



# Family firm succession: the management buy-out and buy-in routes

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## Abstract

**Purpose** – This exploratory study aims to provide fresh insights into the ownership transfer of private family firms through internal management buy-out (MBO) and external management buy-in (MBI) succession routes. The paper aims to explore if flows of information impact the succession planning process and if the nature of succession planning impacts the business sale negotiation process relating to family firms that select MBO/MBI succession routes.

**Design/methodology/approach** – Guided by insights from agency theory and theories relating to information asymmetries and negotiation behaviour six hypotheses were derived. Private family firms that had received venture capital and the MBO/I deals had been completed between 1994 and 2003 were identified. A structured survey was administered to 117 senior members of acquiring MBO/I management teams after the deal had been completed in several European countries. Non-parametric chi-square tests and Mann-Whitney “U” tests were used to test the presented hypotheses.

**Findings** – Evidence highlights the importance of information sharing and that the family owner(s) may not always be in the strongest position. MBOs reported lower information asymmetry. Also, lower information asymmetry was reported when vendors and management were involved in succession planning. Internal managers with greater access to information were found to influence the negotiation process and determine who is more likely to benefit from the price to be paid for the firm. A mutually agreed price was less likely when management controlled information and when personal equity providers (PEP) were involved in the process supporting the interests of the MBO/I team.

**Practical implications** – Family firm owners need to plan for succession planning. Vendors of family firms need to leverage external professional advice when negotiating the sale of their ventures to ensure “family agendas” are protected.

**Originality/value** – This study has extended the conceptual work of Howorth *et al.* surrounding the succession of family firms through MBOs and MBIs. Rather than relying on case study evidence alone, cross-sectional survey evidence was explored within a univariate statistical framework to explore gaps in the knowledge base relating to succession planning and business sale negotiation behaviour.

**Keywords** Family firms, Management succession, Management buy-outs, Management buy-ins, Negotiating

**Paper type** Research paper



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## Introduction

Harvey (2006, p. 2) has asserted that:

Among UK independent limited family companies over 40 per cent aim to pass on their business to the next generation, but in the economy as a whole only 4 per cent of businesses are inherited. The UK Small Business Service has estimated that businesses without plans for generation change have some 400,000 employees exposed to the threat of unemployment.

Ownership transfer, in one form or another, is assumed to be crucial to the success and continuity of the private business. The inability of private family owners to successfully transfer the business to new owners may lead to a rise in business closure rates, and to more limited pools of entrepreneurial knowledge (Stokes and Blackburn, 2001). To ensure business survival, owners of family firms may need to develop succession and estate planning (Beckhard and Dyer, 1983). More owners of private family firms, therefore, need to address the attitudinal, resource and operational barriers to inter-generational succession within the family (or dominant kinship group).

Evidence suggests that many owners of family firms are concerned with ensuring continued independent ownership (Westhead, 1997), and this can be achieved by transferring management and control to the next generation of family members (Lansberg, 1999; Morris *et al.*, 1997). The prime rationale for this inter-generational succession stems from the belief that family members are able to accumulate social capital, resources and specific knowledge on how to run the firm in a more efficient and profitable manner than would otherwise be possible (Bjuggren and Sund, 2001). In reality, many family firms face difficulties successfully transferring their businesses to the next generation (Lansberg, 1999). There may be no successor or suitably qualified successor. Further, the commitment of the chosen successor towards their family firm may be questioned (Sharma and Irving, 2005). Evidence from the USA suggests that 30 per cent of family firms survive into the second generation and only 15 per cent survive into the third (Kets de Vries, 1993; Ward, 1987). In addition to the succession event itself, concern has been raised surrounding the reluctance of family firm owners to effect inter-generational succession planning within the lifetime of the incumbent entrepreneur (Bachkaniwala *et al.*, 2001). Two-thirds of family firms actually fail to plan at all for generational succession (Cliffe, 1998). In these circumstances, where passing on the firm to another family member is not an option, ensuring the perpetuation of an organisation may require the family owning the business to exit (Willard *et al.*, 1992).

Studies have focused on the development of private family as well as issues relating to ownership succession issues (Shepherd and Zacharakis, 2000) and succession planning (Sharma, 2004; Zahra and Sharma, 2004; Westhead, 2003; Birley *et al.*, 1999; Birley, 1986)[1]. Nevertheless, gaps in the knowledge base exist relating to the succession (or exit) routes that do not involve the inter-generational transfer of business ownership from one generation of dominant family firm owners to the next generation of family members. Several succession (or exit) routes are available to owners of independent private firms (Howorth *et al.*, 2004; Stokes and Blackburn, 2001; Cromie *et al.*, 1995; Wright and Coyne, 1985). First, the private family firm can be passed on to another member of the family (i.e. inter-generational succession); second, the firm can be sold to another organisation through a trade sale; third, the firm can be floated on a stock exchange; fourth, the firm can be sold to members of the existing

management team (i.e. the management buy-out (MBO) includes internal and existing members of the management team prior to the sale of the private family firm); and finally, the firm can be sold to an external management team (i.e. a management buy-in (MBI)).

As earlier intimated, there may not be suitable family members willing or able to take on the ownership and management of the business, which is a widespread international problem (Wright *et al.*, 1992). The transfer of the family firm either through a trade sale or an initial public offering (IPO) are options that need to be considered by private family firm owners. There are, however, distinct drawbacks associated with these succession routes. A trade sale may be unattractive to family owners because it may mean that they are no longer involved in the purchased firm. The IPO succession route may be beyond the financial and technical competence of the existing owners of many family firms (Poutziouris, 2002). Owners of private family firms (i.e. vendors) may sell the business to the existing internal management team prior to the sale through a MBO, or to an external management team through a MBI. Recent evidence suggests that the latter succession routes are now being considered by owners of private family firms (Howorth *et al.*, 2004; Bachkaniwala *et al.*, 2001). Both the latter succession routes provide a means of realising the owner's investment combined with allowing continued independent ownership of the firm. An MBO is the purchase of a business by its existing management, usually in co-operation with outside financiers such as venture capital firms and banks. An attractive feature of an MBO is that the majority of the management team can remain intact (Wright and Coyne, 1985). Additionally, members of the family can continue to be involved in the firm albeit to a lesser degree. In an MBI, the firm is sold to managers who are external to the business, again possibly with outside financiers. MBIs will occur where family firms have no internal management successor. Whether internal or external managers become the new owners of the firm there is a greater possibility post-MBO/I that the firm's identity and ethos will remain the same, both of which are important considerations for family firm owners (Westhead, 1997) who want to, or have to, exit their business.

MBO/Is are a vital part of the economy. Evidence gathered by the Centre for Management Buy-out Research (CMBOR) suggests that they account for over a half of all takeover activity in the UK. Moreover, a fifth all MBO/Is across Europe relate to the take-over of family firms. Despite the scale of this phenomenon, most family firm studies have focused on the inter-generational transfer of ownership and control (Sharma and Irving, 2005; Sharma *et al.*, 2003a; Westhead, 2003; Handler, 1994). There is relatively little evidence relating to family firm succession via a MBO or a MBI.

Insights from several theoretical perspectives have been utilised to explore issues relating private family firm development and the MBO/I succession routes (Howorth *et al.*, 2004). Agency theory is often employed to investigate the links between ownership and management structure and the financial performance of firms (Westhead and Howorth, 2006a). Efficiencies may arise when risk bearing (i.e. ownership) and decision-making (i.e. management) are separated. It is assumed that efficiency gains will outweigh the agency costs associated with owners monitoring the actions and performance of managers (Fama and Jensen, 1983a, b, 1985). However, there is some debate about the usefulness of agency theory in a family firms context (Sharma, 2004; Arthurs and Busenitz, 2003; Astrachan, 2003; Greenwood, 2003;

Randoy and Goel, 2003; Schulze *et al.*, 2003). Howorth *et al.*(2004) have asserted that agency theory may only provide a partial explanation of private family firm dynamics. Agency theory focuses on firm level ownership and management issues. Ownership and management are viewed as dimensions of a performance-based system where rational economic objectives (i.e. profit maximisation) are assumed. The family system in private firms can increase ownership and management complexity (Neubauer and Lank, 1998). The family can be viewed as a part of a relationship-based system. Reported behaviour may not be economically rational because non-financial objectives prevail. In the latter context, the explanatory power of agency theory may be more limited, especially if “family agenda” goal congruence exists (Arthurs and Busenitz, 2003).

Howorth *et al.* (2004) explored management and ownership issues with regard to the MBO/Is of eight private family firms in England. Guided by insights from agency theory, trust theory and negotiation behaviour theory, they explored the sales of private firms to MBO and MBI teams. They found that the success of the deal hinged on good relationships and equal information between the vendor (i.e. family firm owners) and purchaser (i.e. the MBO or MBI team). Deals that were perceived to be beneficial from the lenses of the vendors and the purchasers were associated with close relationships between parties. Following the MBO/I, the former family firm owners were able to play an ambassadorial role in the acquired firms to maintain the former culture and identity. Family firm owners selecting the MBO or MBI succession routes can, therefore, ensure the survival of family firms. However, there is scant empirical evidence relating to information sharing and succession planning issues prior to the ownership change, and the role of management relating to the MBO and MBI succession routes. There is also a dearth of empirical evidence relating to the strategic objectives of the family owners during the MBO/I process. Practitioners may have an important role in the process. Again, there is limited evidence relating to the role of private equity providers (PEPs) in private family firms with regard to the MBO/I sale process.

This exploratory study seeks to provide fresh empirical evidence to the highlighted gaps in the knowledge base. It is the first study to explore a large dataset to examine information sharing and succession planning in private family firms that have selected MBO or MBI succession routes. A novel feature of the 117 responding purchased firms is that they were located in several European countries. Further, several testable hypotheses were derived from insights with reference to agency theory and theories relating to information asymmetries and negotiation behaviour. With regard to this conceptual platform, the following two broad research questions were explored:

- RQ1.* Do flows of information impact the succession planning process relating to family firms that select MBO or MBI succession routes?
- RQ2.* Do flows of information and the nature of succession planning impact the business sale negotiation process relating to family firms that select MBO/MBI succession routes?

The theoretical insights guiding the study are discussed in the following section. Several hypotheses are derived. The data collection process and the research methodology are discussed in the next section. Results are then presented. Finally, conclusions and implications are discussed.

## Theoretical insights and the derivation of hypotheses

### Context

Traditionally, agency theory is employed to explore the relationship between a firm's ownership and management structure and its financial performance. Where there is separation of ownership and control, agency control mechanisms are put in place to align the goals of managers with those of the owners. It is often assumed that this is a non-issue for private family firms, which are expected to have goal congruence due to closely held ownership and close relationships between family owners and managers. However, some family firms have very diverse ownership and control structures (Westhead *et al.*, 2001), which may impact on business development. With regard to the themes of ownership, management and family several "types" of family firms can be identified (Westhead and Howorth, 2006b). Consequently, an agency perspective focusing on the impact of information asymmetries arising from the separation of ownership and control and from the family/non-family relationships is appropriate to explore the succession planning behaviour of family firms.

Information flows between family firm owners and potential MBO/I team members can be shaped by the inter-linkages between the family, ownership and management systems. Most notably, members of the dominant family-owning the firm may solely discuss information relating to the firm within the family system. This may create an imbalance of information in favour of the family members. Family owners, who are also managers, may be reluctant to transfer their tacit knowledge to "outsiders" (i.e. managers who have no kinship links with the owners), especially if the original intention of the family firm owners was to pursue inter-generational succession. Schulze *et al.* (2003) argue that the dispersion of ownership in family-held firms can drive a wedge between the interests of the family members who lead a firm and other family owners. In addition, Chua *et al.* (2003) suggest that the relationship between family owners and management increase in importance with greater business size and with the criticality of management to the business.

If family members engage in succession planning the process may subsequently proceed more smoothly (Morris *et al.*, 1996). The sharing of information between various stakeholders in the family (i.e. family owners and managers as well as non-family managers) can be complex and may be linked to the succession planning process. Sharma *et al.* (2003b) detected that the succession process was driven by the availability of a willing and trusted successor rather than a genuine desire to retain the business in the family. The family firm succession process itself can be problematical, particularly if the key owner of the firm refuses to delegate responsibilities to successors, or to let go. Further, the process is difficult if there is resentment and jealousy among the offspring of the key owner, and where different generations of owners do not share the same values and traditions (Dyer and Handler, 1994).

The owners of the family firm may prefer to sell their equity in the business to managers who they already know (i.e. managers who are outside the family but who are already involved inside the firm in running the business). Inside management who have worked with the key owner/founder for some time may have developed relationships of trust that enable them to obtain rich flows of information. Incumbent managers may also become familiar with the detailed operations of the firm, especially where the key founders/owners of the firm have become more distant from the business. Conversely, a management team that is both outside the family and external to the business (i.e. a MBI

team) may have less access to appropriate flows of information relating to key aspects of the organisation, even though these external managers may have considerable in-depth industry knowledge (Robbie and Wright, 1995). External management is, in addition, less likely to have developed relations of trust with the key founders/owners.

If various ownership and management parties involved in a family firm engage in succession planning they may have an impact on the negotiation process relating to the sale of the venture. Negotiation behaviour may be influenced by whether the parties concerned emphasise individual or joint gains (Dabholkar *et al.*, 1994). A distinction can also be made between competitive, command and coordinative behaviour (Howorth *et al.*, 2004). With regard to competitive behaviour, both vendor (i.e. family firm owners) and purchaser (i.e. the MBO or MBI team) are interested in maximising their own positions, taking a short-term perspective. Under command behaviour, the vendor may seek to maximise individual gains, but may be committed to the future success of the firm. However, with reference to coordinative behaviour, there is a focus on joint gains and the maintenance of long-term relationships between purchasers and the vendors.

#### *Succession planning in private family firms*

Family firm owners, internal and external management, and PEPs could all potentially be involved in the succession planning process. If the planning is carried out in an atmosphere of trust and respect a mutually beneficial succession route can be discussed and planned. Moreover, if an MBO succession route is selected, existing management, by virtue of being insiders, may have built up greater knowledge of the business and a relationship of trust with the family owners that leads to them being brought into discussions about succession. Conversely, external management who secure an MBI may not be privy to all appropriate information prior to the purchase of the family firm because they are less well-known and trusted (Robbie and Wright, 1995). This discussion suggests the following hypotheses:

- H1. The MBO/I succession route will be associated with lower information asymmetry problems if family firm owners and the management team are equally involved in succession planning.
- H2. Family firms selecting an MBO succession route will report greater involvement by existing management in succession planning than firms selecting an MBI succession route.

#### *Business sale negotiation behaviour in private family firms*

Relationships between owners and management can have an impact on negotiation behaviour during the business sale process (Howorth *et al.*, 2004). If owners and managers are both committed to the long-term future of the firm and have good relationships, they may be more likely to work well together during the succession process. Negotiations may be coordinative and associated with flexibility, extensive information sharing and two-way communication. However, if owners and managers are more interested in short-term personal gains, negotiations may be less productive. Family owners may be reluctant to share information if they do want (or are not allocated) some form of continued involvement in the business after the sale of the venture. Conversely, greater information sharing is expected if family owners expect long-term involvement in the firm after the MBO/I. If information is not shared

between owners and managers it may be difficult to negotiate a mutually agreed price. Further, management teams that do not play an active and/or an equal role in succession planning discussions may be less likely to negotiate a mutually agreed price. A paternalistic owner may simply offer management a fixed price, which the owner perceives to be a “fair” price, depending on their time-horizon. In contrast, a dominant family firm owner focusing on short-term interests may propose a fixed price that maximises their own (family) gain.

The involvement of PEPs in succession planning discussions may reduce the probability of a mutually agreed price being agreed between family owners and MBO/I teams. Venture capital firms experienced in negotiating MBO/Is may be in a stronger position to negotiate with the family owners than are internal management team members, who are likely to be undertaking a MBO for the first time. If family owners propose a price that maximises their interests, a venture capital firm may be in a stronger position to challenge and reduce the proposed price. In contrast, internal managers may be reluctant to engage in price bartering discussions with family firm owners. Management team members may have no prior managerial or business ownership experience to leverage, and they may be concerned if the negotiations do not go well the deal may be lost, and they may lose their existing jobs (Wright and Coyne, 1985). Where management is in a stronger position to drive the succession and negotiation process, for example where the owner is less involved in running the business (Howorth *et al.*, 2004), the venture capital firm may help negotiate a price that is more advantageous to them. This discussion suggests the following hypotheses:

- H3.* A mutually agreed sale price between family firm owners and management is likely if they are both committed to the future of the family firm.
- H4.* A mutually agreed sale price between family firm owners and management is unlikely if information surrounding the family firm is not equally shared.
- H5.* A mutually agreed sale price between family firm owners and the management is unlikely if the succession planning issues are not discussed equally between them.
- H6.* A mutually agreed sale price between family firm owners and the management is unlikely if a PEP is involved in discussions regarding succession planning.

### **Data collection and research methodology**

A unique database was utilised to identify a random sample of private family firms that had reported a MBO or MBI. The sample was derived from the CMBOR database that effectively comprises the population of MBOs and MBIs across Europe. A twice-yearly survey of private equity and venture capital firms, intermediaries and banks is conducted to obtain details on new MBOs and MBIs completed. Respondents are incentivised to supply data with a free copy of a review of the market. Press and annual company reports are used to gather additional data as well as to validate information gathered from other sources. This study focuses on private family firms that received venture capital and the MBO/I deals were completed between 1994 and 2003.

A growing consensus suggests that a family firm is one that is owned by a dominant kinship group where the owners operate their firm as a family business (Westhead and Cowling, 1998). A fairly broad family firm definition was operationalised. A firm was regarded as a family firm if both the following criteria were met prior to the MBO/I:

- more than 50 per cent of the ordinary voting shares were owned or controlled by a single family group related by blood or marriage; and
- the firm was perceived to be a family business.

Guided by the conceptual platform and discussions with practitioners, a questionnaire was designed to explore several issues relating to the family firm MBO/I succession routes. The questionnaire was designed in English. Variations in practice in each country in Europe were considered during the questionnaire design process. The questionnaires was translated into French, German, Italian and Spanish and then back translated into English. Face and content validity issues were considered during a pilot study. A total of 20 family firms that had been the subject of a venture-backed MBO or MBI were contacted. Senior management in the acquired private family firms who were involved in negotiating the MBO/Is were contacted. After the pilot study, one question was slightly modified.

The postal questionnaire survey was conducted between June and September 2004. Senior management in the acquired private family firms who were involved in negotiating the MBO/Is possessed the detailed information requested, and they were regarded as the key informants (Kumar *et al.*, 1993). The questionnaire was, therefore, mailed to the chief executive officer (CEO) of these former family firms that had effected succession through a venture backed MBO or MBI. Two weeks after the first mailing, a reminder was sent to the non-respondents. A week later each non-respondent was contacted by telephone by skilled interviewers located in CMBOR. Further reminders were administered from the European Private Equity and Venture Capital Association (EVCA). In total, 1,645 firms were sent a questionnaire. As a result of these efforts, information was gathered from 117 MBO/Is, which equates to a 7 per cent response rate. This response rate is in line with surveys of this kind in Europe (Bygrave *et al.*, 1994). Information was gathered from the following respondents: 84.3 per cent were CEOs/presidents, 5.6 per cent were directors, including deputy CEO, and the remaining 10 per cent were senior management.

If additional resources had been available senior management in the non-responding acquired private family firms could have been contacted to obtain a profile of their demographic characteristics and motivations. This richer data would have allowed the issue of “family firm senior management self-selection bias” to be rigorously explored. Non-respondents who have exhibited the reluctance to respond to a survey may, however, be unwilling to respond to further data requests, even when the data requested is basic and more limited. The non-response issue is, therefore, difficult to address. Responses to the survey were compared with the population of family MBO/MBIs held on the CMBOR database. No marked difference was detected when the survey responses were compared with national population patterns (Table I). The industrial distribution of survey responses was generally in line with the overall population (Table II). Firms engaged in construction activities were slightly over-represented, whilst firms engaged in computing/electronics were slightly



Country	Venture capital-backed private family buy-outs		Total number of questionnaires sent	Total number of questionnaires returned	Per cent of all returns
	Total number	Per cent			
Austria	6	0.30	5	0	0.00
Belgium	28	1.40	25	0	0.00
Denmark	15	0.75	15	3	2.56
Eire	5	0.25	5	0	0.00
Finland	20	1.00	19	2	1.71
France	282	14.11	193	9	7.69
Germany	110	5.51	88	7	5.98
Italy	87	4.35	71	8	6.84
Lithuania	1	0.05	0	0	0.00
The Netherlands	58	2.90	43	1	0.85
Norway	8	0.40	7	1	0.85
Poland	2	0.10	1	0	0.00
Portugal	5	0.25	2	0	0.00
Romania	2	0.10	2	0	0.00
Slovenia	1	0.05	0	0	0.00
Spain	68	3.40	60	3	2.56
Sweden	30	1.50	28	3	2.56
Switzerland	28	1.40	25	3	2.56
UK	1,242	62.16	1,056	77	65.81
Total	1,998	100	1,645	117	100

**Table I.**  
Response by country

under-represented. This information suggests that the sample of surveyed firms may be representative of the population of firms. The survey gathered information from 66 MBOs (56 per cent) and a further 51 MBIs (44 per cent).

We were aware that sample size could impact on a statistical test selected to explore whether an effect exists (i.e. a difference between respondents reporting a “yes” rather than a “no” response to a statement). A statistical test may be insensitive (at small sample sizes) to real differences (Hair *et al.*, 1995). To avoid ignoring potentially important real differences, several technical issues were considered: sample size, statistical power (i.e. the probability of correctly rejecting the null hypothesis when it should be rejected), and significance level (i.e. alpha) (Hair *et al.*, 1995). Statistical power and sample size should determine the significance level (i.e. the probability that the null hypothesis is correct) selected. Following the precedent of previous exploratory studies, we sought to avoid Type II errors (i.e. accepting the null hypothesis when it should be rejected). Therefore the 0.1 level of significance was selected to test for differences (Hair *et al.*, 1995, p. 12).

Information relating to information sharing was gathered from 115 surveyed respondents. A total of 49 respondents (43 per cent) reported that the vendor and management shared relevant information equally. A further 66 respondents suggested information was not shared equally (57 per cent). With regard to the latter group, 24 respondents (21 per cent) suggested the vendor controlled all of the information; 24 respondents (21 per cent) indicated that the vendor controlled most of the information;

Industrial sector	Survey responses (%)	CMBOR database (%)
Biotechnology	0.0	0.1
Computing/electronics	8.6	12.5
Consumer related	23.1	23.1
Construction	9.4	3.1
Energy	0.0	0.4
Industrial products/services	10.3	13.4
Manufacturing	22.2	19.9
Medical/health related	6.0	3.6
Services	10.3	13.4
Transportation	2.6	2.5
Other	7.7	8.1

**Table II.**  
Comparison of industrial  
distribution

15 respondents (13 per cent) suggested that management controlled most of the information; and a further three respondents (2 per cent) reported that they controlled all the relevant information. A significantly larger proportion of MBO rather than MBI respondents indicated that the “vendor and management shared relevant information equally” (52 per cent compared with 31 per cent, chi-square significance level = 0.03). Conversely, a significantly smaller proportion of MBO rather than MBI respondents reported that the “vendor controlled most of the relevant information” (13 per cent compared with 31 per cent, chi-square significance level = 0.01).

Information relating to agreement about price was gathered from 114 surveyed respondents. A total of 61 respondents reported that a mutually agreed price had been negotiated (54 per cent), whilst the remaining 53 respondents indicated a mutually agreed price had not been negotiated (46 per cent). In total, 31 respondents (27 per cent) reported the vendor proposed a fixed price that maximised their valuation, whilst a further 13 respondents (11 per cent) reported that the vendor had suggested a fair price that was in the best interests of the company. Five respondents (4 per cent) reported that the management proposed a fixed price, three respondents (3 per cent) reported the vendor required management to match an outside bid, and one respondent (1 per cent) indicated that the vendor offered the company to management at a lower price than an external bid.

Information relating to succession planning was gathered from 115 surveyed respondents. In total, 25 respondents (22 per cent) reported that there had been no succession planning at all, 52 respondents (45 per cent) reported that the planning had taken place one year or less before succession, 23 respondents (20 per cent) reported that succession planning had taken place two years before the succession, whilst the remaining 15 respondents (13 per cent) reported that succession planning had taken place three or more years before the succession.

The sample size issue influenced the selection of statistical tests utilised to test the presented hypotheses. As widely used in family firm studies (Westhead *et al.*, 2001), this study used bivariate non-parametric statistical tests to identify statistically significant differences between respondents. Non-parametric tests have less rigorous assumptions than parametric tests (de Vaus, 1991), do not depend on assumptions

about the precise form of the distribution of the sampled population, and can be used on data from a variety of measurement scales. These tests are appropriate when analysing small samples and where samples are of different sizes, and the variances are unequal or heterogeneous (Bryman and Cramer, 1990). Chi-square tests were used to identify differences between respondent who reported “yes” or “no” responses with regard to selected statements, while Mann-Whitney “U” tests were used in relation to variables measured on five-point Likert scales.

## Results

### *Overview*

Results from the non-parametric statistical tests are summarised in Table III. The results are discussed in the following sections.

### *Succession planning*

Respondents were asked to report “yes” or “no” responses to five statements relating to succession planning. A distinction was made between respondents reporting “information was not shared equally” and those that indicated that “information was shared equally” with regard to succession planning. Table IV shows that two statistically significant differences were detected. A larger proportion of “information was not shared equally” respondents (43 per cent) rather than “information was shared equally” respondents (25 per cent) cited “management not involved at all”. A weakly significantly smaller proportion of “information was not shared equally” respondents (13 per cent) compared with “information was shared equally” respondents (25 per

Hypothesis	Definition	Hypothesis supported
H1	The MBO/I succession route will be associated with lower information asymmetry problems if family firm owners and the management team are equally involved in succession planning	Supported
H2	Family firms selecting an MBO succession route will report greater involvement by existing management in succession planning than firms selecting an MBI succession route	Supported
H3	A mutually agreed sale price between family firm owners and management is likely if they are both committed to the future of the family firm	Weakly supported
H4	A mutually agreed sale price between family firm owners and management is unlikely if information surrounding the family firm is not equally shared	Weakly supported
H5	A mutually agreed sale price between family firm owners and the management is unlikely if the succession planning issues are not discussed equally between them	Weakly supported
H6	A mutually agreed sale price between family firm owners and the management is unlikely if a private equity provider (PEP) is involved in discussions regarding succession planning	Supported

**Table III.**  
Summary of hypotheses supported

Statement <sup>a</sup>	Information not shared equally (n = 63)		Information shared equally (n = 48)		Degrees of freedom	Chi-square statistic	Sig. <sup>b</sup>
	No.	%	No.	%			
Management not involved at all: yes	27	42.9	12	25.0	1	3.812	0.05
Management and vendors discussed succession, process driven by vendor: yes	16	25.4	15	31.3	1	0.464	0.50
Management and vendors discussed succession, process evenly balanced: yes	8	12.7	12	25.0	1	2.791	0.10
Management and vendors discussed succession, process driven by migt: yes	7	11.1	5	10.4	1	0.014	0.91
Management instigated process by approaching vendor with an offer: yes	5	7.9	4	8.3	1	n.a. <sup>c</sup>	

**Notes:** <sup>a</sup> Vendor is synonymous with the family firm owner; <sup>b</sup> Pearson chi-square asymptotic significance level (two-tailed test); <sup>c</sup> the assumptions of the test were violated and it was not possible to compute a chi-square statistic

**Table IV.**  
Information sharing and succession planning

cent) suggested “management and vendors discussed succession, process evenly balanced”. This evidence supports *H1*.

Respondents were asked to report “yes” or “no” responses to five statements relating to the role of management in the succession planning process. Table V shows that three statistically significant differences were detected. A significantly larger proportion of MBI (50 per cent) rather than MBO (23 per cent) respondents indicated “management not involved at all”. Conversely, significantly smaller proportions of MBI rather than MBO respondents reported that the “management and vendors discussed succession, process evenly balanced” (8 per cent compared with 27 per cent), and the “management and vendors discussed succession, process driven by management” (4 per cent compared with 16 per cent). This evidence supports *H2*.

#### *Business sale negotiation behaviour*

Information was gathered with regard to 11 strategic objectives cited during the sale process prior to the MBO/I. The degree of importance respondents attached to each objective was measured on a five-point Likert scale, where “very low importance” was scored 1 and “very high importance” was scored 5. Responses made by “no mutually agreed price” and “mutually agreed price” respondents are summarised in Table VI. Two statistically significant differences were detected. “Mutually agreed price” respondents attached significantly more importance to “return on shareholder equity” (means of 3.6 and 3.1 for “mutually agreed price” and “no mutually agreed price” respondents, respectively) and “market value increment” (means of 3.7 and 3.0 for “mutually agreed price” and “no mutually agreed price” respondents, respectively). *H3* is, therefore, weakly supported.

Respondents were asked to report “yes” or “no” responses to five statements relating to information sharing and the sale process. A distinction was made between respondents reporting “no mutually agreed price” and those suggesting a “mutually agreed price”. Table VII shows that only one statistically significant difference was detected. A statistically smaller proportion of “mutually agreed price” respondents (7 per cent) rather than “no mutually agreed price” respondents (19 per cent) suggested that the “management controlled most of the relevant information”. This evidence provides some support for *H4*.

Respondents were asked to report “yes” or “no” responses to five statements relating to the role of management with regard to the sale process. Table VIII shows that only one weakly significant difference was detected. A smaller proportion of “mutually agreed price” respondents (21 per cent) rather than “no mutually agreed price” respondents (35 per cent) suggested that the “management and vendors discussed succession, process driven by vendor”. This evidence weakly supports *H5*.

Respondents were asked to report “yes” or “no” responses to five statements relating to the role of the private equity provider (PEP) with reference to the sale process. Table IX shows that two statistically significant differences were detected. A smaller proportion of “no mutually agreed price” respondents (30 per cent) rather than “mutually agreed price” respondents (50 per cent) suggested that the “private equity provider was not involved at all”. Conversely, a weakly significantly larger proportion of “no mutually agreed price” respondents (26 per cent) rather than “mutually agreed price” respondents (12 per cent) suggested that the “private equity provider discussed succession with the vendor and the management”. *H6* is, therefore, supported.

Statement <sup>a</sup>	MBI (n = 50)		MBO (n = 62)		Degrees of freedom	Chi-square statistic	Sig. <sup>b</sup>
	No.	%	No.	%			
Management not involved at all: yes	25	50.0	14	22.6	1	9.169	0.00
Management and vendors discussed succession, process driven by vendor: yes	17	34.0	14	22.6	1	1.803	0.18
Management and vendors discussed succession, process evenly balanced: yes	4	8.0	17	27.4	1	6.852	0.01
Management and vendors discussed succession, process driven by mgmt: yes	2	4.0	10	16.1	1	4.256	0.04
Management instigated process by approaching vendor with an offer: yes	2	4.0	7	11.3	1	n.a. <sup>c</sup>	

**Notes:** <sup>a</sup> Vendor is synonymous with the family firm owner; <sup>b</sup> Pearson chi-square asymptotic significance level (two-tailed test); <sup>c</sup> the assumptions of the test were violated and it was not possible to compute a chi-square statistic

**Table V.**  
Role of management in the succession planning process

**Table VI.**  
Strategic objectives cited during the sale process prior to the MBO/I

Strategic objective	No mutually agreed price				Mutually agreed price				Sig. <sup>b</sup>
	Mean <sup>a</sup>	No.	Median	S. dev.	Mean <sup>a</sup>	No.	Median	S. dev.	
Sales growth	4.24	49	4	0.85	4.10	58	4	0.91	0.42
Net profit from operations	4.33	51	5	0.89	4.43	58	5	0.88	0.39
Cash flow from operations	4.14	51	4	0.98	4.26	57	5	0.86	0.58
Return on shareholder equity	3.10	51	3	1.27	3.61	56	4	1.12	0.04
Capital restructuring	2.26	50	2	1.29	2.21	56	2	1.20	0.94
Short-term profitability	3.25	51	3	1.37	3.11	56	3	1.30	0.63
Long-term profitability	4.12	51	5	1.11	4.14	57	4	0.99	0.88
Market value increment	3.04	50	3	1.37	3.67	57	4	1.39	0.02
Market share expansion	3.14	51	3	1.31	3.40	57	4	1.15	0.30
To accumulate family wealth	3.30	50	3	1.30	3.13	55	3	1.56	0.69
To increase employment	2.14	50	2	1.09	2.14	56	2	1.00	0.88

**Notes:** <sup>a</sup> Mean calculation based on a five-point scale from 1 = very low importance to 5 = very high importance; <sup>b</sup> Mann-Whitney asymptotic significance level (two-tailed test)

## Conclusions and implications

### *Key findings*

This study has highlighted an important gap in the knowledge base relating to the range of exit routes that can be selected by the owners of private family firms. Presented findings extend understanding of the succession process in family businesses (Sharma, 2004), and shed light on the feasibility of alternatives to inter-generational succession (Stokes and Blackburn, 2001). Rather than relying on case study evidence alone (Howorth *et al.*, 2004), this study has provided fresh empirical evidence from a random sample of private family firms in Europe that had selected MBO or MBI exit routes rather than inter-generational succession. This study has extended the conceptual work of Howorth *et al.*(2004) regarding the succession of family firms through MBOs and MBIs. Several theoretically derived hypotheses were tested. With reference to a unique sample of firms located across Europe this exploratory study used non-parametric techniques to test presented hypotheses. Table III shows that three hypotheses were supported and a further three hypotheses were weakly supported. The results emphasise the importance of information sharing. Most notably, evidence suggests that the family owner(s) may not always be in the strongest position when selling the family firm. This study also extends the work of Chua *et al.*(2003) who highlighted the criticality of management in family firms. Evidence from this exploratory study confirms that management with greater access to information can influence the negotiation process. Further, management can influence who is more likely to benefit from the price to be paid for the family firm. In addition, this study extends the work of Sharma *et al.*(2003b). This study has highlighted the importance of identifying a willing and trusted successor, rather than focusing solely on retaining the business in the family.

### *Implications for family firms*

This study has highlighted that conflicts of self-interest between family firm owner(s) and the incumbent or external management, who are about to take over the family

Statement <sup>a</sup>	No mutually agreed price (n = 52) No. %	Mutually agreed price (n = 61) No. %	Degrees of freedom	Chi-square statistic	Sig. <sup>b</sup>
Vendor controlled all the relevant information: yes	12 23.1	11 18.0	1	0.441	0.51
Vendor controlled most of the relevant information: yes	11 21.2	13 21.3	1	0.000	0.98
Vendor and management shared relevant information equally: yes	19 36.5	30 49.2	1	1.827	0.18
Management controlled most of the relevant information: yes	10 19.2	4 6.6	1	4.154	0.04
Management controlled all the relevant information: yes	0 0.0	3 4.9	1	n.a. <sup>c</sup>	

**Notes:** <sup>a</sup> Vendor is synonymous with the family firm owner; <sup>b</sup> Pearson chi-square asymptotic significance level (two-tailed test); <sup>c</sup> the assumptions of the test were violated and it was not possible to compute a chi-square statistic

**Table VII.**  
Information sharing and the sale process



**Table VIII.**  
Role of the management  
with regard to the  
sale process

Statement <sup>a</sup>	No mutually agreed price (n = 52)		Mutually agreed price (n = 58)		Degrees of freedom	Chi-square statistic	Sig. <sup>b</sup>
	No.	%	No.	%			
Management not involved at all: yes	16	30.8	22	37.9	1	0.622	0.43
Management and vendors discussed succession, process driven by vendor: yes	18	34.6	12	20.7	1	2.681	0.10
Management and vendors discussed succession, process evenly balanced: yes	8	15.4	13	22.4	1	0.877	0.35
Management and vendors discussed succession, process driven by mgmt: yes	7	13.5	5	8.6	1	0.661	0.42
Management instigated process by approaching vendor with an offer: yes	3	5.7	6	10.4	1	n.a. <sup>c</sup>	

**Notes:** <sup>a</sup> Vendor is synonymous with the family firm owner; <sup>b</sup> Pearson chi-square asymptotic significance level (two-tailed test); <sup>c</sup> the assumptions of the test were violated and it was not possible to compute a chi-square statistic

Statement <sup>a</sup>	No mutually agreed price (n = 50)	Mutually agreed price (n = 58)	Degrees of freedom	Chi-square statistic	Sig. <sup>b</sup>
	No. %	No. %			
Private equity provider not involved at all: yes	15 30.0	29 50.0	1	4.449	0.04
Vendor approached PEP to discuss succession: yes	9 18.0	8 13.8	1	0.358	0.55
PEP discussed succession with management: yes	9 18.0	10 17.2	1	0.011	0.92
PEP discussed succession with the vendor and the management: yes	13 26.0	7 12.1	1	3.454	0.06
PEP made proactive approach to vendor before succession: yes	4 8.0	4 6.9	1	n.a. <sup>c</sup>	

**Notes:** <sup>a</sup> Vendor is synonymous with the family firm owner; <sup>b</sup> Pearson chi-square asymptotic significance level (two-tailed test); <sup>c</sup> the assumptions of the test were violated and it was not possible to compute a chi-square statistic

**Table IX.**  
Role of the private equity provider (PEP) with regard to the sale process

firm, can retard and/or tarnish the succession planning and the sale process from the lenses of the vendors (i.e. family firm owners) and the purchasers (i.e. MBO or MBI teams). In some instances, the mediating contribution of an independent professional advisor is warranted. Evidence suggests when vendors and purchasers discuss succession equally there are fewer problems associated with information asymmetry, highlighting the importance of succession planning. A mutually agreed price was found to be linked to contexts where management controlled most of the relevant information. This finding confirms qualitative evidence (Howorth *et al.*, 2004) that the internal management team can be in a stronger position. Moreover, if the acquiring management teams leverage the resources and the management expertise of private equity providers this can, in some instances, increase the bargaining power of the acquiring management team at the expense of the vendors. More vendors of family firms may, therefore, need to leverage external professional advice when negotiating the sale of their ventures to ensure “family agendas” are protected.

#### *Implications for MBO and MBI managers*

Presented evidence suggests that incumbent internal managers need to make themselves aware of the aims of the owner(s) of family firms. Management needs to appreciate that they can leverage their information relating to the family firm, which may not be possessed by the family owner(s). In some instances, the family firm vendors can control the flow of information surrounding the assets (and liabilities) of the family firm. External management teams need to address information asymmetry issues (Robbie and Wright, 1995). The onus is on MBI teams to conduct pre-purchase due diligence evaluations to ensure all essential information is analysed. External management may be able to obviate some of these difficulties by targeting family firms with whom they have developed relationships, as well as involving some incumbent management as equity-holders in the transaction.

#### *Implications for consultants*

Consultants could play a proactive role in highlighting the need for succession planning well in advance of a family firm succession crisis (i.e. the death of a CEO). To ensure the protection of jobs in surviving competitive firms, consultants may have a role in drawing the attention of family owners to the range of ownership transfer options, particularly, for those firms where inter-generational succession options are not feasible (i.e. there are no family successors or successors are not willing to join the family firm). In some instances, consultants may need to convince some family firm owners that the family business is a saleable asset. Further, consultants can play a crucial role in convincing family owners that a MBO/I may be both feasible and acceptable (i.e. “family agendas” are protected) in ensuring the continuation of the business. As earlier intimated, family firm vendors should utilise consultants to ensure a mutually agreed price is paid, particularly when the internal management team is in a stronger bargaining position due to their broader knowledge of the assets of the family business. Family firm owners may need consultants who have specialist skills in negotiating MBO/Is that go beyond simply the provision of tax planning and similar services.

Internal and external management teams members may also require professional advice, particularly if they have no prior business purchase experience to leverage. Management teams may need advice surrounding the venture capital firms that will

provide the most appropriate support because the latter firms have different strengths in terms of reputation, business sector and general management experience. Presented evidence has highlighted that a mutually agreed price between the vendors and the purchasers was less likely when a PEP had been involved in succession planning discussions. MBO/I teams seeking to maximise their interests should, therefore, utilise the skills and knowledge of the latter type of consultants. This evidence suggests that more MBO/I management teams should use the intermediary skills of venture capital consultants to ensure their interests are protected.

#### *Implications for further research*

Enterprise scholars need to present an evidence base that can guide practitioner resource allocation decisions. Scholars need to present clear research questions and theoretically derived hypotheses. This exploratory study is associated with several limitations that can be addressed in additional studies. First, information was gathered from the senior members of the management teams that had purchased the private family firms. Validity issues could be explored in future studies that gather information from all the stakeholders in the succession process including the lenses of the family and the venture capital participants. Second, evidence was gathered from a cross-sectional survey. Longitudinal qualitative and quantitative studies are warranted to explore in more detail the “why”, “how” and “so what” questions. Third, by conducting this exploratory study an important gap in the knowledge base relating to the linkage between high business “failure” rates and information imbalances between family owners and external management was detected (CMBOR, 2004). The failure rate for MBOs of family firms completed over the 1990 to 1995 period was 13.3 per cent (13.3 per cent for all MBOs) compared with a 19.4 per cent rate (17.5 per cent for all MBIs) for MBIs of family firms (CMBOR, 2005). The reasons for the higher failure rate in family firm MBIs need to be explored. Fourth, the unit of analysis in this study was private family firms, which had been acquired by MBO/I teams that had been venture capital backed. Future research needs to consider differences between the processes of sale to an MBO/I team, sale to a corporate acquirer and succession to other family members. Comparative studies are warranted that shed light on differences in negotiations between owners and management in the absence of private equity providers. Fifth, there may be differences across countries and institutional environments with respect to the acceptability and feasibility of succession outside the dominant kinship group. Where takeover markets are relatively weak, as in some continental European countries, acceptability that a family firm is an asset that is transferable in the market place may be difficult (Wright *et al.*, 1992). Wider family networks may be more important in some countries, raising issues about the sale to distant relatives in preference to incumbent managers. Theoretically derived hypotheses, therefore, need to be explored within univariate and multivariate statistical frameworks in a variety of national, cultural and industrial settings. Finally, this study only analysed responses from the senior members of acquiring MBO/I management teams that had completed a deal with family firm owners. This selection bias issue needs to be explored in studies that monitor processes when the deal is not completed with family firm owners. Again, studies are warranted to explore in detail the “why”, “how” and “so what” questions.

**Note**

1. The family firm definition operationalised in this study is discussed in the following section relating to data collection and research methodology.

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