Small Business Transfer Decisions: What Really Matters? Evidence from Ireland and Scotland

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ABSTRACT

There comes a time when owner-managers of small firms choose, or are forced, to retire. This decision gives rise to a business transfer decision, where the owner-manager must decide whether to transfer the business to a family member, sell the business or shut down the business. While this transfer choice is a key business decision which impacts on the long-run survival and profitability of the firm and the region in which it is located, little is known about what factors influence the owner-manager's decision. In this paper, we explore how firm and regional characteristics impact the transfer decision. Using evidence collected from in-depth interviews with Irish and Scottish (N=236) owner-managers, we find that whilst factors such as the size and location of the firm have the same impact on owner-managers in both countries, the importance of other factors such as sector, gender, the existence of an exit plan and the owner-manager's intentions for the firm differ. We emphasise the need to put incentive mechanisms in place to increase the attractiveness of purchasing a viable small business.

Key Words: entrepreneurial exit; succession; business transfer; small firms

INTRODUCTION

Small firms are quickly becoming the driving force of the modern economy (Audretsch and Thurik, 2000). Within the EU-27, for example, the majority (98.7 per cent) of firms employ less than fifty employees and are classified as small firms. These firms employ 50.4 per cent of the workforce and generate 39.9 per cent of the total value added (European Commission, 2009). Today many of these small firm owner-managers have a similar concern – they are getting older (Small Business Service, 2004) – and, as a result, many choose to or are required to retire. These owner-managers have a number of exit options available to them (Birley and Westhead, 1993; Petty, 1997) which may or may not result in the continued

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operation of the firm: they may transfer the business to a family member, sell the business to a third party (e.g. an employee, a latent or experienced owner-manager or via initial public offering) or close down the business and dispose of its assets. While the decision to exit the firm by the owner-manager is a key business decision, few scholarly studies have accounted for or tried to explain the multifaceted nature of this exit decision, referred to in the literature as 'entrepreneurial exit', from the entrepreneur's perspective (Wennberg et al., 2010; DeTienne and Cardon, 2010). In an attempt to fill this gap in the literature, this paper examines how factors such as the age, size, sector, exit plan and location of the firm impact on the exit decisions of 236 Scottish and Irish small firm owner-managers.

In 1994, the European Commission acknowledged that small business transfer was a major issue of concern. By 2003, they requested member states to put supports in place for these small companies with a view to preserving the economic value of these firms (European Commission, 2003). Currently, 450,000 firms within the EU-27 successfully transfer between owners each year (European Commission, 2011). Of the 1.7 million firms which close each year, 620,000 (or 37 per cent) attempt to transfer prior to closure: 470,000 of these firms fail to transfer for economic reasons (i.e. they have no valuable assets), while the remaining 150,000 (representing 600,000 jobs) close due to inefficiencies in the transfer process (European Commission, 2011). As a result, the Commission argues that we need to make it easier for viable businesses to transfer. Understanding the factors which lead an owner-manager to choose a particular exit strategy may help us to improve the number of successful transfers, which in turn may increase the number of active firms in the economy, leading to economic and employment growth.

Previous research in this area has primarily examined intergenerational succession in family businesses. Bennedsen et al. (2006), Santarelli and Lotti (2005), Burkart et al. (2003), Miller et al. (2003), Bjuggren and Sund (2002), Dyck et al. (2002), Kimhi (1997), Morris et al. (1997), Lansberg (1988), and Beckhard and Dyer (1983), amongst others, examine the attributes of family succession and most conclude that family succession is the preferred option among owner-managers. Intergenerational succession involves a number of decisions such as choosing a successor, timing the transfer of management responsibilities, timing the transfer of ownership, income distribution before and after transfer, and the compensation of other heirs (Kimhi, 1997). These issues must be managed sensitively as latent family issues tend to surface (e.g. sibling rivalries, management style differences, roles of in-laws and financial positions of family members) and these issues influence the viability and success of the transfer (Beckhard and Dyer, 1983; Dyck et al., 2002).

While traditionally small firms transferred to family members, this is no longer the case (Small Business Service, 2004). Consequently, we need to explore a wider set of business transfer strategies. One alternative available to small firm owner-managers is to sell their business, either via a management buyout or a trade sale. A management buyout provides the owner-manager with a means of realising the majority of his or her wealth while at the same time ensuring the continued independent ownership of the firm (Westhead, 2003). The advantage of a management buyout is that it is simple: the incumbent managers will be familiar with the firm, its product groups, competition in the marketplace, rivals, customers and, most importantly, the true value of the firm. This is likely to increase the amount of money the owner-manager can acquire for his or her business. Unfortunately, owner-managers often find it difficult to find a suitable employee to take over the running of their business. When this happens they can sell the firm, an option which can be highly lucrative and desirable if the owner-manager can signal the quality of the firm to the market (Haunschild, 1994). However, if the owner-manager is unable to signal the quality of the firm then asymmetric information between buyer and seller about the performance of the business and its growth potential may lower the trade sale price (Akerlof, 1970). In some industries, this may lead to a reduction in the type and quality of businesses that are for sale and it may result in the failure of the business to transfer. Martin et al. (2002) identify a number of attributes that increase this risk, including poor business performance, over-reliance on the idiosyncratic knowledge of the owner-manager, the absence of medium-term plans for business transfer, and businesses intended to meet the personal and lifestyle goals of the owner-manager as opposed to their strategic business objectives.

In this paper, using new data gathered in telephone and face-to-face interviews with 236 owner-managers of long-lived small firms in Ireland (N=177) and Scotland (N=59), we examine the effect of firm and regional variables on the owner-managers' expected exit strategy. We define a long-lived small firm as a firm with less than 50 employees which has operated for at least ten years. We are fortunate to have data on mature small firms in two regions, Ireland and Scotland. While some consultancy reports (European Commission, 2006, 2011; Martin et al., 2002; Small Business Service, 2004) advise policy makers of the risks associated with transferring a business few authors compare their findings across regions. The composition of firms in our Irish and Scottish samples is similar, in that a large proportion claim to be family-owned businesses, and they have a similar age profile. MacFeely and O'Brien (2009) argue that 46 per cent of service firms in Ireland are family firms while Reid and Harris (2004) argue that 69 per cent of small and medium enterprises (SMEs) in Scotland comprise family-owned firms. In addition, age-related transfer failure is a concern for both regions as approximately 23 per cent and 25 per cent of self-employed people in Ireland and Scotland respectively are over 55 years of age (Central Statistics Office, 2006; Office for National Statistics, 2008). Moreover, similar proportions (50 per cent) of firms in both regions continue after the exit of the owner-manager (Fitzsimmons and O'Gorman, 2008; Levie, 2006). We acknowledge that there are differences in the tax regimes between the two regions which could alter the expectations of owner-managers. In particular, transfers through the family are currently subject to a lower rate of tax in Ireland (10 per cent in Ireland versus 20 per cent in Scotland if the firm is transferred during the lifetime of the owner-manager). Given that this favourable Irish tax regime is currently under review, it is interesting to examine the owner-managers' expectations under a higher tax regime (McBride, 2011). Therefore, we take the opportunity in this paper to show the results of a multinomial probit estimation which examines the influence of firm and regional variables on the expected exit strategy of owner-managers from both regions so that similarities and differences in the findings can be identified.

Briefly, our ideas are developed as follows: the next section locates our hypotheses in the extant literature; the following section discusses the primary source data and key variables used to test our hypotheses; the fourth section outlines the multinomial probit model and reports our results; and the final section presents some conclusions.

THEORETICAL ISSUES AND HYPOTHESIS SPECIFICATION

Many authors, including DeTienne (2010) and Brockner et al. (2004), argue that owner-manager exit is an important part of the entrepreneurial lifecycle. This is particularly the case in small businesses where the owner-manager is likely to either own or have a large ownership stake in the firm. While Greabner and Eisenhardt (2004) argue it is imperative that we understand the owner-manager's perception of their exit strategy, to date much of the research in this area has focused on larger firms, and on the exit choices of chief executive officers of publicly traded organisations (Wasserman, 2003; Shen and Cannella, 2002; Kesner and Sebora, 1994; Carroll, 1984). With the exception of intergenerational succession (Diwisch et al., 2009; Burkart et al., 2003; Miller et al., 2003; Sharma et al., 2003; Bjuggren and Sund, 2002; Dyck et al., 2002), few have examined the exit choice of small firm owner-managers. DeTienne (2010) argues that, in an SME, these choices are influenced to a large part by the owner-manager's perception of exit. In this paper we build on recent work by DeTienne and Cardon (2010), who found that threshold theory combined with the theory of planned behaviour can help us understand the different exit choices.

Threshold theory is based on the idea that firm exit is a function of firm performance and the owner's performance threshold (Gimeno et al., 1997). This threshold is the level of performance below which the owner-manager will liquidate the firm, and it is a function of the owner-manager's human capital (e.g. previous entrepreneurial experience, industry experience, age and education level) (see Gimeno et al., 1997). The theory of planned behaviour, on the other hand, developed by Ajzen and Fishbein (1980), suggests that the probability a certain behaviour will occur is dependent on the intention of the individual to engage in that behaviour. Krueger et al. (2000) argue that this theory works best when the behaviour under examination is rare, hard to observe or involves unpredictable time lags. This theory has been successfully used to explain an entrepreneur's start-up intentions (Krueger et al., 2000), outcomes (Kolvereid and Isaksen, 2006) and exit intentions (Leroy et al., 2010; DeTienne, 2010). Following Leroy et al. (2010), we argue that entrepreneurs' exit intentions are an important predictor of the actual exit outcome. Combining these theories, DeTienne and Cardon (2010) argue that entrepreneurs intend to pursue different exit paths based on previous entrepreneurial experience, industry experience, age and education level.

In this paper, we examine the exit choices of owner-managers who operate long-lived firms in all sectors of the Irish and Scottish economies. Given that the vast majority of firms in our sample are long-lived firms (i.e. at a minimum they have been trading for ten years), human capital theory explanations for their exit choice cannot be verified as many of the owner-managers are planning to retire, to engage in some aspects of entrepreneurial recycling (DeTienne and Cardon, 2010; Mason and Harrison, 2006) or to engage in renascent entrepreneurship (Stam et al., 2008). Therefore, rather than relying on human capital theory for the formulation of testable hypotheses, we broaden the range of factors along the lines of Leroy et al. (2007), who include personal, social, business and industry-related variables. The remainder of this section summarises what we know about the factors which influence owner-managers' expected exit choices. These factors include firm-specific factors (i.e. the age, type and size of firm; the gender of the owner-manager; the existence of a succession plan; and the owner-manager's intentions for the firm) and regional-specific factors (i.e. entrepreneurial talent in the region where the firm is located and proximity of the firm to an urban centre).

Focusing on the firm-specific factors, we begin by examining how the age of a firm is likely to impact the exit choice of each owner-manager. The liability of old age hypothesis (Caves, 1998; Aldrich and Auster, 1990) argues that older firms are less able to adapt to changing economic and market conditions. As a result, while close-knit inter-organisational networks embedded in a regional community can help foster a firm's growth (Heidenreich, 1996), it is precisely these relationships that can block change, creativity and innovation (Loderer et al., 2011). Leonard-Barton (1992) argues that older firms are often unable to anticipate or react adequately to changing economic circumstances and consequently Loderer et al. (2011) claim that many older firms are likely to have outdated production, marketing and distribution techniques and are therefore more likely to fail. Many studies find that only 30 per cent of family businesses survive past the first generation while only 10 per cent make it to the third generation (see Davis and Harveston, 1998; Handler, 1992, 1990; Lansberg, 1999). Others, such as Zajec et al. (2006), find that the liquidation or sale of company assets is almost entirely determined by the maturity of the firm. Foreman-Peck and Nicholls (2008), in a study of two million SMEs in the United Kingdom (UK), found that firms over twenty years of age are less likely to be sold. Similarly, using a German dataset, Wagner (2004) found evidence that older firms are less likely to attract nascent entrepreneurs and are therefore less likely to transfer. Based on this evidence, we hypothesise that:

H_1: Owner-managers operating older firms are less likely to expect to transfer their firm.

An entrepreneur has many options available to him when he transfers his firm. Transferring the business to a family member can often provide a business with a competitive edge in the market (Bjuggren and Sund, 2002). However, if it is not possible to transfer the business to a family member then the next preferred option is to transfer to an employee (Battisti and Okamuro, 2010; Scholes et al., 2007; Bleackley et al., 1996). Sharma et al. (2003) outline the importance of identifying willing and trusted employees as potential successors. Parker (2009), Wagner (2004), and Sorenson and Audia (2000) argue that small firms are seed beds for budding entrepreneurs as they give employees the opportunity to acquire information about the transition from paid employment to self-employment. Unfortunately, owner-managers often find it difficult to find suitable candidates with an adequate level of competence, access to finance and/or a willingness to bear the risk of taking over the running of the business (Small Business Service, 2004). Elfenbein et al. (2010) and

Gompers et al. (2005) argue that, in many cases, this is due to entrepreneurial spawning – the tendency for employees to quit and become entrepreneurs themselves. Coupled with this, Battisti and Okamuro (2010) argue that small firms are less attractive to outside buyers and consequently are more likely to close if they fail to transfer to an employee. Since the availability of suitable candidates within the firm conditions the owner-manager's expectations, we hypothesise that:

H_2: The larger the firm the more likely that the owner-manager expects to transfer their firm.

Other characteristics, such as the gender of the entrepreneur and the sector in which the firms operates, are also likely to impact the exit choice made. Royer et al. (2008) propose that:

1. Where industry-specific, technical and family business-specific experiential knowledge is not very relevant (e.g. service sector positions such as in petrol stations and shops) then firms are just as likely to be sold as to be passed to a family member.
2. Where industry-specific and technical knowledge is high but family knowledge is low (e.g. biotechnology or information technology) then firms are more likely to be sold.
3. Where industry-specific and technical knowledge are low but family knowledge is high (e.g. construction and craft firms) then firms are likely to be passed to family members.
4. Where industry-specific, technical and family business-specific experiential knowledge are all high (e.g. companies that build, design and/or manufacture equipment often on a larger scale basis, or that may operate in niche markets) then family successors are preferable if they have the expert knowledge; if not then an employee (called an insider substitute or quasi-family member) is the preferred option.

The Small Business Service (2004) argues that smaller-sized firms, retailers and craft-based businesses (e.g. hairdressers and mechanics) are more likely to close than to transfer. Lotti and Santarelli (2005), in a study of family firms in Italy, found evidence that manufacturing firms are more likely to transfer (either through sale or family succession) than service sector firms. Similarly, Goodchild et al. (2003), in a study of small firms in New Zealand, found that while succession practices differ widely across the service sector the most common form of exit is firm closure (especially for those involved in retail services). Therefore, we hypothesise that:

H_3: Owner-managers operating service sector firms are less likely to expect to transfer their firm.

While the relationship between gender and entrepreneurship has received much attention in the literature, the link between female owner-managers and their succession choice has only received modest consideration. Some studies have examined the performance of women who have entered their family's business (Vera and Dean, 2005; Hollander and Bukowitz, 1990; Salganicoff, 1990). Those that do examine gender and intergenerational succession find a bias against women in the succession process (Pyromalis et al., 2006). Many argue that females start businesses for non-economic reasons (DeMartino and Barbato, 2003) such as schedule flexibility and family obligations (Boden, 1999). As a result, Justo and DeTienne (2008: 5) argue that females are more likely to operate smaller, less profitable firms and are likely to exit when 'life quality needs are not met as a result of the heavy work demands implied by business ownership'. While some recent research notes that female owners engage more in succession planning than their male counterparts (Center for Women's Business Research, 2004; MassMutual Financial Group and the Family Firm Institute, 2003; Harveston et al., 1997), there is no evidence that they are more successful at selling their firms. On the basis that male owner-managers are more likely to be operating larger, more profitable, growth firms we hypothesise that:

H_4: Male owner-managers are more likely to expect to transfer their firm.

With the ageing of business owners come many inherent risks; these risks can be mitigated with succession planning. There is some consensus that succession must be anticipated long in advance and managed as a planned process (Dyck et al., 2002; Sharma et al., 2001). Conner and Armitage (1998) argue that exit behaviour is more likely to be influenced by deliberative planning than by automated habits and, as a result, planning becomes an important precursor to successful transfer. Despite this, recent research indicates that fewer than 50 per cent of entrepreneurs consider their exit strategy prior to making an exit decision (Dahl, 2005). This is a concern as many authors argue that succession planning, unlike some other forms of business planning, requires a formal and structured approach (Dyck et al., 2002; Sharma et al., 2001; Handler, 1990; Malone, 1989; Lansberg, 1988; Ward, 1987; Dyer, 1986; Ambrose, 1983). This is not only due to the many different aspects required for succession planning, but the longer time horizon needed to prepare the next generation of business owners to ensure ongoing success (Cabrera-Suarez et al., 2001; Goldberg, 1996). Therefore, we hypothesise that:

H_5: An owner-manager is more likely to expect their business to transfer if they have an exit plan in place.

Following the theory of planned behaviour, an owner-manager's exit intentions are an important predictor of the actual exit outcome (Blackburn and Stokes, 2000; Bagozzi et al., 1989). Formal theories of entrepreneurship, like Blanchflower and Oswald's (1998), emphasise that rational goals for establishing a new business may go beyond pecuniary considerations to non-pecuniary considerations, such as a desire for autonomy and control or to have a business to pass on to family members. The personal intentions and values of the owner-manager can influence his or her beliefs surrounding how the succession problem can be solved. DeTienne and Cardon (2010) support this view, arguing in particular that the options for exit for founders of lifestyle firms are limited. Therefore, we hypothesise that:

H_6: Owner-managers with more pecuniary motives are more likely to seek alternative exit paths whereas owner-managers operating with less pecuniary motives are more likely to close their firm or transfer it to a family member.

Turning next to the regional-specific factors, we begin by arguing that if no family members work in the firm, and the firm has no suitable and willing employees, then the owner-manager must look to the surrounding region to find a buyer. As a result, the level of entrepreneurial talent (Markley, 2006) in a region may condition the owner-manager's expectations about the likelihood of selling his or her business. Entrepreneurial talent in a region depends on the stochastic distribution of entrepreneurial talent among the inhabitants and on regional-specific factors that enhance this ability. Maskell and Malmberg (1999) argue that access to locally available tacit knowledge enables firms to develop a competitive edge. This knowledge may be stored in the people in the region (Christensen and Drejer, 2005) or it may be stored through the institutionalisation of learning processes over time (Gertler et al., 2000). This type of embedded knowledge may be interpreted as a common culture and is similar to the Marshallian notion of 'as if it were in the air' (Marshall, 1920: 225). Thus, we hypothesise that:

H_7: The greater the level of entrepreneurial talent in a region, measured by the proportion of managers in the workforce, the more likely it is that the owner-manager expects to transfer their business.

Carree and Dejardin (2007) argue that owner-managers are attracted to profitable growing markets. From this standpoint, it seems that owner-managers who operate mature businesses located in relatively more economically vibrant regions, whether due to urban economies or agglomeration economies, are more likely to seek a buyer for their business. In rural settings there are fewer opportunities for family members (or locals) to live and work in the region; as a result, many family members take over the operation of the family firm (or a local business as a going concern). The declining numbers of businesses being transferred to family members indicates that the desire of younger generations to take over family businesses is diminishing (Bachkaniwala et al., 2001). This threatens the survival of these businesses and the continuation of the jobs generated in these rural communities. Thus, we argue that a key variable influencing a firm's succession decision is the proximity of the firm to a key urban centre or market. The decision of where to locate is influenced by the opportunities, in terms of demand, offered by various regions. For a firm with growth opportunities, infrastructure sets the stage and creates the strategic context in which firms can flourish. Nyström (2007) claims that firms located in urban regions may experience positive external effects. She argues that lower transport costs and proximity to suppliers and customers reduce costs and improve the quality of the good or service provided. In addition, numerous studies show that investors are better able to obtain information on nearby companies (e.g. Loughran and Schultz, 2008) and are therefore more likely to purchase a firm located nearby. As a result, information asymmetries will be higher in rural firms where there are fewer nearby investors. A recent UK study found that over half of the buyers in the UK are only prepared to purchase businesses within five miles of their home (Allinson et al., 2007), thus we hypothesise that:

H_8: An owner-manager is more likely to expect to transfer their business if they are located close to a large urban centre, measured here as the capital city.

The discussion above situates the concept of entrepreneurial exit in the literature. Through a discussion of the potential influences on the expectations of the owner-manager it identifies a number of hypotheses for further testing. It contributes to the scant empirical literature which examines the different facets of entrepreneurial exit (DeTienne and Cardon, 2010) and puts forward possible explanations to explain owner-managers' expected exit choices. This is important as all owner-managers experience exit. Next, we examine these issues using a unique dataset for long-lived small firms in Ireland and Scotland.

DATA DESCRIPTION

The key variable of interest in this paper is the owner-manager's expected exit strategy. This variable and some firm-, owner-manager- and market-related characteristics were gathered in telephone interviews using structured survey instrumentation with a sectorally representative random sample of 1,320 owner-managers of SMEs (companies with fewer than 249 employees) in Ireland selected from Kompass Ireland (http://ie.kompass.com/) between October 2008 and February 2009. Three hundred and sixty-seven businesses took part in the study (a response rate of 28 per cent), of which 177 were long-lived small firms. The owner-managers' expected exit strategy is the unit of analysis in this study. Long-lived small firms were defined as being small at start-up (less than fifty employees, though the vast majority were micro enterprises, with no more than ten employees) and having traded for at least ten years.

The expectations of the owner-managers of long-lived small firms for their exit strategy in Ireland are compared with similar data gathered earlier for 59 long-lived small firms in Scotland. This data were gathered in face-to-face interviews conducted between October 2001 and February 2002. These long-lived firms were selected from a sample of 90 surviving firms in Scotland which were traced from three parent samples of small businesses (N=396) which were interviewed in previous fieldwork studies undertaken in the 1980s and 1990s by Professor Gavin Reid and his co-research workers at the Centre for Research into Industry, Enterprise, Finance and the Firm, St. Andrews University. The parent samples were random samples from the population of small firms in Scotland at the time of the initial interviews (see Reid, 1993; Reid and Andersen, 1992; Reid, 1996; Smith, 1997). These businesses were small at start-up and were founded prior to 1991.

The firms interviewed provide a good representation of the relevant populations of small firms in Ireland and Scotland. Almost all sectors by Standard Industrial Classification (SIC) codes were represented in both samples, from agriculture (01) to domestic services (99). The main sectors represented in Ireland were wholesale and retail trade and repair of vehicles and motorcycles (34.6 per cent); manufacturing (16.3 per cent); real estate, renting and business activities (14.1 per cent); hotels and restaurants (7.9 per cent); construction (7.3 per cent); other community, social and personal activities (7.3 per cent); and agriculture, hunting and forestry (3.9 per cent). This compares reasonably well with those in Scotland although there is a slight manufacturing bias: wholesale and retail trade and repair of vehicles and motorcycles (36.5 per cent); manufacturing (31.7 per cent); real estate, renting and business activities (12.7 per cent); hotels and restaurants (4.8 per cent); construction (3.2 per cent); other community, social and personal activities (7.9 per cent); and agriculture, hunting and forestry (1.6 per cent). The sample proportions between extractive/manufacturers (SIC 01–60) and services (SIC 61–99) were 29.6 per cent and 70.4 per cent respectively in Ireland, which compares reasonably well with figures obtained from the business demography data in 2009 produced by the Central Statistics Office (see http://www.cso.ie/en/surveysandmethodology/industry/businessdemography/). Manufacturers (NACE (Nomenclature statistique des Activités économiques dans la Communauté Européenne) Code 2 Sectors B to F) represented 29 per cent of the active businesses in 2009 in comparison with 71 per cent in services (NACE Code 2 Sectors G to N excluding holding companies). The sample proportions between extractive/manufacturers (SIC 01–60) and services (SIC 61–99) were 37 per cent and 63 per cent respectively for the Scottish subsample. Figures from the Department of Trade and Industry, for all UK small firms, suggest that 27 per cent were in manufacturing and 73 per cent were in services, which gives a similar breakdown to that of our sample in Ireland. The geographic scope of the Irish sample was extensive: 10.2 per cent were located in Dublin; 9.4 per cent in the mid-east; 6.6 per cent in the midlands; 10.2 per cent in the west; 11.9 per cent in the border area; 12.5 per cent in the mid-west; 13.9 per cent in the south-east; and 25.2 per cent in the south-west. Over half (57 per cent) of the firms in the Scottish sample are from urban areas (such as Edinburgh, Glasgow and Dundee), over a quarter (27 per cent) are from non-urban centres (such as Argyll, Aryshire, Banff and Moray), and a sixth (16 per cent) are from the highlands and islands in Scotland.

The definitions and summary statistics of the measures for Scotland and Ireland are presented in Table 1. The expectation of the owner-managers of these long-lived small firms for their exit strategy is referred to as 'Exit type' in Table 1. Greater detail on the composition of this measure is provided below. We have detailed firm-specific information including the age, size, sector and location of the firm. We have information on the owner-manager such as their gender, whether s/he has an exit plan (a binary dummy variable taking on the value of 1 if s/he had an exit plan) and an ordinal variable on the owner's intentions for their business at start-up. The latter was ordered on a scale of 1 to 10 where a score of 1 was seen as a low pecuniary motive (e.g. to provide an alternative to unemployment, to have a business to pass onto family members) for setting up a business and a

Table 1: Definitions and Summary Statistics

		Ireland			Scotland		
Variable Name	**Definition**	**N**	**Mean**	**St. Dev**	**N**	**Mean**	**St. Dev**
Firm-Specific Variables							
Exit type	Categorical variable: 1 = family transfer; 2 = sell the firm; 3 = shutdown	177	1.8	0.68	59	1.8	0.57
Age	Number of years the business was in operation at the time of interview	177	42.78	46.18	59	25.83	16.19
Size	Number of full-time equivalent employees at the time of interview	177	6.96	8.69	59	9.33	8.35
Sector	Categorical variable: 1 = extractive and transformative; 0 = services	177	0.22	0.420	59	0.32	0.47
Gender	Categorical variable: 1= male owner; 0 = female owner	177	0.76	0.42	59	0.90	0.30
Exit plan	Categorical variable: 1= owner has an exit plan; 0 = otherwise	177	0.50	0.50	59	0.42	0.49
Intentions	Categorical variable: range from 1 to 10, where values close to 1 indicate less pecuniary motives at start-up and values close to 10 represent greater pecuniary motives	177	4.03	2.49	59	4.03	3.24
CapEmp	Categorical variable: 1= if the firm has an employee who is capable of taking over the firm; 0 = otherwise	177	0.29	0.45	N/A		
CapChild	Categorical variable: 1= the firm's owner-manager has a child who is capable of taking over the firm; 0 = otherwise	177	0.62	0.48	N/A		
Regional-Specific Variables							
Prof&Man	Percentage of professionals and managers in the region where the firm is located	177	31.24	4.08	59	37.45	5.68
City	Distance in miles from the firm to the capital city	177	161.4	91.63	59	77.74	79.34

score of 10 was viewed as a strong pecuniary motive (to earn a high rate of return, to sell on a business). We collected data on the percentage of managers in the region where each firm is located from the Scottish Office for National Statistics and the Irish Central Statistics Office and we computed the distance from each firm to the capital city (in miles) using Google Maps. Two further variables on the capability of employees (CapEmp) and family members (CapChild) as potential successors were available for the Irish firms. These variables are binary in nature taking on the value of 1 if the owner-manager had family members (or employees in the case of CapEmp) who were capable of taking over the business and 0 otherwise. The latter two variables are included in the extended multinomial probit estimation performed solely using the Irish data, the results of which are presented in Table 3.

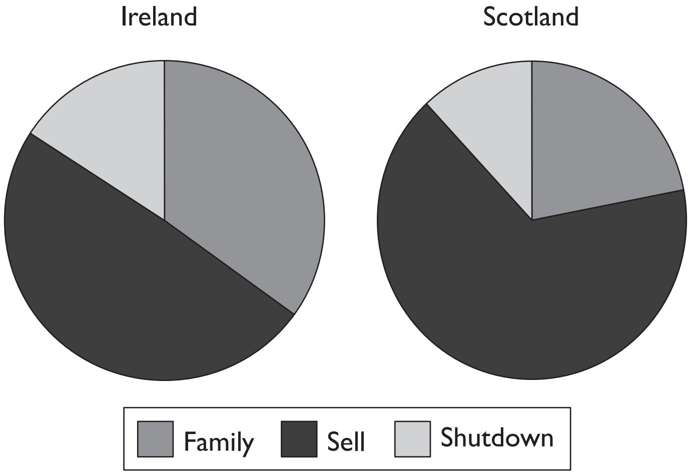
To establish the owner-managers' expected transfer strategy we asked the respondents 'Assuming you leave your business at some stage, which of the following options is your most likely exit strategy?'

- Sell or pass on to a child or another family member
- A trade sale
- Sell to management or staff
- Advertise the business for sale without identifying a buyer
- Close the business and sell the assets
- Undecided

These categories were collapsed into three in order to reduce the number of degrees of freedom used in the analysis and because the numbers of firms in the management buyout category is quite small: (i) family succession; (ii) sales (trade sales, other sales and management buyouts); and (iii) shutdown (including those who intend to shut down and those who are undecided). Figure 1 shows that of the 177 owner-managers interviewed in Ireland, 35 per cent expect to pass their business to a family member and 49.2 per cent expect to sell their business, while 15.8 per cent have no clear transfer route identified and therefore are likely to shut down. The corresponding figures for Scotland are 22 per cent for family succession, 66.1 per cent for sale and 11.9 per cent for shutdown (see Figure 1). An analysis of variance (ANOVA) test confirms that there are differences in the exit strategies of owner-managers between Ireland and Scotland.[1] In particular, we find that significantly more owner-managers in Ireland (than in Scotland) intend to transfer their business to a family member [$F_{1,234}$ = 3.467 with p-value < 0.10], while significantly more owner-managers in Scotland intend to sell their firm [$F_{1,234}$ = 5.177 with p-value < 0.05]. There is no difference in the number of owner-managers expecting to shut down their business [$F_{1,234}$ = 0.545 with p-value > 0.10] across the two regions.

Focusing on the Irish firms in our sample we see that the average trading age of the firms in our sample is 24 years; the median age is 22 or almost one generation. Nineteen per cent of Irish firms in this sample are over the age of 30. Many of these firms are facing or

Figure 1: Expected Exit Type by Country



have faced the threat of age-related transfer failure. Turning now to Scotland, these firms are approximately 26 years old. Twenty-three per cent of the Scottish firms included in our sample have been trading for over 30 years.

The average Irish firm in our sample employs approximately seven employees (standard deviation = 8.69). The median number of employees is four. Scottish firms employ an average of nine staff; the median staff is seven. The vast majority of the business owners are male: 76.3 per cent of Irish business owners and 90 per cent of Scottish business owners interviewed were male. Slightly more Irish business owners have a business plan (50 per cent) in comparison with Scottish business owners (42 per cent). The Irish businesses on average are located 161 miles from their capital city whereas on average the Scottish firms are located 78 miles from their capital city. A similar percentage of professionals and managers are resident within the region where the firms are located: 31 per cent for Ireland and 37 per cent for Scotland. On average, business owners in Ireland have more pecuniary intentions on starting a business than Scottish business owners: an intentions score of 4.03 (standard deviation = 2.49) versus 2.18 (standard deviation = 1.71) respectively.

EMPIRICAL RESULTS

This section tests the hypotheses identified in the second section using data gathered in 236 interviews with owner-managers in Ireland and Scotland. We use a multinomial probit model to examine how each of the factors discussed above (i.e. age, size, exit plan, etc.) impacts on the owner-manager's expected exit choice (i.e. whether s/he intends to transfer to family, sell the business or shut down the business). We assume that an exit choice is selected when it yields the highest utility for the owner-manager; in other words, if the owner-manager expects to gain the most from transferring the business to a family member then this is the strategy they will choose. An owner-manager can gain from the transfer in many ways: they may receive a monetary payment for the business, they may experience joy and satisfaction from leaving a legacy to their family and/or they may gain from seeing the business they built from scratch grow and survive.

A multinomial probit estimation technique (see Louviere et al., 2000), where the owner-manager's expected exit choice is represented as a decision among unordered alternatives, is adopted to examine variation across exit strategies.[2] In this estimation, each owner-manager's indirect utility from choosing a particular exit strategy is a function of the attributes of the firm, the region in which the firm is located and a stochastic error. The indirect utility of each alternative is not observable, but the owner-manager's expected exit choice is. A typical representation is:

$$U_{ij} = \beta' X_{ij} + \alpha'_j Z_i + \varepsilon_{ij}$$

Where U_{ij} represents the utility of owner-manager *i* from choosing exit strategy *j*; *i* ranges from 1 to 236 depending on the owner-manager under consideration; *j* takes the value of '1' when the owner-manager expects to transfer to a family member, '2' when the owner-manager expects to sell their business and '3' when the owner-manager expects to shut down their business, X_{ij} is a vector of firm-specific measures such as age and size of the firm and Z_i is a vector of regional characteristics such as the entrepreneurial talent in the region where the firm is located. If each owner-manager wishes to maximise his utility, the probability that he chooses family succession, *F*, over other potential exit strategies such as sale, *S*, or firm closure, *C*, is:

$$P_{iF} = U_{iF} > U_{iS} \text{ and } U_{iF} > U_{iC}$$

In other words, the probability that owner-manager *i* chooses family succession is based on that fact that his expected utility from transferring the firm to a family member is greater than (1) the expected utility of selling the firm and (2) the expected utility from closing the firm. This expression can easily be written to represent the case where firm sale is the preferred option:

$$P_{iS} = U_{iS} > U_{iF} \text{ and } U_{iS} > U_{iC}$$

and where firm closure is the preferred option:

$$P_{iC} = U_{iC} > U_{iS} \text{ and } U_{iC} > U_{iF}$$

Due to identification restrictions the multinomial probit model does not yield the probability of a particular alternative. It does however give the probability of choosing one particular alternative relative to another, for example the probability of selling the firm relative to transferring it to a family member.

The results of the multinomial probit estimation are presented in Table 2. This table examines the impact of our five firm-specific variables (firm age, firm size, whether the firm

Table 2: Results of Multinomial Probit for Ireland and Scotland

	Ireland			Scotland		
	Sale *relative to* **Family**	**Sale** *relative to* **Shutdown**	**Family** *relative to* **Shutdown**	**Sale** *relative to* **Family**	**Sale** *relative to* **Shutdown**	**Family** *relative to* **Shutdown**
Age	-0.005	-0.009**	-0.003	-0.010	-0.021	-0.011
Size	-0.012	-0.040	0.052**	0.164*	0.257*	0.092
Sector	-1.297*	-0.851**	0.446	-0.650	-0.072	0.578
Gender	-0.405	-0.932**	-0.527	0.431	1.496**	1.065
Exit Plan	0.321	0.510	0.188	-1.548**	0.471	2.019**
Intentions	0.071	0.004	-0.066	0.175	0.296*	0.120
Prof/Man	0.027	0.019	-0.008	-0.058	-0.033	0.024
City	-0.001	-0.003***	-0.001	-0.012*	-0.010**	0.001
Constant	0.180	1.683	1.502	3.101	0.047	-3.054
N	177			59		
Wald chi^2	41.32			48.26		
P-*value*	0.0005			0.000		

Note: *** significant at *p*-value less than 0.1; ** significant at *p*-value less than 0.05; * significant at *p*-value less than 0.01. Estimated with robust standard errors.

is in the services sector, the gender of the owner-manager, whether the owner-manager has an exit plan, and the owner-manager's intentions for the firm at the time of start-up) and two regional-specific variables (entrepreneurial talent in the region in which the firm is located and the distance of the firm to the capital city) on the owner-manager's expected exit choice. Looking at Table 2, we are interested in the direction and the significance of the relationships. For example, in the first column for Ireland we see that the first category is *sale relative to family*. In this category, we are examining the probability with which the owner-manager expects to sell his firm, in comparison with the probability with which he expects to transfer his firm to a family member. The first variable we examine is *age*. Age has a negative sign; this implies that owner-managers who intend to sell their firm are likely to be operating younger firms than those who intend to transfer their firm to a family member. This variable is not statistically significant and therefore we cannot confirm this positive finding. To interpret the relationships we look at each factor individually while holding all other factors constant. When examining the category *sale relative to family* only one variable is statistically significant, that is the *sector* variable. This variable takes a value of 1 if the firm is in the extractive or transformative sector and a value of 0 if the firm is in the services sector. The sign of the variable is negative, indicating that Irish owner-managers who expect to sell their businesses are less likely to own a firm in the extractive or transformative sectors than an owner-manager who expects to transfer their firm to a family member. This result confirms Royer et al.'s (2008) finding that the preferred exit route for those operating firms where technical and family business-specific experiential knowledge is high (i.e. many extractive or transformative sector firms) is family transfer.

Continuing with the Irish data but looking next at the second column labelled *sale relative to shutdown*, here we examine the probability with which the owner-manager expects to sell their business in comparison with the probability with which they expect to close their business. In this case, we find four significant variables: *age*, *sector*, *gender* and *city*. Each of these variables has a negative sign. The *age* variable tells us that owner-managers who intend to sell their firm are operating younger firms, on average, relative to those who intend to shut down their business *ceteris paribus*. The *sector* variable indicates that those who intend to sell their business are more likely to be operating service sector firms *ceteris paribus*. The *gender* variable indicates that female owner-managers are more likely than their male counterparts to expect to sell their business, holding everything else constant, while the *city* variable indicates that those intending to sell their business are more likely to be located closer to the capital city than those who intend to shut down their business.

The third and final column of data for the Irish case examines the probability with which an owner-manager expects to transfer their business relative to the probability with which they expect to close their business. This column is labelled *family relative to shutdown*. Here we identify one significant variable, *size*, and this variable has a positive sign. This indicates that those owner-managers who intend to transfer their business to a family member are more likely to be operating a larger firm *ceteris paribus* than those who intend to close their firm.

Turning to the Scottish sample we begin by examining the first column, labelled *sale relative to family*. Here, we find that owner-managers who intend to sell their business are more likely to be operating larger firms that those who intend to transfer to a family member *ceteris paribus*. This set of owner-managers are less likely to have an exit plan in place relative to those who intend to transfer *ceteris paribus*, and they are likely to be located closer to the capital city *ceteris paribus*. Column 2 and Column 3 of the Scottish results examine the probability of transfer relative to closure. In the column labelled *sale relative to shutdown* we find evidence that the owner-managers who intend to sell their business are likely to be operating larger firms than those who intend to close *ceteris paribus*. In addition, these owner-managers are more likely to have had more pecuniary motives at the time of start-up. Similar to the Irish case, we find that this set of owner-managers are more likely to be operating firms located closer to the capital city whilst, in comparison with the Irish case, we find that male owner-managers are more likely than their female counterparts to expect to sell their firm *ceteris paribus*. Finally, in the column labelled *family relative to shutdown* we find evidence that the owner-managers located in Scotland who intend to transfer their business to a family member are more likely to have an exit plan in place relative to those who intend to close their firm.

Our results suggest that the factors impacting an owner-manager's expected exit choice vary considerably across regions. This suggests that policy makers need to pay close attention to firm and market dynamics when designing business transfer policies and it indicates that a one-size-fits-all policy within the EU-27 will not work. Only two of our seven hypothesis are supported in both regions, these are H_2 (larger firms are *more* likely to expect to transfer) and H_8 (firms located closer to the capital city are *more* likely to expect to transfer). In Ireland we find that owner-managers of larger firms are more likely to expect to transfer their business to a family member rather than close it, whilst in Scotland owner-managers of larger firms are more likely to sell their business rather than close it down or transfer it to a family member. This result confirms earlier findings in the literature by authors such as Battisti and Okamuro (2010), who also find evidence that smaller long-lived firms are more likely to close. In terms of location, both sets of results show that owner-managers who intend to sell their business are likely to be located closer to the capital city.

In one case, we find contradictory evidence between the Irish and Scottish results; this is in the case of H_4 (male owner-managers are *more* likely to expect to transfer their business). In particular, we find that male owner-managers in Scotland are more likely to expect to sell while female owner-managers in Ireland are more likely to expect to sell. One possible explanation for this relationship is put forward by Justo and DeTienne (2008). These authors argue that, with the exception of family business ownership, female owner-managers typically have a weaker psychological attachment to their business and are, therefore, more likely to be operating smaller, less profitable firms (Greene et al., 2003). In Ireland 64 per cent of the female owner-managers we interviewed identified themselves as being ‘involved in a family business’ and, therefore, it is likely that this is impacting on their intention to continue to operate, grow and transfer the business.

In Ireland we find some support for H_1 (younger firms are *more* likely to expect to transfer), while we find no evidence of this relationship in Scotland. The result for Ireland supports the findings of Zajec et al. (2006), Foreman-Peck and Nicholls (2008) and Wagner (2004), who report that younger firms are more likely to transfer. Based on the Irish sample, we reject H_3 (service sector firms are *less* likely to expect to transfer) and conclude that service firms are more likely to transfer, while we find no evidence for or against this hypothesis in Scotland. There is no obvious reason for this finding in Ireland based on our data and thus this finding warrants further research. It is possible that the turnover of the firm (Bruederl et al., 1992) is more important than the sector in which the firm is located; however, we currently have no useable data on this variable.

In Scotland, we find support for H_5 (those with an exit plan are *more* likely to expect to transfer). This finding is well supported in the literature with authors such Dyck et al. (2002), Cabrera-Suarez et al. (2001), Sharma et al. (2001), Handler (1990), Malone (1989), Sonnenfeld and Spence (1989), Lansberg (1988), Ward (1987), Dyer (1986) and Ambrose (1983) highlighting the correlation between having a well-thought-out succession plan and effective business transfer. We also find support for H_6 (those with pecuniary motives are *more* likely to transfer) in our Scottish data. This finding is supported by DeTienne and Cardon (2010) who also find that, for their sample of 128 United States (US) entrepreneurs, that an owner-manager’s life experience and intentions play a significant role in their choice of exit strategy. H_5 and H_6 are not supported using the Irish data. Finally, we find no support in either region for H_7 (firms located in regions with high levels of entrepreneurial talent are *more* likely to expect to transfer).

These results suggest that while there are some similarities across the regions in terms of the size and location of the firms there are also some important differences. One possible explanation for these differences is the disparate inheritance tax policies being implemented across the regions at the time of interview. Since authors such as Bradley and Burroughs (2010: 39) argue that the 'tax component of succession planning is becoming one of the most important issues there is to deal with', Irish inheritance tax policies are currently under review and this is the key difference between our samples, we briefly examine how Irish inheritance tax policies may be incentivising family succession over other exit routes.

Policy Implications: Inheritance Tax

In Ireland, there are currently favourable tax incentives for those wishing to transfer their firm to a child: owner-managers over the age of 55 get total relief from capital gains tax when they dispose whole or part of their business assets or shares in their company to their child. In addition, substantial capital acquisition tax relief is available to a child inheriting a family firm, where the market value of those assets is reduced by 90 per cent in determining any liability for gift or inheritance purposes. There are currently no incentives in Ireland for those who wish to transfer their firm to an employee. To examine if this tax incentive impacts on owner-managers' exit strategies, we re-estimate the multi-nominal probit model for Ireland and include two additional variables, *capable child* and *capable employee*. The results are presented in Table 3.

The first thing we notice is the significance of the *capable child* (CapChild) and insignificance of the *capable employee* (CapEmp) variable while all other results are the same as those reported in Table 2. The significance of the *capable child* variable indicates that owner-managers who intend to sell their business are significantly *less* likely to have a *capable child* working in the firm than those who intend to transfer the firm to a family member, while those who intend to transfer to family are significantly *more* likely to have a *capable child* than those who intend to shut down their business. This variable is not significant in the regression comparing those who intend to sell with those who intend to shut down, indicating that neither of these groups have children capable of taking over the firm. While we do not have enough data to test whether the decision to transfer to a child is related to the tax benefits of such a transfer, it is interesting to note that in our Irish sample 92 per cent of those who expect to transfer to family currently have a capable child working in the firm. In addition, over half of the owner-managers we interviewed who have a capable child intend to transfer the firm to that child, 39 per cent intend to sell the firm and 9 per cent intend to shut down. Of the 39 per cent who have a capable child but who intend to sell, most are operating very small firms (61 per cent have fewer than five employees, 40 per cent have fewer than two employees) in the services sector (88 per cent) and are most likely first generation firms (60 per cent have been trading for less than 30 years).

Table 3: Results of Multinomial Probit for Ireland

	Sale *relative to* **Family**	**Sale** *relative to* **Shutdown**	**Family** *relative to* **Shutdown**
Age	-0.004	-0.009**	-0.004
Size	-0.023	0.035	0.058**
Sector	-1.280*	-1.021**	0.258
Gender	-0.605	0.771***	-0.166
Exit Plan	0.338	0.569	0.230
Intentions	0.051	0.024	-0.026
Prof/Man	0.028	0.025	-0.002
City	-0.001	-0.003***	-0.002
CapChild	-1.829*	0.469	2.298*
CapEmploy	0.530	0.394	-0.136
Constant	1.429	0.929	-0.500
N	177		
Wald chi^2	80.54		
P-*value*	0.0000		

Note: *** significant at *p*-value less than 0.1; ** significant at *p*-value less than 0.05; * significant at *p*-value less than 0.01. Estimated with robust standard errors.

Having an employee working in the firm who the owner-manager views as ‘capable’ of taking over the operation of the firm has no impact on the owner-manager’s expected exit choice. In our sample, 29 per cent of those intending to transfer to family, 35 per cent of those intending to sell their business and 18 per cent of those intending to shut down currently have an employee who they view as capable of taking over the operation of the firm. The fact that this variable does not impact an owner-manager’s decision is notable since management buy-in (MBI) and management buyout (MBO) are seen as viable transfer strategies in many countries (see, for example, Howorth et al., 2004). There are many benefits to selecting an MBO, including the reduction in asymmetric information and, therefore, better valuation of the firm. Our findings suggest that this issue warrants further concern, particularly as the Irish government is considering removing the incentive to transfer to a family (McBride, 2011) while the European Commission is requesting that a greater effort is made to support all possible exit routes (European Commission, 2006).

CONCLUSION AND POLICY RECOMENDATIONS

Business transfer failure is an international phenomenon (see, for example, studies in Belgium: Leroy et al., 2007; Canada: Bruce and Picard, 2006; Netherlands: van Teeffelen et al., 2005; the UK: Martin et al., 2002; and the US: Wennberg et al., 2010). The failure of businesses to transfer successfully from one generation to another presents a potential threat to the survival of SMEs and, therefore, to output and employment growth. As the number of family business transfers declines worldwide it is important that owner-managers examine alternative transfer strategies. Since very little is known in the literature about what characteristics influence an owner-manager's choice of exit strategy it is difficult to develop policies which will enable viable businesses to transfer successfully. This paper attempts to address this void.

In Ireland, we find that owner-managers who expect to transfer their business rather than shut it down are more likely to be operating younger firms, larger firms, service sector firms and firms located closer to the capital city, and be female. In Scotland this set of owner-managers are more likely to be operating larger firms, be male, have an exit plan, have founded their firm for pecuniary motives, and be located closer to the capital city. Each of these variables is independent of each other and a firm would not have to display all characteristics in order to be more likely to transfer.

Our research raises awareness about the factors that impact the small business owner-manager's expected choice of exit mode and may serve as the prelude to future research activities. If viable small firms are to survive to the second generation and beyond it is critically important for academic researchers, business consultants and small business owner-managers to understand how the succession process unfolds. Succession is not an accident or an event but a sophisticated process occurring over a long period of time. It is a long-term dynamic issue that requires an ability to adapt constantly in the light of evolving circumstances.

Future research needs to look at ways of raising awareness of the importance of succession planning among SME owners. It is also important that nascent entrepreneurs are made aware of the opportunities and advantages of purchasing an existing business rather than starting a business from scratch. Policy makers have an educational and advisory role to play: they could make owner-managers of older firms and smaller firms more aware of the potential exit choices available to them. Consideration should be given to the idea of one-stop shops, mentoring processes and self-analysis toolkits. One-stop shops, for example, could give out information on all aspects of the transfer process and could signpost people on to relevant intermediaries.

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ENDNOTES

1 An analysis of variance (ANOVA) test provides a statistical test of whether or not the means of several groups are equal. In this case, it tests whether the mean number of *family transfers* is the same in Ireland and Scotland, whether the mean number of *sales* is the same in Ireland and Scotland and whether the mean number of *shutdowns* is the same in Ireland and Scotland.

2 A multinomial probit estimation (MNP) technique is adopted as MNP does not impose the independence assumption. Arrow (1951) identified the importance of the independence of irrelevant alternatives (IIA) property. The idea is that if the chooser is comparing two alternatives according to a preference relationship, the ordinal ranking of these alternatives should not be affected by the addition or subtraction of other alternatives from the choice set. Specifically, the ratio of choice probabilities for any two alternatives does not depend on the characteristics of any other alternatives. The logistic model does not estimate substitution patterns across choices well.

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