

# **SUCCESSION IN FAMILY BUSINESSES IN SOUTH AFRICA: A COMPARATIVE STUDY OF OWNER-MANAGERS AND SUCCESSORS**

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## **ABSTRACT**

Family businesses are fast becoming the dominant form of business enterprise in both developing and developed economies and play a vital economic and social role in these economies. As family businesses are a primary contributor to the economic and social wellbeing of all capitalist societies, their general lack of longevity is a cause for concern. One of the main reasons (if not the single most important reason) of the high failure rate among first- and second-generation family businesses is their inability to manage the complex process of ownership and management succession from one generation to the next. Hence, the primary objective of this study is to identify the factors that impact on successful succession. The results suggest that the willingness of the successor to take over the family business and undertaking estate planning are important to the success of succession for both owner-managers and successors.

## **INTRODUCTION**

South Africa, as is the case with most developing countries, has to deal with a burgeoning unemployment problem. Recent figures (2002) indicate that up to 37% of households in South Africa survive on less than R1000 per month (Woolard 2002). Poverty and unemployment are closely linked, in that 53% of the South African population falling in the poorest quintile are unemployed, compared to 4% of the most affluent 20% of the population.

It is important for South Africa's future stability to find solutions to the unemployment problem in order to give poor South Africans some means of sustained income generation. Unfortunately, existing large corporations and the public sector have proved themselves unable to address the endemic problems of unemployment and poverty. Hence, the focus is increasingly shifting to the role the small business sector can play in solving the economic problems facing the country.

Approximately 80% of businesses in South Africa could be classified as family businesses (Ackerman 2001:325), which are mostly small to medium-sized (Maas 1999:2; Magretta 1998:114). In fact, family businesses are fast becoming the dominant form of business enterprise in both developing and developed economies and play a vital economic and social role in these economies. The influence and number of family businesses can be expected to increase substantially in the near future. This rapid growth could be attributed to the rationalising process taking place in many large corporations, together with the growing inability of the formal sector to create new jobs. Family businesses can therefore offer powerful opportunities for further economic growth in South Africa.

## **PROBLEM STATEMENT AND OBJECTIVES**

As family businesses are a primary contributor to the economic and social wellbeing of all capitalist societies, their general lack of longevity is a cause for concern. It has been estimated that, internationally, only 30% of family businesses survive to the second generation, while fewer than 14% make it beyond the third generation (Bjuggren & Sund 2001:12; Fleming 1997). In South Africa, only one in four family businesses survive into the second generation, while only one in ten makes it to the third generation (Engine of growth 1994:25; Hugo 1996:8). The social cost of this high failure rate has contributed to negative social and economic growth in South Africa.

According to several authors, the main reasons (if not the single most important reason) for the high failure rate among first- and second-generation family businesses is their inability to manage the complex process of ownership and management succession from one generation to the next (Corbetta & Montemerlo 1998:8; Fleming 1997:46; Leach 1994:147). This inability is particularly true at the time of transition between the founder and the next generation.

Against this background, it is clear how important it is to identify the factors that influence succession in family businesses and to address succession proactively, to ensure the survival of more family business so that they can play their rightful economic and social roles in the South African economy. The more successful the transition, the better the chances of the survival and long-term profitability of these businesses. A well-considered and well-planned succession will maximise the chances of finding a competent successor and will ensure a smooth leadership transition between generations (Neubauer & Lank 1998:133,157,164).

Hence, the primary objective of this study is to identify the factors that impact on successful succession. The possible influence of various factors (independent variables such as family harmony, estate planning and governance structures) on the dependent variable, namely the Perceived success of the succession process are theoretically modelled and empirically tested.

This study will not only test the existence and magnitude of these relationships, but also compare and contrast which of these factors are important for two major stakeholder groups in the succession process, namely owner-managers and successors. It is important for the continued prosperity of the family business and harmony within the family that family business leaders and all stakeholders have a sound understanding of the critical success factors for succession.

## **THEORETICAL BACKGROUND**

### **The independent variables**

Based on exhaustive literature review and qualitative interviews with family business member the following independent variables were identified (Venter 2003):

1. Willingness of the successor to take over the family business (WILLING)
2. Family harmony (HARMONY)
3. Governance processes and planning (GOVERNANCE)
4. Owner-manager's outside interests (INTEREST)
5. Internal preparation level of the successor (INTERNAL PREP)
6. Financial security of the business and owner-manager (SECURITY)
7. Trust in the successor's abilities and intentions (TRUST)
8. Relationship between owner-manager and successor (RELATION)
9. Estate planning (ESTATE)
10. External preparation level of the successor (EXTERNAL PREP)
11. Agreement to continue the business (AGREE)

### **The dependent variable**

Handler (1989:216), Sharma (1997:11) and Stempler (1988) suggest that the satisfaction of predecessor, successor, and other family members with the succession process can be used as an indication of the perceived success of the succession process. Others, such as Harvey and Evans (1995:12) and Hume (1999:22), recommend that not only the satisfaction of various stakeholders with the succession process defines a successful succession, but also the successor's ability to keep the family business healthy by means of sustained growth and continued profitability. It therefore appears that in order to ensure the success of the succession process, all the different stakeholders involved in the process (the predecessor, successor, family, network, suppliers, etc.) must be satisfied with its outcomes, and the successor should have the ability to ensure the sustainability and financial security of the family business after the succession process has been completed. This paper therefore focuses on the two main players in the succession process, namely the owner-manager and his/her successor.

## **METHODOLOGY**

A theoretical model of factors that influence successful succession (the independent variables) was tested by means of a large-scale empirical study. A questionnaire with 104 items was developed making use of a 7-point Likert-type scale. These questionnaires were

mailed to a convenience sample of 2458 respondents in 1038 small and medium-sized family businesses (employing less than 200 workers) in South Africa. A total of 332 usable questionnaires were returned.

The multivariate technique of exploratory factor analysis was used to assess the discriminant validity of the measuring instrument. After 9 iterations, 52 variables from the questionnaire were grouped into 13 distinct factors explaining a total of 67% of the variance in the data. During the exploratory factor analysis, the dependent variable (in this study being the Perceived success of the succession process) split into two variables, namely Satisfaction with the succession process and Continued profitability of the business.

In order to compare whether the owner-managers and successors have different perceptions of which factors influence the success of succession (Satisfaction with succession process and the Continued profitability of the business), the dataset was divided into two sub-samples, the first consisting of responses received from the 123 owner-managers (both retired and retiring owner-managers) and the second consisting of responses received from the 209 successors (potential or current successors). Multiple linear regression analysis was performed to assess whether the identified independent variables exert a significant influence on Satisfaction with the succession process (SATISFIED) and the Continued profitability of the business (PROFIT) for the two sub-samples of respondents separately:

For this purpose, the following null hypotheses were formulated for both the owner-manager sample and the and successor sample:

- H<sup>0a</sup> : For owner-managers, there is no relationship between the identified factors and the satisfaction with the succession process.
- H<sup>0b</sup> : For owner-managers there is no relationship between the identified factors and the continued profitability of the business.
- H<sup>0c</sup> : For successors, there is no relationship between the identified factors and the satisfaction with the succession process.
- H<sup>0d</sup> : For successors there is no relationship between the identified factors and the continued profitability of the business.

## **EMPIRICAL RESULTS**

### **Results for owner-manager sub-sample: Satisfaction**

The independent variables included in the regression analysis explain 45.0% of the variance the dependent variable SATISFIED (satisfaction with the succession process) in the owner-manager sub-sample. Three of the independent variables namely WILLING, HARMONY and TRUST exerted a significant positive influence on the dependent variable SATISFIED at the 1% confidence level. In other words, the more the owner-manager perceives the successor to be willing to take over the business, the more harmony there is within the family and the more the owner-manager trusts in the successor's abilities and intentions, the more satisfied the owner-managers will be with the succession process.

## **Results for owner-manager sub-sample: Future profitability**

In total, the independent variables explained 31.9% of the variance in the dependent variable PROFIT (the expected future profitability of the family business after succession) in the owner-manager sub-sample. Two of the dependent variables namely WILLING and EXTERNAL PREP exert a significant positive influence on the dependent variable PROFIT at the 1% confidence level and the independent variable TRUST exert a significant positive influence at the 5% level. This means that the more the owner-manager perceives the successor to be willing to take over the business, trusts the successor's abilities and intentions and the more preparation the successor receives external to the business, the more likely the business is to remain profitable after succession. The relationship between the variables ESTATE and PROFIT is, however, negative. This finding implies that the more estate planning is performed within the business, the less likely the business is expected to be profitable after succession, according to the owner-manager respondents.

The two null hypotheses ( $H^{0a}$  and  $H^{0b}$ ) are thus rejected as relationships do exist between the identified factors and the Satisfaction with the succession process and the Continued profitability of the business (the two indicators of a successful succession).

## **Results for the successor sub-sample: Satisfaction**

A full 52.9% of the variance in the dependent variable SATISFIED in the successors sub-sample can be explained by the identified independent variables. Only one independent variable namely AGREE exerts a significant influence on the dependent variable SATISFIED at the 5% confidence level. This implies that the more the successor perceives there to be an agreement among family members to continue the business, the more satisfied the successor will be with the succession process.

## **Results for the successor sub-sample: Future profitability**

The independent variables included in the regression analysis explained 27.2% of the variance in the dependent variable PROFIT in the successor sub-sample. Two of the independent variables namely ESTATE (at a 1% confidence level) and WILLING (at a 5% confidence level) exert a significant influence on the dependent variable PROFIT. In other words, the more the successor is willing to take over the business the more likely the business is of remaining profitable. Similarly to the relationship identified among owner-managers, the relationship between ESTATE and PROFIT is also negative. In other words, according to successors, the more estate planning is done the less likely the family business is of continuing profitability after succession.

The two null hypotheses ( $H^{0c}$  and  $H^{0d}$ ) are thus rejected as relationships do exist between the identified variables and the Satisfaction with the succession process and the Continued profitability of the business.

## **MANAGEMENT IMPLICATIONS**

The empirical results show that there are several factors that influence the success of the succession process in small and medium-sized family businesses. Possibly the most important of these is the willingness of the successor to take over the business. This factor

is perceived to influence both the satisfaction with the succession process, as well as the continued profitability of the business for owner-managers and successors alike. Important elements of “willingness to take over” include whether the successor is looking forward to and have a strong desire to manage the family business, finds it exciting to work in the family business, is committed to continue the family business, and believes that his or her personal development goals could be satisfied in the context of the family business.

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