

Family Business Succession and Its Impact on Financial Structure and Performance

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Vincent Molly,^{1,2} Eddy Laveren,² and Marc Deloof²

Abstract

In this article the authors study the impact of a family business transfer on the financial structure and performance based on a sample of 152 small- to medium-sized businesses. The aim is to identify the effects of a succession by relying on panel data gathered over the period 1991 to 2006 resulting in more than 2,000 firm–year observations. The main findings are that a transfer from the first to the second generation negatively influences the debt rate of the company, whereas in successions between later generations this effect is reversed. With respect to firm growth, analyses indicate that in first-generation companies the growth rate decreases after the transition, whereas in next-generation firms no effect on the growth level can be identified. Finally, no evidence is found that a family firm's profitability is affected by succession, which shows that a transfer should not necessarily be seen as a negative event in the life cycle of a family business.

Keywords

family business, succession, financial structure, performance

Figures published by the European Commission (2003, 2006) show that approximately one third of European enterprises will be transferred to the next generation in the next 10 years. This comes to an average of 690,000 small and medium-sized enterprises (SMEs) that will change hands each year, potentially affecting 2.8 million jobs. Based on U.S. figures, Birley (1986), Ward (1987, 1997b), and Kets de Vries (1993) showed that about one third of family businesses survive into the second generation and that 10% to 15% make it into the third generation. Overall, the above figures make clear that business transfers in general, and family business successions more specifically, constitute one of the most difficult steps in the life cycle of family firms that merits further investigation (Miller, Steier, & Le Breton-Miller, 2003). Several studies find evidence of a change in the debt rate and performance of family firms after an inter-generational transfer took place. Although both increases and decreases have been identified, the impact of a family business succession on the financial structure and performance is still unclear.

As has been acknowledged by several authors (e.g., Bennedsen et al., 2007; Blanco-Mazagatos, de Quevedo-Puente, & Castrillo, 2007; Perez-Gonzalez, 2006), a major shortcoming of past empirical studies is that they tend to rely on cross-sectional data. With cross-sectional data only indirect evidence can be provided on changes in company behavior following a transfer. The first aim of our study is therefore to investigate postsuccession financial structure and performance within the company by following a longitudinal approach based on panel data. In addition, researchers such as Giambatista, Rowe, and Riaz (2005) point to the lack of theoretical lenses used in the extant succession literature. Therefore, we frame our research questions within two perspectives:

¹Hogeschool-Universiteit Brussels, Brussels, Belgium

²University of Antwerp, Antwerp, Belgium

Corresponding Author:

Vincent Molly, Hogeschool-Universiteit Brussels, Stormstraat 2, Brussels 1000, Belgium
Email: vincent.molly@hubrussel.be

an agency perspective (Jensen & Meckling, 1976) and a stagnation perspective (Miller, Le Breton-Miller, & Scholnick, 2008). Third, several authors have shown that a transfer from the founder to the second generation can be different from that occurring in later generations (e.g., Davis & Harveston, 1998, 1999; Schulze, Lubatkin, & Dino, 2003; Villalonga & Amit, 2006). We therefore investigate whether the effect of a succession from the first to the second generation on company decisions and behavior differs from a succession between later generations. Finally, because the succession literature has mostly focused on the impact of management turnovers and/or changes in CEO status on the behavior of listed companies (e.g., Huson, Malatesta, & Parrino, 2004; Sraer & Thesmar, 2007), our article is oriented toward the analysis of the impact of succession on the behavior of private SMEs.

Our study contributes to the literature in several ways. First, it broadens our knowledge about the influence of a business succession on company decisions and behavior. In addition, we contribute to the literature by using a longitudinal analysis, which better allows identifying the direct consequences of a business transfer. Moreover, by focusing on leadership transition in the context of private SMEs and by distinguishing between transfers from the founder to the second generation and successions occurring in later generations, we extend the traditional approach followed in past studies.

The remainder of this article is structured as follows. In the next section we review the literature on the impact of succession on the financial structure and performance of a family business and formulate some testable hypotheses. The third section provides information on the sample and discusses the methodology used in this article. In the fourth section the empirical results are presented. In the last section a conclusion is made and some limitations and practical implications are formulated.

Literature Review and Formulation of Hypotheses

Many studies in the succession literature take into account the agency perspective to analyze managerial behavior (Giambatista et al., 2005). The agency perspective was introduced by Jensen and Meckling (1976) and focuses on information asymmetries among managers, shareholders, and bondholders. Although several studies point to the lower exposure of family firms to

agency costs (e.g., Daily & Dollinger, 1992; Fama & Jensen, 1983), these agency problems do occur in family businesses and can increase when these firms develop over generations. As shown by several authors (e.g., Davis & Harveston, 1999; Smith & Amoako-Adu, 1999), many of these problems arise because of increasing family conflicts and dysfunctional altruistic behavior from the moment the next generation takes over the leadership of the company.

Related to this view, Miller et al. (2008) introduce the stagnation perspective to analyze the nature of family firms. The stagnation perspective combines several reflections in family business studies on the conservative and sometimes dysfunctional nature of the family firm. Because many of the problems in family firms often originate from family conflicts, nepotism, succession difficulties, and so on, there is some common ground between the stagnation and agency perspectives. According to Miller et al. (2008) this stagnation perspective can manifest itself in several ways, such as a lack of financial and managerial resources often found in family firms, risk-averse and conservative behavior, a reluctance to growth, and the short-lived nature of many family firms resulting from the former "weaknesses." The authors conclude by suggesting that the stagnation perspective can become particularly relevant to explain the characteristics and behavior of family businesses developing over generations.

In what follows, we take the agency and stagnation perspective into account in analyzing the literature on the effect of a family business succession on the financial structure and performance of companies. It allows us to identify to what extent stagnation is to be expected in family firms after succession and how this can affect the debt rate, growth rate, and profitability of the firm.

Impact of Succession on Financial Structure

Existing studies of the impact of succession on the financial structure of family firms are based mainly on cross-sectional data, investigating capital structure differences between founder-controlled and descendant-controlled family firms. Moreover, the literature with respect to the succession effect on capital structure is still inconclusive. Although some studies find a positive effect of succession on debt financing, other studies find a negative relation between succession and debt financing. These results have been explained

by either a different demand for debt financing (or willingness to borrow) or a different availability of debt financing (or ability to borrow) in family firms developing over generations.

Several studies argue that when family firms progress from one generation to the next, they become less willing to attract debt financing because of a reduced readiness to take risk. Referring to Ward's (1987, 1997b) model that discriminates between family firms where the business rather serves the family (family orientation) and family firms where the family rather serves the business (business orientation), Reid, Dunn, Cromie, and Adams (1999) find that family orientation becomes more important as family firms develop over generations. Family-oriented firms are more reluctant to use "risky" external sources of capital as this could dilute family control. In a similar way, Kaye and Hamilton (2004) indicate that descendants usually have a lower willingness to take risks compared to their parents. As they have a stronger preference for wealth preservation instead of further wealth creation, they try to avoid a highly leveraged capital structure. The reluctance of many owners of smaller family firms to use a highly leveraged capital structure (Miller & Le Breton-Miller, 2005; Ward, 1997b) is a consequence of the family's desire to transfer a healthy company over different generations, thereby safeguarding the family's name and the lifework created by the founder. Thus, the higher risk aversion and the lower willingness to attract debt financing reduce the available financial resources for next-generation family firms, which is consistent with the stagnation perspective.

In addition, the idea of increasing stagnation after succession also results from the study of Schulze et al. (2003). Using an agency perspective, Schulze et al. argue that equity ownership is likely to become more diffuse with each transition in a family firm to the next generation. This can lead to a divergence of interests between the shareholders who serve on the board of the firm, who will prefer to reduce financial leverage because increased risk has a negative effect on the safety of their personal investments. However, in a cousin consortium, mostly found in the third and later generations, there will be a further dispersion of ownership. At this stage, risk preferences of family owners will be more in line with those of institutional investors and shareholders of public firms, which will lead to a higher willingness to take risk and use debt financing. The

results of Schulze et al. (2003) show that especially in sibling partnerships there is a lower willingness to bear risk compared to controlling owners and cousin consortiums because increased levels of loss aversion, goal misalignment, and conflicts among family members reduce these firms' incentive to use debt to fund their investments. This relates to the view of Shepherd and Zacharakis (2000) that descendants are less willing to undertake risky activities because they usually have invested large amounts of capital for buying themselves into the company.

The stagnation perspective is also supported by studies that focus on the lower ability of family firms to attract debt financing after a succession. For example, Anderson, Mansi, and Reeb (2003) take into account information asymmetries between bondholders and shareholders and find evidence that the former may consider succession from the founder to the next generation as harmful to their wealth because the descendants can be less qualified to lead the company. Other authors point to the fact that succession usually increases the number of family members involved in the business. An increase in the number of active and passive family shareholders after succession may lead to intrafamily conflicts (Davis & Harveston, 1999; Harvey & Evans, 1995), higher dividend payout ratios, and less attention to reinvesting retained earnings (e.g., Schwass, 2005). Beckhard and Dyer (1983) and Paul (1996) suggest that intrafamily conflicts are a major contributor to family business failure. Creditors may therefore be less willing to provide debt to next-generation-managed family firms.

Although the above mentioned studies predict a negative relationship between intergenerational succession and the debt rate, other authors suggest that next-generation family firms will actually find it easier to attract debt financing compared to their first-generation counterparts and therefore may have higher debt rates. Le Breton-Miller and Miller (2006) and Gersick, Davis, Hampton, and Lansberg (1997), for example, point to the importance of long-term relationships between family firms and external stakeholders such as banks. If the transition of a family firm is managed successfully, the firm may get better conditions when seeking debt finance from banks because a long-term relationship with the bank will give the firm the status of a reliable debtor. Moreover, the family firm could have higher incentives to meet current and future obligations because the family name is at stake.

In addition, several other studies suggest that family firms may want more debt financing after succession. Based on the agency theory, Blanco-Mazagatos et al. (2007) point to the increasing weakness of family ties and problems of opportunism and altruism over the course of generations. Family members who run the firm are able to enjoy excessive salaries and perks or could take decisions in their own interest. Family members who are not actively involved in the business may therefore enforce the use of higher amounts of debt financing because debt can serve as a governance mechanism that reduces agency costs resulting from managerial opportunism. In that way, a higher demand for debt financing can be expected in next-generation family firms compared to their first-generation counterparts.

Moreover, according to De Massis, Chua, and Chrisman (2008), the tax burden that may result from a transfer in ownership during the succession can put a serious strain on the family firm's resources. Successors often need to borrow high amounts of capital to buy the shares of the company, which requires them to draw money out of the business through higher salaries or dividend payments to pay off their mortgages and interests (Bjuggren & Sund, 2001, 2005). Because of these cash withdrawals, many next-generation family firms will be characterized by a higher demand for debt financing.

The above literature overview clearly shows that one can expect to find a significant impact of succession on the financial structure of family firms. Although the effect of a generational transfer on the level of indebtedness can be either positive or negative, the idea of stagnation seems to prevail, implying that succession will generally reduce the debt financing rate. However, a transfer from the first to the second generation will not necessarily have the same effect as a succession occurring in later generations. This can be attributed to an increased level of ownership dispersion as well as a higher need for external financing to fund the transition, where both issues should be more pronounced in third or later generation successions. It can therefore be expected that the negative impact of succession on leverage when a family firm is handed over from the first to the second generation will be partly neutralized or even reversed to a positive effect for transfers occurring between later generations of family members. Based on these insights, we therefore hypothesize,

Hypothesis 1a: A family business transfer in first-generation family firms will lead to a negative effect on the debt rate of the company.

Hypothesis 1b: A family business transfer in next-generation family firms will lead to a neutral to positive effect on the debt rate of the company.

Impact of Succession on Performance

Existing research on the impact of a generational transfer on the performance of a family firm is still inconclusive. Although some authors point to stagnating performance of next-generation family firms, others come to opposite conclusions. Moreover, the various arguments can be further differentiated depending on whether they apply to the willingness or the ability of next-generation family firms to increase profit and growth.

Several studies are based on the idea that when family firms move from one generation to the next, their goals change, which can result in stagnation. First-generation family firms are more business oriented than are later generation firms, which are more family oriented, and firms with a business orientation have a higher capacity to grow (Cromie, Stevenson, & Monteith, 1995; Dunn, 1995; Reid et al., 1999). Similarly, Martin and Lumpkin (2004) find that in successive generations entrepreneurial orientation tends to diminish and give way to family orientation, as stability and inheritance concerns become the business's principal drivers. Thus, it is clear that this stronger family orientation can confine the firm's prosperity because it often results in a lower willingness to grow.

A similar conclusion results from the study of Schulze et al. (2003), although these authors focus on agency problems between principal and minority family owners of family firms that went through a succession. They find evidence that an increased level of ownership dispersion in family firms evolving to a sibling partnership can result in a more risk averse behavior, eventually leading to a reduction of firm growth. However, they also indicate that this effect is being reversed in a cousin consortium, as in this stage family owners will again have a higher willingness to take risks and will focus more on growth.

According to Ward (1997a), increased conflicts among family members are one of the main reasons behind the stagnation of a family business. Consistent with this argument, Mishra, Randøy, and Jenssen (2001)

find that family ownership in younger firms has a higher positive effect on firm value compared to later generations of family firms, mainly because of the weakening of family ties and lower cohesiveness among family members over generations. Related to this view, Davis and Harveston (1998, 1999) introduced the idea of “generational shadow.” This term refers to those successions that prove to be incomplete because of the continuing influence of older generation family members who no longer directly control the company. As this behavior can constrain the successors’ motivation and increase the chance of conflicts, a dysfunctional effect on the company can be expected. Davis and Harveston further show that the generational shadow cast by the founder is much greater than the generational shadow cast by subsequent generations. They also point to the effect of organizational learning that occurs in companies that have already experienced a succession. Family firms that have been involved in one or more succession events will probably have their own standard practices that work best for them. In this way, they state that the transition between the founder and the second generation can often be seen as the most difficult and turbulent one. Overall, based on the above literature, the negative effect of succession on firm performance is expected to occur especially in family firms evolving from the first to the second generation.

Other studies attribute a stagnation of the family business and a lower performance after succession to the descendants’ lack of competences and skills. Because the alternative of hiring a better and more experienced external manager is often disregarded, these companies face a lack of managerial resources, which limits their ability to attain high performance (e.g., Bennedsen, Nielsen, Perez-Gonzalez, & Wolfenzon, 2007; Cucculelli & Micucci, 2008). For a sample of listed firms in the United States, Villalonga and Amit (2006) examine the impact of family ownership, control, and management on firm value. Their results show a nonmonotonic relation between generation and firm value. Descendant CEOs seem to exert a negative effect on firm value that is totally attributable to second-generation family firms. On the other hand, Villalonga and Amit find a significant positive incremental contribution of third-generation family businesses to firm value. This contrasts with the findings of Perez-Gonzalez (2006), who observes that especially third-generation family firms are less profitable in running their business, given the significant declines in

return on assets of these companies compared to family firms in which control is handed over from the first to the second generation. Perez-Gonzalez argues that promoting family CEOs in publicly traded corporations can significantly hurt performance because of the lower talent of family descendants. Finally, the study of Morck and Yeung (2003) brings forward that lower growth can be expected in firms controlled by descendants as the latter might be less hard working and less able compared to the founder as the real entrepreneur.

Other authors have attributed the stagnation of firms after succession to the lack of financial resources (e.g., Bjugren & Sund, 2005; Miller & Le Breton-Miller, 2006; Upton & Petty, 2000). The increasing demand for dividends by family members as family businesses enter second or later generations may result in a serious reduction of available financial means that are needed to support the firm’s development and growth. Furthermore, the sale of the shares to the next generation may be financed by the successors from the firm’s operating cash flows by means of increased salaries or dividend payments. Such cash withdrawals can restrict the firm’s ability to attain future growth.

Although the above literature suggests that family business succession leads to stagnation and reduced firm performance, other studies predict a positive effect of succession on performance. Zahra (2005) and Fernández and Nieto (2005), for example, find that when new generations of family members become actively involved in the company, wealth increase and strategic renewal become more important. The underlying argument is that with each succession in a firm, new family members bring fresh knowledge and insights into the company, which positively affects the incentives to innovate, internationalize, and grow. McConaughy and Phillips (1999) also find evidence that descendant-controlled family firms are more profitable than family firms controlled by the founder. Although founder-controlled firms have a higher capacity to grow, family firms managed by descendants have a higher ability to generate profits as they can reap the benefits of earlier investments in capital assets and R&D made by the founder. Also, Diwisch, Voithofer, and Weiss (2009) identify a significant positive effect of past succession on the performance of Austrian SMEs. The study of Sraer and Thesmar (2007), on the other hand, does not find any relation between performance and generational renewal in listed family firms in France.

Overall, it should be clear from the previous literature overview that most studies find evidence of a change in the performance of family firms after an intergenerational transfer takes place. Although both positive and negative effects have been identified, the conclusion that a generational transfer leads to stagnation prevails. However, referring to the past studies that find evidence of a learning effect, differing degrees of ownership dispersion, and the presence of “founder’s shadow,” it is expected that this negative impact of succession on performance will be especially visible in the transfer from the first to the second generation. In transfers between later generations of family firms, we expect that this stagnation effect could be neutralized or could even be reversed to a positive effect. For this reason we hypothesize,

Hypothesis 2a: A family business transfer in first-generation family firms will lead to a negative effect on firm growth.

Hypothesis 2b: A family business transfer in next-generation family firms will lead to a neutral to positive effect on firm growth.

Moreover, as the above literature overview on performance discussed both changes in the growth level of the company and variations in firm profitability, and because authors such as Lumpkin and Dess (1996) point to the multidimensional nature of firm performance, the following two hypotheses can further be formulated:

Hypothesis 2c: A family business transfer in first-generation family firms will lead to a negative effect on firm profitability.

Hypothesis 2d: A family business transfer in next-generation family firms will lead to a neutral to positive effect on firm profitability.

Research Method

Data

This study is based on both survey data and publicly available archival data. For gathering information on family involvement in a company as well as on the occurrence of a family business succession, a questionnaire was sent out to 2,500 Flemish (northern part of Belgium) companies. The sample was constructed based

on the Bel-First DVD of Bureau Van Dijk (September 2006), containing detailed financial information on more than 300,000 Belgian businesses. Several criteria were used to derive our survey population. In a first step some industries were left out of the analysis, especially those involved in the financial sector and in the educational and social sectors. We further selected only SMEs with total employment between 10 and 250 employees. Micro firms (fewer than 10 employees) were ignored, as they often lack a high degree of formality in their organizational structure and management (Gray & Mabey, 2005). Finally, only limited liability companies were selected, given that these firms represent the major legal form of companies in Belgium. This resulted in a total population of 15,137 companies.

Because the questionnaire was specifically developed for measuring family influence in an organization, only potential family firms were selected based on four additional criteria. Two are related to the name of the directors and the company name and the other two are based on address information. By investigating whether two or more company directors had the same family name or whether the company was named after one of its directors, we indirectly had an indication of the occurrence of family involvement in these firms. A company was further expected to be a family firm if two or more directors resided at the same address or when at least one of the directors resided at the business address. In this way, almost 54% of the 15,137 companies (i.e., 8,146 firms) were found to correspond to at least one of these four criteria, meaning that they could be regarded as potential family firms. In a next step a random sample was drawn out of these 8,146 potential family businesses to arrive at a group of 2,500 companies. A postal survey was sent to the managing directors of these companies. After two rounds, a response rate of 20.16% was obtained, resulting in a population of respondents of 504 companies. This response rate is in line with those of other studies addressing managing directors in SMEs (Geletkanycz, 1997; Pearce & Zahra, 1991). To identify the family firms in our data set, we started from the various family firm definitions suggested by Westhead and Cowling (1998). The 504 companies in our data set could all be regarded as family businesses because they had 50% or more of the shares owned by members of the family and/or a managing director who perceived the company as a family business.

Table 1. Profile of Companies in the Sample

Characteristics	Family firms transferred from 1st to 2nd generation		Family firms transferred between later generations		Control group: 1st gen. family firms	
	<i>n</i>	%	<i>n</i>	%	<i>n</i>	%
Number of firms	86		66		110	
Sector (proportion): Manufacturing	30	35	24	36	28	26
Construction	22	26	10	15	18	16
Trade	18	21	21	32	34	31
Services	16	18	11	17	30	27
Company age (<i>M</i>)	26		71		19	
Total assets (<i>M</i>)	4,070,994		4,499,901		2,613,480	

To assess the presence of nonresponse bias, we compared the firms that responded to the first round of our questionnaire against those that cooperated in the follow-up survey. No significant differences could be found between those two groups of respondents with respect to the size, sector, age, or location of the company. We also compared these business characteristics between the responding firms and the original 2,500 firms of the survey population. With respect to all these variables, the group of respondents had similar characteristics to those of the survey population of 2,500 firms.

As has been outlined in the beginning of this article, a longitudinal approach is followed for studying the effect of a generational transition on the performance and capital structure decisions of family firms. For this reason, publicly available archival data were gathered for the period 1991 to 2006 in the form of balance sheet and profit and loss account figures from the Bel-First database and data provided by the National Bank of Belgium. Only companies that, in the period of analysis, experienced their first succession (i.e., from the first to the second generation) or that were handed over between later generations of family members were selected. As we further required that each company in the sample had financial information available for at least 1 year preceding and 1 year following the transfer, all successions took place between 1992 and 2005. This resulted in a subgroup of 152 family business successions. Because some of these companies were founded after 1990 and thus have no financial information available for the whole period of analysis, our sample concerns an

unbalanced panel data set of more than 2,000 firm-year observations across this 16-year period (1991–2006). In addition, 110 first-generation family firms that have not yet experienced a succession are also included in the analysis as a control group. The remaining firms in our total sample of 504 companies were neglected in this study as they mainly concern next-generation companies that did not go through a transfer in the period of analysis or did not respond to the questions in the survey related to the generation managing the company or the year of the transfer in management.

Table 1 gives an overview of the profile of the companies in our sample. Apart from the 110 first-generation family firms that are used only as a control group, 86 of all family business successions in this study occur between the first and the second generation. The other 66 firms are thus family businesses that have already experienced a succession in the past, as they are transferred between the second and third or between later generations in the period of analysis. We further learn that, in the year of succession, first-generation family firms that are transferred to the second generation have been in business for 26 years on average, whereas second-generation and later-generation family firms have 71 years of operation at the moment of succession. With regard to the size of the companies experiencing succession, we find that the mean total assets figure increases from 4.1 million euro to 4.5 million euro. Finally, when looking at industry differences between the companies that are involved in a family business transfer, more or less the same distribution can be found among the various sectors.

Variables

Dependent variables. To test our first two hypotheses that are related to the capital structure of the company, leverage is measured by taking the total amount of debt scaled by total assets. With respect to the other hypotheses, we analyze firm performance first of all by looking at the growth rate of the company. For this purpose, growth in total assets is taken into consideration. The choice to measure assets growth instead of sales growth is because of the absence of sufficient sales figures for all firms, as for Belgian SMEs the disclosure of sales figures is voluntary in their financial statements. Finally, profitability is measured by means of the operating return on assets (OROA). This is in line with the work of Perez-Gonzalez (2006), Huson et al. (2004), and Denis and Denis (1995), where OROA is calculated by dividing the operating profit by total assets.

Independent variables. In this article, the effect of a generational transfer on company performance and capital structure is analyzed by relying on two questions of the questionnaire. The first question relates to the year in which the most recent management transfer occurred from generation to generation. It enables us to identify when succession took place in the company because information is given on the year in which the next generation got the post of managing director of the company, irrespective of the role of the incumbent after the succession. The second question measures which generation of family members managed the company at the time the survey was being held (2006). Based on these two questions and in accordance with the hypotheses, two dummy variables are constructed that measure the occurrence of the management transfer from the first to the second generation (TransferFirst) and between next-generation family members (TransferNext), respectively. They take on value 1 in the year after succession and the following years onward, and 0 otherwise. This allows measuring the permanent change in the dependent variables following the management transfer.

Corresponding to the work of Harris and Raviv (1991), Rajan and Zingales (1995), and Fama and French (2002), we further include some other determinants in analyzing a company's level of indebtedness. Tangibility, calculated as fixed assets to total assets, is used as a measure of the collateral value of the firm. It is expected that large proportions of tangible assets in the balance structure will lead to a higher willingness of lenders to

supply debt to the company. We also use the assets growth rate in our analysis on the level of debt as a measure of current investments, which is supposed to be positively related to leverage. We further include another measure of firm profitability by taking earnings before interest, taxes, depreciation, and amortization divided by total assets (gross return on assets). It differs from the OROA because it takes into account the effect of depreciation and amortization on the firm's profit. As this variable is a measure of the internal financing capacity of the firm, a negative impact can be expected on the level of debt, given that many owners and managers prefer to finance their activities with internal funds rather than debt. With respect to the regression on assets growth, gross return on assets is included as a control variable, as it incorporates the finding of Carpenter and Petersen (2002) that the growth rate of small firms is often constrained by the availability of internal financial means. In analyzing the firm's OROA, debt is used as an independent variable corresponding to the work of Anderson and Reeb (2003), and Sraer and Thesmar (2007). A negative effect can be expected because high debt rates can reduce the firm's ability to attract additional debt financing, which reduces the firm's ability to invest in valuable projects. On the contrary, there could also be a positive effect because debt can serve as a governance mechanism that limits the free cash flow problem in the company. Finally, in all our analyses we also integrate firm size as a control variable corresponding to Romano, Tanewski, and Smyrnios (2001), Delmar, Davidsson, and Gartner (2003), and Anderson and Reeb (2003) by means of the logarithm of total assets. In addition, year indicators are included to control for macroeconomic factors. Company age is not included in the regressions because of the collinearity problem that can occur between this variable and the year dummies in a within-firm analysis (Honjo & Harada, 2006).

The results in this study were checked for their robustness against outliers in the sample by removing the most extreme 1% cases of the dependent variables in our analyses. Descriptive statistics and Pearson correlations of the variables used in this study are shown in Table 2.

Empirical Models

Previous studies that analyzed the effect of a generational transition on firm behavior based on cross-sectional

Table 2. Descriptive Statistics and Correlations of Dependent and Explanatory Variables

Variables	M	SD	1	2	3	4	5	6	7	8
1. Total debt to total assets	0.63	0.23								
2. Assets growth	0.08	0.21	.11**							
3. Operating return on assets	0.06	0.09	-.18**	-.01						
4. Company age	44.62	39.10	-.16**	-.02	-.05*					
5. Log size	7.54	1.12	-.03	.09**	.17**	.22**				
6. Gross return on assets	0.16	0.11	-.16**	.07**	.69**	-.16**	-.04			
7. Tangibility	0.31	0.22	.06**	.01	-.14**	-.19**	-.20**	.22**		
8. Transfer 1st to 2nd generation (dummy)	0.22	0.42	-.05*	.01	.00	-.21**	.07**	-.01	-.00	
9. Transfer between later generations (dummy)	0.20	0.40	-.10**	-.04	.06**	.38**	.19**	-.04*	-.10**	-.27**

* $p < .05$. ** $p < .01$.

analysis have some limitations that can be eliminated using panel data methodology (Bennedson et al., 2007; Blanco-Mazagatos et al., 2007; Perez-Gonzalez, 2006). Cross-sectional analysis, for example, does not allow controlling for all time-invariant characteristics that might have an impact on the firm's financial structure or performance. In addition, it gives only indirect evidence of the impact of succession, making it less suited to studying dynamics of change in a company or to indicate causal effects. For this reason, we start in this study from a longitudinal setting to more accurately identify the pure succession outcomes in a company. Moreover, by following a fixed-effects approach, the within-firm variation in capital structure and performance because of succession is analyzed by controlling for time-invariant characteristics that are often difficult to observe or measure (e.g., the family business's history or culture). These characteristics vary across firms but are assumed to be constant for each individual firm. They also capture effects that are specific to the industry in which the firm operates. Fixed-effects panel data analysis does not allow using industry dummies in the regression models because industry is expected to be time invariant and therefore is included in the firm's intercept. The following regression models are tested based on fixed-effects panel data analysis,

$$\text{Debt}_{i,t} = \alpha_i + \alpha_1 \text{Logsize}_{i,t} + \alpha_2 \text{Tangibility}_{i,t} + \alpha_3 \text{GrossROA}_{i,t} + \alpha_4 \text{Growth}_{i,t} + \alpha_5 \text{TransferFirst}_{i,t} + \alpha_6 \text{TransferNext}_{i,t} + \alpha_t \text{Year}_t + \varepsilon_{i,t}$$

$$\text{Growth}_{i,t} = \alpha_i + \alpha_1 \text{Logsize}_{i,t} + \alpha_2 \text{GrossROA}_{i,t} + \alpha_3 \text{TransferFirst}_{i,t} + \alpha_4 \text{TransferNext}_{i,t} + \alpha_t \text{Year}_t + \varepsilon_{i,t}$$

$$\text{OROA}_{i,t} = \alpha_i + \alpha_1 \text{Logsize}_{i,t} + \alpha_2 \text{Debt}_{i,t} + \alpha_3 \text{TransferFirst}_{i,t} + \alpha_4 \text{TransferNext}_{i,t} + \alpha_t \text{Year}_t + \varepsilon_{i,t}$$

where α_i represents the time-invariant unobservable firm and/or industry-specific effects and α_t the firm-invariant time-specific effects as represented by the year indicators.

In what follows, we start from the approach of Barber and Lyon (1996), who suggest the use of a control group-matching method for measuring changes in accounting data following an event. To control for a potential mean reversion effect and to evaluate the results relative to an appropriate benchmark, we matched each of the family firms that experienced a succession in the period of analysis to a similar family firm from the first generation that had not yet been involved in a succession. For every sample firm we looked for a control firm within the same industry and with a similar pre-event capital structure, growth, and profitability figure, respectively. The one-to-one matching procedure was performed as follows: For each sample firm experiencing succession, one out of the 110 first-generation family firms was selected from the same industry based on the one-digit Nace-bel code, which also had a capital structure, growth, and profitability figure, respectively, in the year before succession that was closest to that of the sample firm but that fell within $\pm 20\%$ of the sample firm's figure. If there were no matched firms based on these criteria, the procedure was repeated regardless of the firm's industry. This means that, in this step, we looked only for a control firm with a similar capital structure, growth, and profitability figure, respectively. By taking

the difference between the sample and control firm's accounting data, adjusted debt, adjusted growth, and adjusted profitability figures were calculated and integrated in our models, as they better allow us to isolate the pure impact of the succession event on the financial structure and performance of the company.

Research Results

Financial Structure

In this section we discuss the results of the regression analysis regarding the impact of succession on the financial structure of family firms. The effects of both a transfer from the first to the second generation and a transfer between later generations of family members are presented. As mentioned before, the impact of a succession is measured starting from 1 year after the transfer to the following years onward. To rule out any change in leverage because of luck or because of a reverting trend toward the mean, we subject our analysis to the approach suggested by Barber and Lyon (1996), where the regression model starts from the firms' industry and debt-adjusted capital structure figures for testing Hypotheses 1a and 1b. The results are presented in Table 3.

The results indicate that after controlling for several firm characteristics, a significant effect can be found for both transfer dummies. The model gives evidence of a significant negative effect of succession on the firm's leverage in first-generation family firms, as the adjusted level of indebtedness seems to decrease by four percentage points. With respect to successions in next-generation family firms, the opposite conclusion holds true, as the regression identifies a significant increase of about six percentage points in the adjusted debt rate of the company. Apparently, the effect that can be identified in family firms experiencing their first succession is being reversed in firms that are handed over between later generations. Therefore, Hypotheses 1a and 1b are supported.

With respect to the other independent variables, also size, profitability, tangibility, and growth have a significant impact on the adjusted debt rate in the company. The results show that larger firms are more indebted than smaller ones but that especially in firms of a smaller size the use of debt financing rises sharply. Also, company growth has a significant positive impact on the debt rate.

Table 3. Regression Analysis: Financial Structure

Independent Variables	Coeff.	SE	Coeff.	SE
Controls				
Log size	.11***	.02	.12***	.02
Tangibility	-.09*	.05	-.12**	.05
Gross return on assets	-.31***	.06	-.32***	.06
Growth	.00***	.00	.00***	.00
Intergenerational succession				
Transfer from 1st to 2nd generation (dummy)			-.04***	.02
Transfer between later generations (dummy)			.06***	.02
Year (0, 1) indicators	Yes		Yes	
R ²	.09		.11	
ΔR ²			.02***	
F	8.59***		10.10***	
Number of observations	1,970		1,970	
Number of firms	150		150	

Note: SE = robust standard errors.

* $p < .10$. ** $p < .05$. *** $p < .01$.

On the other hand, tangibility exerts a negative influence on the use of debt. This counterintuitive effect can be explained by the fact that the companies in our sample have a large proportion of short-term debt in their capital structure and that firms usually try to match the duration of their assets and liabilities. Finally, with respect to firm profitability a negative effect can be found. This seems logical, as firms that are able to generate larger amounts of internal financial means are less dependent on debt financing for funding their activities.

Performance

Beside the effect of succession on the capital structure, we also analyze the impact on firm performance, as presented in Table 4. We again used the matching method of Barber and Lyon (1996) by starting from the group of 110 family firms from the first generation that has not yet experienced a succession. These companies allow us to calculate industry- and performance-adjusted figures, which are used as dependent variables in our regressions for testing the hypotheses on the impact of succession on the growth rate and profitability of the firm. The first regression in Table 4 describes the results with regard to the growth of the company, and the second regression shows the analysis related to firm profitability.

Table 4. Regression Analyses: Performance

Independent variables	(1) Growth				(2) Operating return on assets			
	Coeff.	SE	Coeff.	SE	Coeff.	SE	Coeff.	SE
Controls								
Log size	.19***	.03	.20***	.03	.02**	.01	.02**	.01
Gross return on assets	.05	.11	.06	.11				
Debt					-.13***	.02	-.13***	.02
Intergenerational succession								
Transfer from 1st to 2nd generation (dummy)			-.08**	.03			-.01	.01
Transfer between later generations (dummy)			.00	.03			.01	.01
Year (0, 1) indicators	Yes		Yes		Yes		Yes	
R ²	.05		.06		.04		.04	
ΔR ²			.01**				.00	
F	4.66***		4.38***		2.95***		2.73***	
Number of observations	1,744		1,744		2,092		2,092	
Number of firms	139		139		152		152	

Note: SE = robust standard errors.

* $p < .10$. ** $p < .05$. *** $p < .01$.

In testing Hypotheses 2a and 2b, which relate to firm growth, Table 4 indicates that a succession from the first to the second generation leads to a significant decline in the adjusted growth rate of the company of eight percentage points. This makes clear that in family firms experiencing their first succession growth will slow down after the transfer of the company compared to first-generation family firms, which is in support of Hypothesis 2a. However, regarding successions in next-generation family firms, no significant changes in the adjusted growth rate can be identified, meaning that Hypothesis 2b is not supported.

Regarding the other independent variables, we find that the logarithm of size is significantly positively related to the growth rate of the company, which leads to the conclusion that growth increases strongly particularly in smaller firms and that this rise in the growth rate gradually decreases in companies that become larger. With respect to the impact of gross return on assets on the growth rate, the effect is not significant, although the positive coefficient to some extent suggests that firms realizing high amounts of internal financial means have a higher capacity to grow.

The regression results with regard to Hypotheses 2c and 2d, which relate to the impact of succession on firm profitability, are presented in the second regression model of Table 4. The model shows that a succession from the first to the second generation as well as a succession

in next-generation family firms has no impact on the firm's adjusted OROA. As no evidence is found of a change in profitability when a family firm is transferred over generations, Hypotheses 2c and 2d are not supported.

The data further indicate that company size and leverage have a significant effect on the firm's adjusted OROA. Particularly in smaller firms profitability seems to increase strongly with size. With regard to debt as a control variable, the table makes clear that leverage has a significant negative effect on firm profitability. A possible explanation could lie in the fact that existing leverage may limit the firm's ability to raise new debt, which consequently forces the firm to pass up valuable investment opportunities.

Robustness Tests

To assess the validity of our results we applied some robustness tests that mainly concern the use of alternative measures with respect to our analysis on firm profitability and debt rate, together with an assessment of the influence of mergers and acquisitions and potential multicollinearity problems on our results. Apart from the OROA, also return on equity and gross return on assets were taken into consideration in this study, where the latter differs from the OROA as it takes into account the effect of depreciation and amortization on the firm's profit. In this way, we were able to test our

analyses based on these alternative profit measures, where we again focused on adjusted figures following Barber and Lyon's (1996) matching approach. However, in correspondence with our previous findings, no significant effect of succession on the firm's profitability could be detected, which confirms that Hypotheses 2c and 2d are not supported.

With regard to the capital structure, a further robustness check considers the distinction in the firm's debt rate according to the debt maturity structure (long-term vs. short-term debt) and between financial versus nonfinancial debt. However, no clear indication was found that the results in this study can be attributed to a specific type of leverage, meaning that a combination of both long-term versus short-term debt and financial versus nonfinancial debt is responsible for our findings.

The next robustness check refers to the potential influence of mergers and acquisitions, which could potentially distort the results in our analyses. Given the long time span of 16 years (1991–2006) used in this study, some of the found effects could be attributed to the occurrence of a merger or acquisition in the company during the period of analysis. We therefore screened all the firms in our sample for their involvement in such a transaction, where it was found that in only 2 companies of the 152 experiencing a succession a merger or acquisition occurred within a period of five years before or after the intergenerational transfer. As in these firms changes in our dependent variables could result from the merger or acquisition event, they were excluded from our analyses. However, even after ignoring these firms, similar results were obtained as before, which again provides support for the findings in this study.

As a last robustness check we explore the possibility that multicollinearity has an effect on our results by examining the correlations among the independent variables in Table 2. Although the correlations among the independent variables are relatively small, the highest correlations can be found with regard to the firm size and tangibility variables. We therefore replicated our analyses on financial structure by excluding tangibility from our debt model. However, the resulting effects were identical to those found in Table 3. In addition, an alternative measure of firm size was integrated in our analyses based on the logarithm of total employment. However, the use of this alternative size measure does not change our results either. Even if we exclude the

firm size variable from our models, our analyses lead to the same conclusions, with variance inflation factors showing no scores higher than 10 (the highest score was 3.48 in the debt model, 2.99 in the growth model, and 6.02 in the profitability model). Finally, as mentioned before, company age was not included in the regressions because of the collinearity problem that can occur between this variable and the year dummies in a within-firm analysis. If we do integrate firm age in our analyses as a variable controlling for business life-cycle issues, it does not change the results and findings of this study. Overall, we conclude that multicollinearity has little impact on our results.

Discussion and Conclusion

The idea that a family business succession can have an impact on the financial structure and performance of a firm should be no surprise given that a business transfer is one of the most important and critical events in the life cycle of any family firm. In fact, many companies seem to be unsuccessful in overcoming the difficulties surrounding a succession, as has clearly been demonstrated by the various statistics showing the limited survival rates of family firms over generations. Moreover, successions will gradually gain more importance in the next coming years because of the retirement of a substantial amount of business leaders. It is therefore important to study business transfers, as doing so can lead to more insights into best practices regarding how to carry out a succession and on the way in which the business is expected to change because of the transition event.

Although past research has already investigated the impact of a family business succession on company decisions and behavior, the research usually lacks a theoretical underpinning, mainly restricted to the study of large public firms or based on cross-sectional analysis. The current research seeks to overcome these limitations by analyzing transitions in small to medium-sized family firms starting from a panel data setting. The focus on a longitudinal study of succession in these firms allows us to provide direct evidence on the consequences of a transition as both pre- and postsuccession data within a company are analyzed. Moreover, our research questions are formulated based on a theoretical framework including two perspectives, that is, the agency perspective and the stagnation

perspective. This approach allows us to contribute to the existing knowledge resulting from previous studies on family business succession.

As shown by our analyses, the transfer from the first to the second generation seems to negatively influence the leverage of the company. However, in later generations of family firms this effect is reversed, which supports Hypotheses 1a and 1b. With respect to the hypotheses on performance, regression analyses show that in first-generation family firms also the growth rate significantly decreases when a family firm is transferred from the first to the second generation. However, in next-generation family firms, no significant effect of succession on the growth level can be identified. Therefore Hypothesis 2a is supported and Hypothesis 2b is not supported. Finally, with regard to firm profitability, Hypotheses 2c and 2d are not supported given that a family firm's profit figures are not influenced by succession.

Starting from the two theoretical perspectives, this article to some extent shows that succession in the family firm can give way to some form of stagnation that can result in a more conservative financial structure and a limitation of the firm's growth rate. This corresponds to Dunn (1995), Cromie et al. (1995), Reid et al. (1999), and Kaye and Hamilton (2004), who describe the idea that family firms often become more risk averse after succession. As next-generation family members are often more concerned for wealth preservation than further wealth creation, this can result in a lower debt rate in the company and a lower orientation toward firm growth.

Moreover, the agency perspective offers a further explanation for the changing financial structure and performance of family firms over generations because stagnation is often rooted in conflicts between family members. In that sense, it is shown that the stagnation perspective will be especially apparent in second-generation family firms because third or later generation companies are usually less confronted with conflicts between the incumbent and the successor and less characterized by a higher risk aversion which jeopardize their prosperity. Davis and Harveston (1998, 1999), for example, indicate that the transition between the founder and the second generation can be regarded as the most turbulent one. As next-generation family firms are less vulnerable to conflicts resulting from the founder's shadow, and because family managers already have a

broad experience with the transition from earlier successions, it is expected that the transfer in management between later generation family members can be settled more smoothly without harming the company's development. In addition, the study of Schulze et al. (2003) shows that the stronger alignment of the shareholders' interests and reduced agency costs in a cousin consortium, as often found in third-generation family firms, can result in a higher willingness to increase debt financing and to extend again the focus on the firm's expansion in comparison to sibling partnerships. However, beside this idea of increased ownership dispersion, successors could also try to avoid family conflict and to better align the interests of the family and the business by buying the shares from the older generation or from other family descendants. In that sense, De Massis et al. (2008) and Bjuggren and Sund (2001, 2005) also point to the financing issues related to succession, which can seriously increase the need for seeking external financing. As many next-generation family firms have already grown to a sizeable dimension and firm value, it can be expected that especially firms of the third or later generation will need to rely more heavily on debt financing for funding the business transition.

Furthermore, Miller et al. (2008) consider not only the stagnation perspective but also a stewardship perspective. Our findings could be interpreted based on the latter perspective as well. Because family firms evolving to the second generation seem to be more characterized by goal misalignment and conflicts between family owners or managers in comparison with family firms evolving to the third or later generation, the characteristics of second-generation family firms to some extent comply less with stewardship behavior. However, Arthurs and Busenitz (2003) and Wasserman (2006) show that the influence of factors such as psychological ownership on the degree of stewardship behavior should be taken into account. They indicate, for example, that founding managers and those who have higher equity holdings are more likely to behave as stewards because they feel a stronger sense of attachment to the company. Therefore, it would be interesting for future research to analyze the evolution of psychological ownership over generations and to investigate to what extent the level of psychological ownership is influenced by the degree of ownership dispersion in the family firm.

Finally, the finding that firm profitability is not affected by succession corresponds to the study of Sraer

and Thesmar (2007), who found no association between performance and generational renewal in family businesses. One of the reasons of identifying changes in growth but not in profitability when a first-generation family firm is transferred to the second generation could lie in the explanation given by McConaughy and Phillips (1999). Although descendant-controlled family firms have a lower capacity to grow, their profitability is not negatively affected as they are able to reap the benefits of earlier investments in capital assets and R&D made by the founder.

Practical Implications

Despite the limited explanatory power of the performance models, the fact that no significant effect of succession on firm profitability could be found indicates that a transfer is not necessarily a negative event in the life cycle of a family business.¹ However, this idea can be generalized only when, beside firm profitability, other aspects such as family harmony are integrated in assessing the success of a succession. Nevertheless, our results do suggest that taking over the family business can be a valuable alternative for family members to start a new business from scratch. In that sense, the government could take some steps toward stimulating family business successions. Initiatives should be developed and continued that further facilitate family business transfers. A potential measure, for example, lies in the introduction of multiple voting rights as it considerably lowers the financial needs of family members who want to expand the company's success while keeping control in family's hands. Contrary to the Belgian company law, which does not allow for shares with multiple voting rights, this system can be found in Scandinavian countries. Another measure refers to the reduction of taxation related to a family business transfer. Although several countries already took some steps in this direction (e.g., Austria, Sweden, etc.), more work still needs to be done to further limit the financial burden and conditions related to an inheritance or gift of the shares.² A final example of governmental support can be found in several initiatives that increase the awareness of the problems related to a transfer. Entrepreneurs close to their retirement could, for example, be actively approached to support them with advice regarding succession (e.g., in the Netherlands), or potential successors could be trained to take up their role as family business leader

through transparent, well-structured, and coordinated programs or workshops.

Finally, with regard to our finding that a family business succession can cause some stagnation in the sense of lower debt and growth rates, we could come to the conclusion that some potential of these firms remains unanswered. On one hand, this could result in the advice to family business founders not to teach their children to shy away from risk to preserve the wealth they inherited but to stimulate the new business leaders of the following generation to increase their entrepreneurial spirit to work toward the further growth of their business. On the other hand, this conservative behavior should not be detrimental as such. Similar to the risk profile of investors in general, family business owners are free to take decisions in accordance with their degree of risk tolerance. What is more, especially in times of economic crisis, this behavior allows family firms to survive some of their competitors that were too eager for gaining short-term profits and growth by investing in high risk projects.

Limitations and Future Research

Despite the interesting results that could be derived from our analyses, we nevertheless have to mention a few shortcomings comprised in this study. Given the great complexity that usually goes together with the transition of the family firm, it can be expected that the interplay of several factors will determine to what extent succession will have an impact on the company. In this respect, we could refer to several issues such as the level of intrafamily conflicts, the quality and competences of family descendants, the degree of succession planning, the extent to which the succession was forced because of the sudden illness or death of the family business leader, the role of the incumbent after succession, the degree to which ownership and control is transferred between generations, and so on. Even though many of these factors will probably have an interacting or mediating influence on the relationship between the succession event and the firm's financial structure and performance, they could not be integrated in current research because of the unavailability of longitudinal data with respect to these topics. In the same sense, additional data on family businesses that are transferred to nonfamily members and on family firms that experienced more difficulties or even failed after the company was transferred to the next generation could deliver further

insights into this matter. Therefore, future studies should focus on these issues to allow a more precise analysis of the effects of a family business succession. Moreover, a further necessary extension concerns the analysis of the impact of succession on the nonfinancial performance of family businesses. Given that family owners and managers need to deal with both economic and noneconomic considerations when making decisions, future research should try to take into account other than traditional financial performance measures to get a full view on the consequences of a family business succession on the firm's performance.

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Notes

1. This corresponds to the study of Buysschaert, Deloof, Jegers, and Rommens (2008), which also finds a relatively low explanatory power in the models on the profitability of Belgian firms.
2. The statutory rate for company taxation in Belgium is 33.99%. Dividends are taxed at 25% and in some cases at 15%. With regard to inheritance, the tax rate depends on both the relation between the deceased and the heir and the inherited amount of money. Rates vary between 3% and 65%. To promote the intrafamily transfer of small and medium-sized enterprises, the inheritance tax rates are in certain cases and subject to some conditions even lowered to 0%. Gifts are subject to the following flat rates: 3% or 7% depending on the relationship between donator and beneficiary. However, lowered tax rates can apply, for example, 2% in Flanders (subject to some conditions).

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Bios

Vincent Molly is professor of entrepreneurship and family business at the Hogeschool-Universiteit Brussel—Research Centre for Entrepreneurship and research fellow at the University of Antwerp. He conducts research on several issues on small and medium-sized family enterprises including inter-generational differences and succession.

Eddy Laveren is professor of financial management and entrepreneurship at the University of Antwerp. His research is situated in the field of financial management and performance of small and medium-sized enterprises and family firms.

Marc Deloof is professor of finance at the University of Antwerp and the Louvain School of Management of the Université catholique de Louvain. His research focuses on governance, finance, and accounting issues in business groups, multinational corporations, and small and medium-sized enterprises.