely vital issue with their generational business succession. According to Ward (1987); Davis and Harveston (1998); and Kets de Vries (1993) “only 30% of FOBs survive into the second generation, and 15% survive into the third generation.” Miller, Steier and Breton-Miner (2003) explain that poor Business Succession Process (BSP) is the central reason for this. This scenario has not only affected particular organizations, but has also directly affected the national economy due to lack of contribution. Regarding the American Family Business Survey (1997) (cited in Sharma, et al., 2003a) BSPs define as “the transfer of leadership, ownership or control from one family member to another - a goal shared by a majority of family firms” and as “a transfer the leadership one family member to another.”

Conducting the business as a FOB , “each generation takes over the business from the previous generation, and this is the vital managerial challenge for the incumbent, owners, successors and family members” (Miller et al., 2003), but they have failed to do this in a successful manner. BSPs have gone beyond that stage by considering alternative succession modes, not for family control but for the survival of the organization as a FOB. Nelton (1997) expressed that “families are now starting to recognize that it is not the end of the family enterprise if you bring in a non-family executive to lead the firm”. In other words, at present there is a trend to be a FOB as a “family owned - non-family managed” model, not as a “family owned -family managed” model. Therefore, the business succession process of FOBs is better defined as “the passing of the leadership baton from the founder/owner or incumbent owner to a competent successor, who will be either a family member successor or a non-family unrelated manager successor (De Alwis, 2011).”

Further, Lauterbach, Vu and Weisberg (1999), and also Smith and Amoako-Adu (1999), and Lin and Hu (2007), all conducted research in comparing the financial performances of family member successors and non-family unrelated manager successors in public companies to identify the most appropriate successor. Chittoor and Das (2007) discussed making management more professional with three Indian companies using case study methods. Boeker and Goodstein (1993) discussed the impact of organizational performances and the composition of the board of directors for the selection of a future

successor. Those studies have contributed to the knowledge base of the field, but there is still an enormous knowledge gap to fill. No empirical research has been done on post succession performances of medium-size FOBs by comparing family member successors and unrelated manager successors. Therefore major objective of this study was to compare post succession performances of a family member successor with that of an unrelated manager successor in medium-sized FOBs through an empirically developed research base.

## **1 PROBLEMS OF THE STUDY**

As explained previously, BSPs of FOBs have become a serious issue for the longevity of this business entity. Therefore, there is a high tendency among researchers and practitioners to find feasible solutions to this succession issue, however in FOB literature, there are very few studies comparing different succession alternatives to BSPs (Chittoor and Das, 2007; Lin and Hu, 2007).

This research aims to develop an understanding of this phenomenon, identified in the previous section. Hence, the problem statements can be stated as follows:

“Who is the highly satisfied successor mode form family member successor and unrelated manager with the business succession process that they have undergone?”

## **2 RESEARCH OBJECTIVES**

To compare family member successors with unrelated manager successors based on the successors' initial satisfaction with the business succession process.

## **3 SIGNIFICANCE OF THE RESEARCH**

There is a bulk of literature on various issues relevant to FOBs, but the majority of this is focused on inter-generational succession (Handler, 1994 and Wortman, 1994). This is due to poor performance the BSP brings short-term life to the entire unit (Handler, 1994). This poor result affects the business entity and eventually also the national economy. Therefore, business succession processes have become a fundamental topic of FOB research (Sharma, et al., 1996). Almost 99% of the literature on FOB succession deals with inter-generational succession, and very few researchers have given their attention to alternative succession modes (Lauterbach et al., 1999; Smith and Amoako-Adu, 1999; Boeker and Goodstein, 1993; Chittoor and Das, 2007; Lin and Hu, 2007).

## **4 LITERATURE REVIEW**

### **4.1 BUSINESS SUCCESSION PROCESSES (BSP)**

Top management succession is a particularly challenging event for any type of business organization because the successor's approach, competencies and perception directly affect all aspects of the business, and also stakeholder's expectations. The American Family Business Survey (1997) defines BSPs of FOBs as "the transfer of leadership, ownership or control from one family member to another - a goal shared by a majority of family firms." Meijaard, Uhlaner, Flören, Diephuis and Sanders (2005) goes beyond this to define BSPs of FOBs as "...a transfer to someone within the family, to a third party, or to another company". Management buy-ins (MBI) and management buy-outs (MBO) can be considered examples of business transfers as well, as long as the existing economic entity survives." According to Beckhard and Burke (1983) (cited in Handler, 1994) BSPs are "the passing of the leadership

baton from the founder-owner to a successor who will either be a family member or a non-family member; a 'professional manager." According to Barry (1975) and Davis (1982) to have an actual BSP in FOBs, it must have three major components: 1) an incumbent/founder who hands over their leadership role, 2) a successor who accepts the leadership role, and 3) a system by which the handover takes place. For FOBs, family members are interested in transferring management into another family member's hand, mostly transferring to the next generation's hand. This is because their intent is to preserve company ownership and management within the family. They transfer management and control into the hands of the next generation (Morris et al., 1997) without considering the competence level of the successor. The leading justification for this inter-generational succession is the belief that family members are able to accumulate social capital, resources and learn specific knowledge on running the firm in a more efficient and profitable manner (Bjuggren and Sund, 2001). According to Davis et al. (1997), family successors might perform better than unrelated managers, because they have developed better non-monetary rewards which helps guarantee the firms' success. Additionally, Donnelley (1964), (cited in Alestalo, 2010), argues that "to get firm specific knowledge and higher levels of trust of key stakeholders is very hard for outsiders." According to previous research findings, only a limited number of FOBs survive to the second generation and more than two-thirds do not pass to the third generation (Shanker et al., 1996). Kets de Vries (1993) writes that only "30% of FOBs survive into the second generation, and 15% survive into the third generation". Poor successions are the main reason businesses fail to continue (Miller and Breton-Miner, 2003). Other causes are implementing incomplete and vague succession plans, selecting incompetent or unprepared successors, and also family conflicts (Dyer, 1986; Handler, 1990, 1992; Lansberg, 1999; and Morris et al., 1997). Due to this, there is a current trend to operate as a "family owned and non-family managed" business instead of the "family owned and family-managed" business.

Therefore BSPs of FOBs can be better defined as the "transition of leadership from the founder - owner or incumbent-owner to a competent successor. The successor might be a family relative or non-family manager."

## **4.2 ALTERNATIVE SUCCESSORS FOR BUSINESS SUCCESSION**

### ***Family member successor***

As mentioned earlier, FOBs give priority to handing over the business to other family members. In this instance, the business goes to the successor, who has related by blood to the incumbent. This transition is usually done from generation to generation. Sometimes, if no blood relatives are available, FOBs consider handing over the business to a person related to the incumbent-owner by law. Some researchers highly recommend that internal successors are more suitable than unrelated successors because they have greater knowledge of the firm and an established social network (Chung et al., 1987). Cabrera-Sua' rez et al. (2001), express that internal family succession can help FOBs sustain or achieve some competitive advantage over non-FOBs. It is vital that family members contribute to a smooth successor transition because they are the ones who have developed the existing corporate strategy.

### ***Non-family unrelated manager successor***

Sometimes family inter-generational succession is impossible due to such reasons like competent family members being unavailable, family members refusing to take over management or problems with the family member successor. Under these circumstances, companies must make a crucial decision about continuing the family business and protecting family identity. In order to protect family identity, FOBs must then consider appointing outside unrelated managers (Chittoor and Das, 2007). This means recruiting an unrelated manager successor to lead the company (the professionalization of the FOB) for an interim

period until they find a family successor for long term posting as manager. In certain cases, it is very beneficial for the FOB to appoint an interim or "regency" manager (Matser and Lievens, n.d.) until a family successor is fully prepared for the management job. In this way, the family can maintain control of the family business, and it fills the managerial gap. Further reasons to appoint an interim unrelated manager successor are environmental pressures such as those from multinational companies, technological advancements in a field, competition from quality products at low prices, consumerism, media exposure, and lifestyle changes. FOBs must find external unrelated managers to run the business successfully.

### ***Business succession and performance***

An extensive search was done to find available literature on BSPs and its affect to post succession performance, but very few contributions were found. In total, 9 articles were reviewed, but the majority of them do not relate to the FOBs. Some compared FOB performance to non-FOBs. A few studies researched the relationship between performance before succession and its impact on selecting an appropriate succession mode, and other researchers evaluated the post succession performance with succession modes. The majority of research was conducted in the United States, Canada, the United Kingdom and Australia, and only 2 theses conducted research in the Asian region.

### **4.3 SUCCESSION AND POST PERFORMANCE**

There is no clear agreement among researchers on how to measure a successful or effective succession (Dyer, 1986; Handler, 1989a; Morris et al., 1997; and Cabrera-Suárez et al., 2001). Handler (1989a) and Sharma (1997), explain whether it is suitable to use the satisfaction level of the incumbent, the successor, and other family members as an indicator of whether the BSP is perceived to be successful. The initial satisfaction with the business succession process generally encourages better performance and usually brings booming post succession business performance, and this excellent post succession performance brings FOBs some personal satisfaction. Likewise, if stakeholders are not satisfied with the BSP, this discourages them from performing their roles as well as possible in the proper manner, and this will affect post succession performance both directly and indirectly. This finally brings dissatisfaction to the whole business process.

## **5 RESEARCH DESIGN**

This study includes subjective measures to evaluate FOB performance based on the successor's initial satisfaction with the business succession. Cabrera-suárez et al. (2001) and Dyer (1986) suggested using the satisfaction of the incumbent, the successor and other family members with BSP as an indication of the perceived success of the BSP. Sharma et al. (2003a) employed this performance indicator for their research on "predictors of satisfaction with the succession process in family firms." Sharma et al. (2001) collected data to measure satisfaction from incumbents and successors, but no data was collected from family members due to the limitation of the research framework. Their sample framework was FOBs that expected succession within the ensuing five years, and also those for which the event had occurred within the preceding five years. Under this research framework however, this study has collected data from FOBs. Therefore, it has failed to collect data from incumbents and their family members. Therefore, this study has come to the decision to measure initial satisfaction with the business succession process of the successors of various business units. This study defines initial satisfaction with the business succession process as "perceived satisfaction of succession before post succession FOB performance is accurately known."

This research defined family member successor as “individuals who have a relationship with the incumbent and family by blood or by law.” In general, the transition will come from generation to generation, but sometimes, due to the unavailability of blood relations; there is consideration given to whether the business should be handed over to more distant, legally binding relations. Thus, this study considers both types of successors as family member successors.

Professionalization refers to the adoption of unrelated managers to fill management positions, especially the CEO’s position (Zhang and Ma, 2009). The adoption of unrelated managers signifies the separation of ownership and control, or at least it dilutes the family control in the actual management of the business. Under these circumstances, the unrelated manager successor is defined in this research as “an individual who takes full charge of the day-to-day operations while retreating to the board of directors to assume advisory and supervising duties.”

## HYPOTHESIS OF THE STUDY

Hypothesis 1: Successor and post succession performances

Under hypothesis 1, this research evaluated the post succession performance of alternative succession modes. To reach this prospect, this study compared alternative succession modes with their post succession performance based on initial satisfaction with the business succession process

Alternative hypothesis (H1.a): Initial satisfaction with the business succession process is significantly different with family member successors ( $\mu_{SFMS}$ ) to unrelated manager successors ( $\mu_{SUMS}$ )

$$H_1: \mu_{SFMS} \neq \mu_{SUMS} \quad (1)$$

## 6 SAMPLE DESIGN AND DATA COLLECTION DESIGN

### 6.1 SAMPLE DESIGN

This study screened the population of “Family owned business has done their business succession process with family member successor or unrelated manager in Sri Lanka.” Due to a national database for screening being unavailable, SME database was used because according to the literature, the majority of SMEs are FOBs (Commission, 2006).

Sri Lanka does not have a nationally accepted definition for SMEs and different institutions adopt different definitions according to the purpose of various studies. However, the most widely accepted criteria for defining SMEs are that they have a number of employees, fixed investment, and have a certain nature of business (Cooray, 2003). However those definitions are based on mainly three indicators as number of employees, capital employed/total assets and turnover. Some difficulties can be identified with these definitions, when author applies the criterion of capital employed / total assets, and turnover. This may well confuse figures due to inflation and technological improvement. Despite this, most researchers and relevant institutions use the following criteria to classify SMEs: the “value of the fixed assets” (excluding land and building), and the “number of employees in the enterprise” (Cooray, 2003). Due to the inflation factor, the author preferred to use only the “number of employees” for identifying FOB units for their study. According to Sumanasena (n.d)

“The most common categorization based on employees in Sri Lanka is 4 to 49 employees for small-scale enterprises, 50 to 149 for medium scale enterprises and more than 149 employees for the large scale.”

Thus, for this study, the population is defined based on the following criteria:

- 1) The sample unit must fit into the aforementioned definition.
- 2) A family member successor or an unrelated manager successor has been appointed to the top executive senior position (CEO/ Chairman).

The research used a simple random sampling method by considering constraints faced during data collection. Targeted respondents included FOB successors: family member successors and unrelated manager successors that had been appointed within the period 2000 to 2007 in medium-sized FOBs.

## **6.2 DATA COLLECTION DESIGN**

A structured research questionnaire that has developed by combining with universal accepted scales and author developed scales. This questionnaire was basically divided into three sections by considering the following objectives:

Section 1 specially designed to verify which elements of the population should be subjects of the sample. Section 2 designed to collect demographic information about FOBs and the sample element; the successor. This section also helped collect data on pre and post business performance. This section included the following demographic information related to the successor and FOB:

Section 3: Initial satisfaction with the succession process was measured through the scale developed by Sharma et al. (2003a). This instrument was constructed by 12 statements which were equally weighted. The original alpha values for this scale was 0.93.

The questionnaire was originally developed in the English language, and then translated into Sinhala and the Tamil language. It was distributed in two formats: Sinhala and English format, or Tamil and English format, to increase the response ratio from the respondents.

This study utilized postal and electronic mail surveys simultaneously as the data collation method due to the following reasons: to obtain a higher level of response within a short period of time.

## **6.3 RESPONSE RATE**

In total, 156 responses were received during the data collection period. The number of useable returns is 128 (82%) and the number of non-useable returns is 28 (18%). The 28 responses had to be rejected particularly from hypothesis testing, since they did not have several key questions entirely completed. The overall response rate (useable returns 128; total population 3,458) suitable for hypothesis testing is 3.7%. The response rate on the web-based survey was less than that of the postal questionnaire. It is likely that companies apply a spam filter to e-mails from unknown sources, and secretaries usually check and filter incoming e-mails for the executive. This response was still a more than adequate response rate, given the number of parameters in the structural model to be estimated (Hair, Anderson, Tatham and Black, 1995). The 128 usable questionnaires were evenly split between two respondent groups: 86 questionnaires received from family member successors, and 42 received from unrelated manager successors. In addition to the statistical requirements of sample selection, this sample of the study can be matched with the study samples that have been used to evaluate post succession performance of FOBs and non-FOBs, therefore this sample size of the study is considered acceptable for this study (Cucculelli and Micucci, 2008).

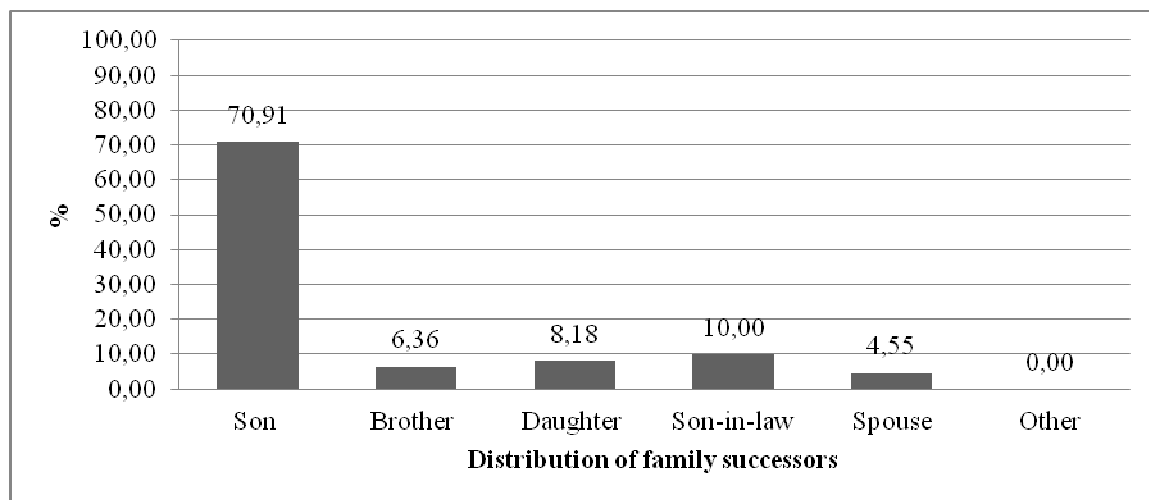
## 7 DATA ANALYSIS AND DISCUSSION

### 7.1 DESCRIPTIVE STATISTICS OF THE STUDY

The normality of the data set was evaluated by Kolmogorov - Smirnov (S - K) and Shapiro - Wilk (S - W) tests. Results are in significant levels of S - K and S - W (greater than 0.05 ( $p > 0.05$ )). Therefore the normality was assumed. Test for linearity measures whether the relationships between the predictors and the outcome variable are linear. It was tested through residual plots obtained by SPSS 17.00 and most of the residuals were scattered around zero point and had oval shapes. Box-plot diagrams were used to identify outliers of the above variables and ones the outliers appeared it was replaced by the mean of the sample set.

### BUSINESS SUCCESSION WITH FAMILY BUSINESS SUCCESSORS (FMSS)

As shown in graph 1, the majority of FOBs are handed over to the son of the family. Of these sons, 57% are the eldest son of the owning family. The second and third highest successor categories are respectively sons-in-law and daughters of the owning family (the total sampling unit is 110).



**Graph 1: Distribution of different people who are family successors**

*Source: Survey data, 2011*

### BUSINESS SUCCESSION WITH UNRELATED MANAGER SUCCESSORS (UMSS)

82% of unrelated manager successors are managers who have pre-experience with the FOB, who have occupied a senior position in the FOB. Under these conditions, the majority of unrelated manager successors have taken over the business with enough appropriate understanding about the business and its surroundings. In some instances, they need to take over the business until family issues are overcome.

In most instances, they have been appointed for the transition period due to the unavailability of suitable successors within the family; or until a family member successor can be trained; because a family member refused the appointment due to family conflicts; or due to poor performance of the FOB. Most of the time, a person is appointed who has worked a long period with the FOB, is trustworthy, and who has been a top-level manager of the company.



## AGE DISTRIBUTION OF THE SUCCESSORS

**Table 1: Age distribution of the successors**

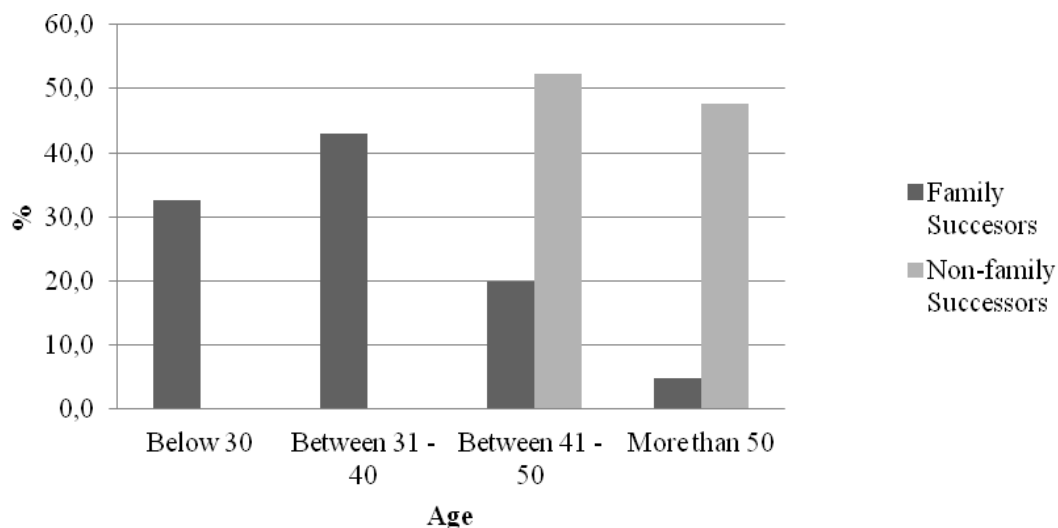
	FOBs which appointed FMS	FOBs which appointed UMS	F statistics (T test)
Age of the successor when he was appointed			
Mean	33.85	47.93	6.003*
Median	35	43	
Standard Deviation	7.10	6.53	
Maximum	51	55	
Minimum	23	35	

\*Significant at 5% level.

Source: Survey Data, 2011

Table 2 presents descriptive statistics of the successor (president and/or CEO) appointed within the period of 2000 to 2010. The samples include 134 appointments except the cases that have not mentioned the age. To test whether a family member successor and unrelated manager successor are significantly different, the sample was tested with Mann-Whitney test statistics.

The results of this test is that “the age of the appointment for family member successor and unrelated manager successor are statistically significant different:  $z = -7.969$ , and  $p < 0.05$ . Family member successor has an average age of 35, while unrelated manager successor has an average age 43.



**Graph 2: Age distribution of successors**

Source: Survey data, 2011

## HYPOTHESIS TESTING

### Initial satisfaction with the succession process

#### Initial satisfaction of the business succession process

Alternative hypothesis (H1): Initial satisfaction with the business succession process is significantly different with family member successors ( $\mu_{SFMS}$ ) to unrelated manager successors ( $\mu_{SUMS}$ )

$$H_1: \mu_{SFMS} \neq \mu_{SUMS} \quad (1)$$

A study compared the level of initial satisfaction of family member successors and unrelated manager successors. Family member successors levels of initial satisfaction ( $M = 2.63$ ,  $SD = 0.65$ ) expressed significant levels of difference with unrelated manager successors ( $M = 3.00$ ,  $SD = 0.41$ ),  $t(128) = 3.939$ ,  $p = 0.000$ , and two-tailed  $df = 117.01$ .

According to the research findings, unrelated manager successors have a higher level of initial satisfaction than the family member successor.

Therefore, alternative hypothesis (H1) is accepted. In other words, initial satisfaction with the business succession process between family member successors and unrelated successors is significantly different.

**Table 2: Initial satisfaction with the business succession process**

	All	Type of business succession		Difference
		Family member successor	Unrelated manager successor	
Initial Satisfaction	2.77	2.63	3.00	0.27*

\* denotes significance at the 5 percent level

Dependent variable: Initial satisfaction with the business succession process

Source: Survey data, 2011

The average satisfaction with the BSP is 2.77. Under this condition, it can be concluded that not all successors are satisfied with the BSP that was carried out. The stakeholders around the BSP should consider the BSP because if they highly satisfied with the business succession, it will positively affect the performance of the business.

## 8 CONCLUSIONS

According to aforesaid findings, successors are not satisfied with the business succession process. This is true of all the succession modes. Unrelated manager successors have higher satisfaction than the family member successors but no successors achieve more than the moderate level of satisfaction. This level achieved indicates “no dissatisfaction and no satisfaction” and this is dissatisfactory for the future of the FOB. If CEOs do not satisfy the way of appointing them, it badly affects the performance.

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