An Integrative Review of Key Determinants Affecting Family Business Succession

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Abstract

This paper explores, integrates, and reviews the literature of factors affecting the process of family business succession. The authors explored and provided a review of literature from 1978 to 2009 of the important key determinants of family business succession. In this paper the authors classified the key determinants of family business succession into five main categories, namely (1) personal characteristic factors, (2) intra-family relationship factors, (3) external relationship factors, (4) context factors, and (5) financial factors. The authors specified the theoretical contribution of family business succession by extending the body of knowledge about the process of leadership transfer. The article also gives further research suggestions by providing key determinants to perform construct validity

Keywords: Family Business, Family Business Succession, Incumbent, Successor

Introduction

The study of family business has been very popular among researchers over the last few decades. Family-owned business can be defined as "a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family" (Sharma et al. 2001). One of the most crucial research topics in the study of family business is "family business succession", which refers to the actions, events, and developments that affect the transfer of managerial control from one family member to another (Sharma et al. 2001).

According to Malinen (2001), family business has been acknowledged as the source of sustainable economic growth. It is notable that a large number of listed companies in Europe and Asia are still family-owned, that is to say the owner of the family has major influence and control over the firm in terms of business ownership and management control. From the studies on the topic of family business, Kets de Vries (1993) suggests that approximately 30% of family firms survived into the second generation of family ownership and roughly 16% survived into the third generation. Morris, et. al (1997), also confirms that the main reason for low survival rate of family businesses across generations is the problem of family business succession.

Therefore, the purpose of this article is to explore and provide a review of relevant literatures from 1978 onwards on the key determinants of leadership transfer in family business.

The Model of Succession in a Family Business

Regarding the process of leadership transfer in the family business, Longnecker, Moore, and Petty (1997) state that the process can be time consuming and can extends over years. Therefore, Longnecker and Schoen (1978) introduce the following model to explain the process of family business succession.

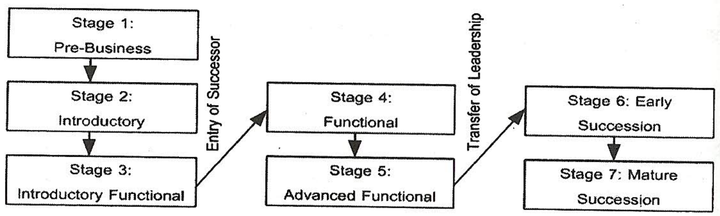

Figure 1: Model of Family Business Succession
Source: Longnecker and Schoen (1978)

The model of family business succession is divided into seven main stages namely: Pre-Business, Introductory, Introductory Functional, Functional, Advanced Functional, Early Succession, and Mature Succession. However, the focus of this

article is on the process of the "Leadership Transfer", which occurred between stage 5 and stage 6.

To determine the factors that affect the leadership transfer in family business, the authors identify and classify key determinants of family business into five main categories: (1) personal factors, (2) intra-family relationship factors, (3) external relationship factors, (4) context factors and (5) financial factors.

For research contribution, this article provides theoretical contribution by extending the body of knowledge about "Leadership Transfer" through the model of family business succession as well as to provide further business implications on the study of family business.

To begin with this literature, it is very crucial to define the basic terminologies used in this research paper, namely: family business, family business succession, incumbent, potential successor, and succession process.

One of the most challenging tasks in the study of family business is to establish a clear definition of what a family business is. Many scholars have attempted to articulate conceptual and operational definitions of family business (Astrachan and Shanker, 2003; Coleman and Carsky, 1999; Astrachan et. al, 2002; and Tsang, 2002). However, the definition of family business employed in this study is the definition given by Chua, Chrisman, and Sharma (1999) which defines family business as "a business that is governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families".

In every business cycle, most family-owned firms must encounter the period of transition or succession from one generation to another. Family business succession refers to the transition of managerial power from one family member entitled to the position of top management in the family business to another family member that is related by blood or by law. Incumbent is the person who holds the top management position in the family business that must relinquish managerial control to the potential successor. The potential successors can be any family members who have the potential to pursue managerial control of the family business when the incumbents step down.

For every succession in a family business, both the incumbent and the successor have to face the succession process. The succession process is the transition period of managerial power between the incumbent and the successor that includes all the actions, events and developments that may affect the transfer of managerial control from one family member to another" (Sharma et al., 2001). This also refers to the time frame within which the incumbent formed the intention of succession to the time when the incumbent relinquish managerial control.

Family Businesses in Thailand

Thailand is an industrialized country in Asia whose economic growth is driven by family-owned businesses. From the study of Suehiro and Wailerdsak (2004), the proportion of family owned businesses listed on the Stock Exchange of Thailand decreased from 48.2% in 1996 to 42.3% in 2000. By collecting the data from the top 100 companies listed in the Stock Exchange of Thailand ranked according to the total revenue earned, Pongpaijit (2006) also reveals that the number of family-owned businesses dropped from 57 companies in 2000 to 56 in 2004, and then to 38 in 2007. This shows that there is a low survival rate for family businesses in Thailand.

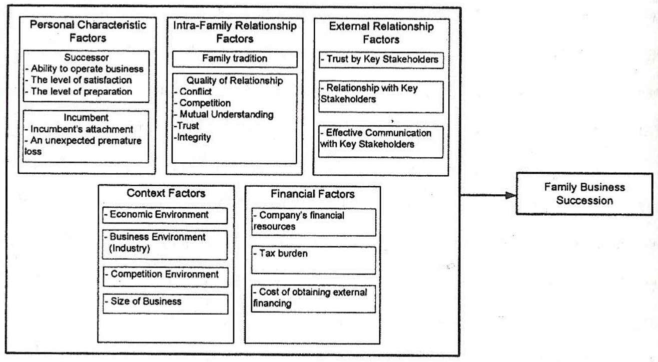

Figure 2: Illustration of key determinants affecting family business succession

Factors Affecting Family Business Succession

In the literature of family business, there are wide ranges of factors that affect family business succession. Ip (2006) states that the literatures of Business Succession usually fall into one of the two broad categories, which are succession within family-owned firm and those which are not family-owned. According to Morris, Williams and Nel (1996), the underlying determinants of successful managerial transition for family owned firms depends on three categories, which are the preparation level of the heirs, the relationship among family and business members, and planning and control activities. Apart from the suggested three factors mentioned above, scholars also suggest an integrative model for successful succession while taking into the consideration of the contextual factors within the family industry and the society (Dyck et. al, 2002; Le Breton-Miller et.al, 2004) Moreover, based on the study of 16 failed successions, Miller, et al. (2003) also finds the organizational structure and the misalignment between an organization past and future are the factor that prevent the succession process to occurs. Parini (2000) also finds that financial factors such as tax burden, level of debts, and amount of internal financial resources have the significant role in determining succession process.

Therefore, objective of this article is to simplify the study of family business succession by focusing only on family-owned firm in Thailand. Ahokangas (1998) states that SMEs are depend on the development potential of key internal and external factors. Hence, to examine the succession process of family business in Thailand, the authors have classified the key determinants affecting family business succession into five main categories as shown in Figure 2, namely: personal factors, intra-family relationship factors, external relationship factors, context factors and financial factors.

Personal Characteristics Factors

Levinson (1971) and Kets de Vries (1988) discover that the main problems arising within the succession process are those due to the personal characteristics of the potential successor and the incumbent. Personal characteristics of the successor may include: the ability of the potential successor in terms of the necessary skills required for the operation of the business, the willingness to continue the family business, and the preparation level that the successor received before taking over the family business.

One of the most crucial factors that will flourish the process of leadership transfer among the family member is the ability of the potential successor during the pre-succession period. If the successor does not possess the necessary business skills and the general knowledge of the overall operation, the succession process is less likely to occur. Hence, to make an effective leadership transfer process, the potential successor must be a high self confidence individual and must have the managerial autonomy to run the business (Goldberg and Woodridge, 1993). If the successor is under qualified by lack of unnecessary skills to operate business and lack preparation level, the potential successor may refuse the position vacated by the incumbent (Potts et. al, 2001; Le Breton-Miller et.al, 2004; Venter et al., 2005). Apart from the individual's characteristics, the satisfaction level that the potential successor has toward the family business can also increase or decrease the willingness to commit to or work for the family (Shama and Raos, (2000). If the potential successor has high degree of dissatisfaction with the family business, there will be low chances that he/she will take over the business from the incumbent due to low level of motivation (Potts et al., 2001, Le Breton-Miller et al., 2004, and Venter et al., 2005). Cespedes and Galford (2004) use the example of Tiverton Media Corporation as an evidence of ineffective leadership transfer in family business because the successor does not have any motivation and willingness to work for the family.

Good preparation level and effective training program in the pre-succession period are the keys to the successful transfer of managerial power from the incumbent to the successor. Morris (1997) classifies the preparation level according to the following factors: formal education level, work experience (outside the firm), training received from the incumbent, entry-level position, and the number of years

working with the family business before the succession takes place. Le Breton-Miller, Miller, and Steier (2004) also discover a positive correlation level between the preparation level that the successor has and the effectiveness of the succession process. Hence, the higher the preparation level that the potential successor has, the higher the chance that he/she will accept the responsibility of managing the family business after the incumbent steps down.

Incumbent's personal characteristics can also determine whether the effective succession will take place or not. From the study of Sharma, Chrisman, and Chua (2001), he level of attachment that the incumbent has towards the family business is found to be one of the major barriers to prevent effective succession. If the incumbent is too appended to the business, the potential successor will not received the opportunity to continue and take full control of the family business, hence creating barriers for effective succession (Potts et al., 2001; Sharma et al., 2001; Haveman and Khaire, 2004, and Le Breton-Miller et al., 2004). With the incumbent's high level of attachment, the successor may lose the motivation to work for the family and decide to search for external opportunities.

Incumbent often has a crucial role in the decision making as well as managing the overall operation of the family business. Therefore, incumbent's decision has been recognized as the significant factor that influences the selection process of the potential successors (Kelly; et.al, 2000). If there is an unexpected and premature loss of the incumbent due to death or illness before he/she has made the selection decision and provide proper training to the potential successor, the chance that the successor will continue the family business will be reduced especially when the potential successor does not have the capabilities or the motivation to take over.

In sum, the above evidences would suggest the following proposition:

P1: The characteristics of the potential successor and incumbent are positively related to the effectiveness of the leadership transfer.

Intra-Family Relationship Factors

Intra–family relationship factors are the relationships among the incumbent, the potential successor and other family members. Family tradition and the quality of the relationship between family members play a major role in determining the fortune and the level of success in family business (Kepner, 1983; Lansberg, 1983). An effective succession process will occur if the successor feels that it is the family tradition or the norm to continue the business (Morris, 1996; Malinen, 2001; Lee, 2003). In order to increase the successor's willingness to accept and pursue the family business, there must be a positive relationship among the family members. If both the incumbent and the successor are able to create mutual understanding with other family members about the future of their business, there will be less conflict, hence, creating a higher prospect for effective succession (Malinen, 2001; Miller et al., 2003; Venter et al., 2005).

Brockhaus (2004) states that the quality of the relationship between the successor and other siblings is another crucial determinant of the succession process in the study of family business. High level of competition and conflict between siblings usually discourage the application for the position within the family, thereby preventing the succession process from occurring. (Cespedes and Galford, 2004; Bruce and Picard, 2006).

According to Sharma and Rao (2000), trust and integrity are considered to be other crucial attributes for an effective succession. In order for the successor to become a legitimate leader and to successfully manage the family business, he/she must be trustable. Thus, the potential successor must be able to earn trust and respect from the incumbent and other siblings in to create effective succession in family business.

Given the above review, the second proposition for construct validity testing is given as follows:

P2: Intra-family relationship is positively related to the effectiveness of the succession process in family business.

External Relationship Factors

Apart from intra-family relationship, the relationships among the other stakeholders outside the family can be constituted as another determinant affecting

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family business succession. The external relationship factor refers to the quality of the relationships among the other stakeholders that are related to the family business for instance the customers, suppliers, employees, as well as the creditors such as the commercial banks other financial intuitions. Cadieux (2007) finds that the quality of the relationship between the stakeholders and the potential successor is one of the criteria that can influence the incumbent's selection decision. If the potential successor is capable of maintaining and creating an excellent relationship among the stakeholders, there will be a higher chance for the incumbent to transfer the business to the successor (Cadieux, 2007; Bruce and Picard, 2006; Cespedes and Galford, 2004).

One of the required key determinants for effective succession process in family business is trust. Potential successor must be trustable from the perspective of other stakeholders since these individuals may possess idiosyncratic knowledge of the firm that may prove to be valuable for the future of the company (Lee et al., 2003). The lower the level of trust between the potential successor and other stakeholders, there will be a higher chance that the business will survive in the future. Hence, if the incumbent foresees this relationship, they may accelerate the succession process by transfer managerial power to the potential successor (Cespedes and Galford, 2004).

In order to create an effective leadership transfer in the family business, there needs to be a clear transitional role for both the incumbent and the potential successor. The problems with unclear roles and responsibilities of incumbent during the transition period may hinder the successor's ability to earn respect from other stakeholders. This eventually prevents the ability for the successor to gain trust, respect and commitment between different business parties and create the barrier for business succession (Massis, 2008). Moreover, with the unclear role assigned to the potential successor during the succession process, he/she may lose the motivation to work for the family and causes the successor to reject the position offered by the incumbent.

Another crucial factor preventing the succession process of a family business is the problem of unclear communication among the incumbent, the potential successor, and other stakeholders. As the process of leadership transfer is considered to be an important process for every business transition, incumbent needs to share his/her owns perspectives regarding to the changes in the organization. Incumbent must be able to communicate the critical objectives of the change, which will be taken place after the transition period. If the incumbent does not pay enough attention to communicate to the successor and other stakeholders about the shared vision and the future of the company, the problems of conflict and misunderstandings may occur, hence, creating ineffective succession process. Therefore, the following proposition for validity testing as suggested as follows:

P3: External relationships have a positive relationship to the effectiveness of the succession process in family business.

Context Factors

Context factors are the factors associated with the changes in the economic environment and business settings that the company operates in. Context factors can also includes other factors that are related to the aspects of the succession process that might prevent the succession process from occurring.

The contingency and the uncertainty in the economic and business environment can influence the incumbent's selection process. Changes in the economy and market conditions can alter the overall profitability and revenue earn in future. The negative changes in the market conditions that might amplify the probability of business failure may hinder the incumbent's decision to transfer the business to potential successor and create pressure for the incumbent to sell the firm (Carlock and Ward, 2001; Cespedes and Galford, 2004; Venter et al., 2005).

Moreover, size of the business is also matters to the succession process in family business. The larger the size of the business, the possibility that the offspring will continue the family legacy will be high. Therefore, the smaller the size, the higher chance that the potential successor will leave the family business and search for other opportunities due to unattractive monetary rewards (Vente et. al, 2005). Hence, the fourth proposition for validity testing can be written as follows:

P4: Context factors are positively related to the effectiveness of the succession process in family business.

Financial Factors

Financial factors can also be a vital contribution in preventing the effective succession. The financial factors are the factors that are related to the limitations in the company's financial resources in terms of tax burden and the cost of obtaining external finance.

Management succession is usually accompanied or followed by ownership succession; therefore, the tax burden that is associated with the inheritance could exceed the family's income. According to Malinen (2001), taxation is one of the biggest obstacle in the succession process of many family businesses. This is due to the complication to understand the complexity of the legal regulations.

By studying the family business in Finland, Malinen (2001) finds that the incumbent usually does not prefer for their child to suffer from financial difficulties after the succession period, which creates high pressure on the incumbent to forgo the succession opportunity. As a result, the incumbent will sell the business to the outsider instead of inherit to the family members.

Thus, the fifth proposition for validity testing can be written as follows:

P5: Financial factors are positively related to the effectiveness of the succession process in family business.

Conclusion

The study of family business has received a considerable attention in the popular press. Therefore, to understand the key determinants affecting the succession process is very crucial for family businesses as it will help to reduce and prevent the problems of transition failure. From the review of literature on the study of family business succession, it can be concluded that there are five key factors to determine effective succession process namely: Personal Factors, Intra-Family Relationship Factors, External Relationship Factors, Context Factors and Financial factors.

Therefore, the objective of this article is to broaden the knowledge of leadership transfer through the model of family business succession. Incumbent will benefits by being able to use the five key determinants to create the effective training strategies during the succession process in order to prevent problems and reduce conflicts between the incumbent and the successor.

Although this review of literature provides the readers with an insight on the five key determinants affecting the process of family business success, however, there are number of limitations that need to be considered. The determinants are classified base on the review of international journals and most of the researches published are examined from the western context. Therefore, the obtained the result might not be able generalize and apply to context of family business in Asia. Therefore, to make this research to be more beneficial, further research based on the Thai context is needed in order to provide significant evidence for the entrepreneurs in Thailand. Readers can use the information from this review of literature to create an empirical study for testing the construct validity of the model according to the five propositions introduced.

Lastly, businesses are different in terms of the size and the sectors that they operate in. Hence, these can be used as the control variables in the future research as to provide more insights on the effect of family business succession.

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